India Ratings Upgrades Union Bank of India's Bonds to 'IND AAA'; Outlook Stable

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India Ratings and Research (Ind-Ra) has upgraded Union Bank of India's (UBI) Long-Term Issuer Rating and bonds' ratings to 'IND AAA' from 'IND AA+'. The instrument-wise rating actions are as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Issuer rating	-	-	-	-	IND AAA/Stable	Upgraded
Basel III Tier II bonds^	-	-	-	INR50	IND AAA/Stable	Upgraded
Basel III AT1 perpetual bonds^	-	-	-	INR98.5	IND AA+/Stable	Upgraded
Certificates of deposit	-	-	-	INR300	IND A1+	Affirmed

^Details in Annexure

Analytical Approach

Ind-Ra continues to take a fully consolidated UBI's wholly-owned subsidiaries - Union Asset Management Company Pvt Ltd, Union Trustee Co Pvt Ltd, Union Bank of India (UK) Ltd, Andhra Bank Financial Services Ltd and UBI Services Ltd - while arriving at the ratings, because of the similar nature of operations.

Detailed Rationale of the Rating Action

The upgrade reflects the bank's improved 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 upgrade also reflects an improvement in UBI's asset quality parameters with a decline in net non-performing asset (NNPA) ratio and an overall improvement in the lending environment, especially for banks. These factors, in the agency's opinion, boosted UBI's profitability in FY24 (FY24 return on assets (RoA): 1.1%) and is expected to be sustained over the medium term. The ratings continue to reflect UBI's systemically-important position and Ind-Ra's expectations that the bank will continue to receive support from the government of India (GoI; holds 74.8% stake).

For AT1 instruments, the agency considers the discretionary component, coupon omission risk and the write-down/conversion risk as key parameters to affirm the rating. The agency recognises the unique going-concern loss absorption features that these bonds carry and 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.

List of Key Rating Drivers

Strengths
- High systemic importance
- Better-than-peers' capital buffers
- Comfortable asset quality metrics
- Improved profitability

Weaknesses
- Moderate funding profile compared to peers

Detailed Description of Key Rating Drivers

High Systemic Importance: UBI's systemic importance is reflected in its high market share in deposits and net advances of around 6.0% and 5.5%, respectively, at FYE24 (FY23: 6.2% and 5.7%, respectively), thereby making it the fifth-largest public sector bank. The bank continues to benefit from its amalgamation with Corporation Bank and Andhra Bank effective 1 April 2020. At end-March 2024, the bank had 8,466 branches (including foreign branches) and over 8,982 automated teller machines, making it a significantly larger franchise. UBI had last received a capital infusion of INR117.7 billion from the GoI in FY20 and the agency continues to expect the government support to come in, as and when required. The bank has been able to raise INR80 billion of equity in FY24 (FY23: nil; FY22: INR14 billion).

Better-than-Peers' Capital Buffers: UBI's capital buffers have improved over FY23-FY24 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 13.7% at FYE24 (FYE23: 12.36%; FYE22: 10.63%) and 15.0% (13.91%; 12.2%;). This also needs to be viewed in context of the bank's NNPAs reducing to about 1.0% at FYE24. The improvement in capital ratios was supported by improved profitability and successful qualified institutional placement of INR80 billion in FY24. Ind-Ra believes the manageable asset quality would enable the bank to maintain material profitability compared to its previous performance through FY25-FY26, where return on assets could be 1% or higher. Ind-Ra believes the existing capital buffers are adequately placed to also absorb asset quality shocks. Further, the bank is planning to raise INR60 billion of equity in FY25, to further strengthen its capital buffers.

Comfortable Asset Quality Metrics: The bank's NNPA level continues to improve and stood comparable to peer banks at about 1.0% in FY24 (FY23: 1.7%; FY22: 3.7%) which was marginally higher than that of peers earlier. The bank's provision cover (net of technical write offs) of about 79.1% at FYE24 (FYE23: 78.8%; FYE22: 69.5%) also stood comparable. At end-March 2024, the bank's restructured loan book was miniscule and the agency expects the restructured portfolio to follow the standard portfolio behaviour. The bank's special mention declined over 35% yoy to INR32.4 million in FY24 (above INR50million). Furthermore, UBI witnessed continuous improvement in gross slippage of about 1.5% in FY24 (FY23: 1.5%; FY22: 4.1%). Overall, the asset quality is likely to be manageable over the near-to-medium term amid the current benign credit environment.

Improved Profitability: UBI's profit increased significantly to about INR136.5 billion in FY24 (FY23: INR84.3 billion; FY22: INR52.3 billion), mainly backed by the decline in its credit costs, growth in advances and improved net interest margins (faster repricing in advances than deposits). The bank's cost-to-income ratio increased slightly to 46.4% in FY24 (FY23: 46.3%, FY22: 45.7%) due to higher employee and technological expenses. The bank's credit cost (provision for non-performing asset/average net advances) continues to improve and stood at 0.8% in FY24 (FY23: 1.6%; FY22: 1.8%). Ind-Ra expects the bank to witness credit cost of less than 1.0% over the near-to-medium term amid the current benign credit environment. The agency expects the bank to maintain adequate profitability with RoA of around 1% amid current benign credit environment and slight decline in net interest margins over the near-to-medium term.

Moderate Funding Profile Compared to Peers: UBI's domestic low-cost current account and savings account (CASA) deposits declined to 33.6% at FYE24 (FYE23: 35.26%; FYE22: 36.54%) in line with the broader banking industry. However, the CASA ratio is weaker than that of peer public sector banks, and the bank has been ceding CASA market share. During FY24, UBI's CASA grew at about 4.1% yoy, the overall deposits, including fixed deposits, grew about 9.3% yoy, while advances grew 14.3% yoy. Given that deposit growth has lagged advance growth for a few quarters, the bank has been under pressure to raise deposit

rates. In FY24, the bank's cost of funds increased to 5.2% (FY23: 4.3%). Given the lower share of the low-cost deposits, UBI's increase in cost of deposits could be marginally higher than peer banks' over the near term. In FY25, the agency expects the bank's cost of funds to increase further moderately.

Liquidity

Adequate: UBI's short-term (one-year) asset-liability deficit (surplus of short-term assets over short-term liabilities to total inflows) was about 0.7% of total assets. The average liquidity coverage ratio was 132% at FYE24 (FYE23: 192.9%; FYE22: 175.38%), well above the regulatory requirement of 100%. UBI's excess statutory liquidity qualifying securities of about INR90 billion 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.

Rating Sensitivities

Positive: Not applicable

Negative: UBI'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.

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 UBI, 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.

About the Company

UBI is a public sector bank with operations across India. At end-March 2024, the GoI held an 74% stake in UBI.

Key Financials Indicators

Particulars (INR billion)	FY24	FY23
Net advances	8,707.8	7,618.5
Total deposits	12,215.3	11,177.2
Net income/loss	136.48	84.3
CET I (%)	13.7	12.4
Capital adequacy ratio (%)	16.9	16.0
Source: UBI, Ind-Ra		

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Rating Watch/Outlook						
	Rating Type	Rated Limits (billion)	Rating	26 October 2023	1 November 2022	15 July 2022	10 February 2022	10 December 2021	12 November 2021	6 October 2021
Issuer rating	Long-term	-	IND AAA/Stable	IND AA+/Positive	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable
Basel III AT1 bonds	Long-term	INR98.5	IND AA+/Stable	IND AA/Positive	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable
Basel III-complaint Tier II bonds	Long-term	INR50	IND AAA/Stable	IND AA+/Positive	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable
Certificates of deposit	Short-term	INR 300	IND A1+	IND A1+	IND A1+	-	-	-	-	-

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Basel III-compliant Tier II bonds	Moderate
Basel III AT1 bonds	High
Certificate of deposits	Low

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

Annexure

Instrument Type	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	INE112A08051	8 November 2019	10	8 November 2029	INR10	8.93	Nil	IND AAA/Stable
Basel III-compliant Tier II bonds	INE692A08094	16 September 2020	10	16 September 2030	INR10	7.42	Call – 16 September 2025	IND AAA/Stable
Basel III-compliant Tier II bonds	INE692A08102	26 November 2020	15	26 November 2035	INR10	7.18	Call – 26 November 2030	IND AAA/Stable
Basel III-compliant Tier II bonds	INE692A08144	24 June 2021	10	24 June 2031	INR8.5	7.19	Call – 24 June 2026	IND AAA/Stable
Basel III-compliant Tier II bonds	INE692A08151	9 July 2021	15	9 July 2036	INR11.50	7.25	Call – 9 July 2031	IND AAA/Stable
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+/Stable
Basel III AT1 Bonds	INE692A08110	15 December 2020	Perpetual	Perpetual	INR5	8.73	Call -15 December 2025	IND AA+/Stable
Basel III AT1 Bonds	INE692A08128	11 January 2021	Perpetual	Perpetual	INR10	8.64	Call – 11 January 2026	IND AA+/Stable
Basel III AT1 Bonds	INE692A08136	29 January 2021	Perpetual	Perpetual	INR2.05	8.73	Call – 29 January 2026	IND AA+/Stable
Basel III AT1 Bonds	INE692A08169	22 November 2021	Perpetual	Perpetual	INR20	8.70	Call-22 November 2026	IND AA+/Stable
Basel III AT1 Bonds	INE692A08177	20 December 2021	Perpetual	Perpetual	INR15	8.4	Call-20 December 2026	IND AA+/Stable
Basel III AT1 Bonds	INE692A08185	2 March 2022	Perpetual	Perpetual	INR15	8.5	Call-2 March 2027	IND AA+/Stable
Basel III AT1 Bonds	INE692A08193	25 July 2022	Perpetual	Perpetual	INR13.20	8.69	Call-25 July 2027	IND AA+/Stable
Basel III AT1 Bonds	INE692A08227	23 Dec 2022	Perpetual	Perpetual	INR6.63	8.4	Call December 2027	IND AA+/Stable

Total utilised	**INR96.88**			
Total unutilised	**INR1.62**			
Source: UBI				

APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Rating FI Subsidiaries and Holding Companies

Evaluating Corporate Governance

The Rating Process

Financial Institutions Rating Criteria

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