Rating Rationale

June 28, 2023 | Mumbai

Indian Overseas Bank

Outlook revised to 'Positive'; Ratings reaffirmed

Rating Action

Rs.200000 Crore Fixed Deposits	**CRISIL AA/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)**
Certificate of Deposits	**CRISIL A1+ (Reaffirmed)**
Tier II Bonds (Under Basel III) Aggregating Rs.800 Crore	**CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)**
Rs.800 Crore Tier II Bonds (Under Basel III)	**CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Withdrawn)**

Note: None of the Directors on CRISIL Ratings Limited's Board are members of rating committee and thus do not participate in discussion or assignment of any ratings. The Board of Directors also does not discuss any ratings at its meetings.
1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has revised its ratings outlook on the tier-II bonds (under Basel III) and fixed deposit programme of Indian Overseas Bank (IOB) to **'Positive'** from 'Stable' while reaffirming the ratings at **'CRISIL AA-/CRISIL AA'**. The rating on the certificate of deposits programme has been reaffirmed at 'CRISIL A1+'.

Also, CRISIL Ratings has withdrawn its rating on tier-II bonds of Rs 800 crore at the bank's request as the outstanding against the same is nil and on receipt of confirmation from the debenture trustee (see Annexure - Details of Rating Withdrawn for details). The withdrawal is in line with the CRISIL Ratings withdrawal policy.

The revision in outlook factors in sustained improvement in earnings and asset quality, and strengthening of capital position, which is likely to be maintained over the medium term. The bank has been profitable since the past three fiscals (fiscal 2021) owing to lower credit cost backed by less incremental stress as well as improving net interest margins (NIMs). Supported by regular capital infusion, the bank was able to build sufficient buffer for its non-performing assets (NPAs) with a provision coverage ratio (PCR)[1] of 77% as on March 31, 2023. With higher provisions and lower slippages, the bank is expected to maintain profitability over the medium term.

Asset quality, while weak, has seen sequential improvement with gross NPAs at 7.4% as on March 31, 2023, compared with 9.8% a year earlier. This improvement was driven by higher write-offs and controlled slippages.

Besides, the capital position has improved, supported by timely capital infusion and internal accrual, leading to tier 1 and overall capital adequacy ratio (CARs) improving to 12.9% and 16.1%, respectively, as on March 31, 2023, from 10.7% and 13.8%, a year earlier.

Capital position is supported by regular fund infusion and expectation of strong support from the majority stakeholder, the government of India (GoI). In March 2021, 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).

[1]PCR including technical write-off was 93% as on March 31, 2023.

Analytical Approach

CRISIL Ratings has considered the standalone business and financial risk profiles of IOB, and has 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:

- **Strong support from the majority owner, GoI**
  The ratings continue to factor in the expected strong government support both on an ongoing basis and in the event of distress. This is because GoI is both 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 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 per annum was infused in fiscals 2016 and 2017. In October 2017, the government outlined a recapitalisation package of Rs 2.11 lakh crore over fiscals 2018-2019. IOB received Rs 4,694 crore in fiscal 2018 and Rs 5,963 crore in fiscal 2019 under this package. Also, GoI allocated Rs 70,000 crore in fiscal 2020, of which IOB received Rs 8,217 crore. During fiscal 2021, GoI infused Rs 4,100 crore. Thus, over the past four fiscals, GoI has infused Rs 22,974 crore in IOB. This has helped the bank to improve its capital ratios and meet regulatory requirements. Tier 1 and overall CAR stood at 12.9% and 16.1%, respectively, as on March 31, 2023.

Adequate capital position supported by internal accrual will limit the bank’s dependence on further capital support from GoI.

Weaknesses

- **Weak asset quality and earnings profile, albeit improving**
  Asset quality remains weak, albeit improving, with NPA ratios higher than the industry average. However, gross NPAs improved to 7.4% as on March 31, 2023, from 9.8% as on March 31, 2022 (11.7% as on March 31, 2021; 14.8% as on March 31, 2020), aided by write-offs. The bank has written off Rs 3,769 crore in fiscal 2022 and Rs 4,618 crore in 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) inched up to 3.1% in fiscal 2023 from 4.0% in fiscal 2022; however, they remain better than in the previous years (5.4% in fiscal 2020, 6.7% in fiscal 2019 and 12.0% in fiscal 2018).

  Earnings, while modest, have been improving with profit reported since the past three fiscals. The bank reported net profit in fiscal 2021 after six consecutive years of incurring losses. Operating margin improved owing to reduction in credit cost to 1.2% in fiscal 2023 and 1.4% in fiscal 2022 from 1.9% in fiscal 2021 and 4.7% in fiscal 2020. Profit after tax (PAT) stood at Rs 2,099 crore in fiscal 2023 with return on assets (ROA) of 0.7% backed by improved NIM and controlled credit cost. Ability to sustain improvement in profitability will remain a key monitorable, with expected impact on NIMs from higher funding cost and trend in slippages determining the trajectory of credit cost.

Liquidity: Adequate

Liquidity is supported by a sizeable retail deposit base, forming a large chunk of total deposits. Liquidity coverage ratio was 172% as on March 31, 2023, which is higher than the regulatory requirement. Also, the bank 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.

ESG profile

CRISIL Ratings believes the environment, social and governance (ESG) profile of Indian Overseas Bank supports its already strong credit risk profile.

The ESG profile for financial sector entities factors in governance as a key differentiator. The sector has a reasonable social impact because of its substantial employee and customer base and can play a key role in promoting financial inclusion. While the sector does not have direct adverse environmental impact, lending decisions may have a bearing on the environment.

IOB has an ongoing focus on strengthening the various aspects of its ESG profile.

Key ESG highlights:

- ESG disclosures of the bank are evolving, and it is in the process of strengthening the disclosures
- The bank is focusing on paperless banking and has disbursed loans towards e-vehicles and solar energy equipment
- The bank’s total workforce comprised around 36.8% women as on March 31, 2023, and it has taken initiatives to promote gender equality within the organisation.
- The governance structure is characterised by 44% of independent directors and none have tenure exceeding 10 years. The bank also has a dedicated investor grievance redressal mechanism.

There is growing importance of ESG among investors and lenders. The commitment of IOB to ESG will play a key role in enhancing stakeholder confidence, given its access to domestic and foreign capital markets.

Outlook Positive

CRISIL Ratings believes asset quality and profitability will maintain positive trajectory. IOB will continue to benefit from the support from GoI on an ongoing basis as well as in the event of distress

Rating Sensitivity factors

Upward factors

- Improvement in asset quality and profitability on sustained basis, with ROA over 0.75% on steady-state basis
- Capitalisation metrics improving considerably with significant cushion over regulatory requirement

Downward factors

- Material change in the shareholding of, or support from, GoI
- 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

Set up in 1937 by Mr M Ct M Chidambaram Chettyar, IOB was nationalised in 1969. Headquartered in Chennai, the bank had 3,220 domestic branches, 4 overseas branches and 3,477 automated teller machines as on March 31, 2023. As on March 31, 2023, total advances and deposits were Rs 189,009 crore and Rs 260,883 crore, respectively. The loan portfolio comprises corporate loans (30%), MSME loans (20%), agriculture loans (25%) and retail loans (25%). Current account and savings account (CASA) deposits to total deposits ratio was 43.7% as on March 31, 2023 (43.4% as on March 31, 2022, and 42.5% as on March 31, 2021).

For fiscal 2023, the bank reported PAT of Rs 2,099 crore on total income (net of interest expense) of Rs 12,364 crore, compared with Rs 1,710 crore and Rs 11,214 crore, respectively, in fiscal 2022.

Key Financial Indicators

As on / for the half year ended March 31		2023	2022
Total assets	Rs crore	313,746	299,377
Total income (net of interest expense)	Rs crore	12,364	11,214
PAT	Rs crore	2,099	1,710
Gross NPA	%	7.4	9.8
Overall CAR	%	16.1	13.8
Return on assets	%	0.7	0.6

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 and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities - including those that are yet to be placed - based on available information. The complexity level for instruments may be updated, where required, in the rating rationale published subsequent to the issuance of the instrument when details on such features are available.

For more details on the CRISIL Ratings` complexity levels please visit www.crisilratings.com. 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	CRISIL rating with outlook
INE565A08035	Tier II bonds	24-Sep-19	9.0802	24-Sep-29	500	Complex	CRISIL AA-/Positive
INE565A09264	Tier II bonds	10-Dec-18	11.7	10-Dec-28	300	Complex	CRISIL AA-/Positive
NA	FD programme	NA	NA	NA	200000	Simple	CRISIL AA/Positive
NA	Certificate of deposits programme	NA	NA	7-365 days	NA	Simple	CRISIL A1+

Annexure - Details of rating withdrawn

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity level	CRISIL rating with outlook
INE565A09256	Tier II bonds	03-Nov-16	9.24	03-Nov-26	800	Complex	Withdrawn

Annexure - Rating History for last 3 Years

	Current			2023 (History)		2022		2021		2020		Start of 2020
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Certificate of Deposits	ST	0.0	CRISIL A1+		--	29-06-22	CRISIL A1+	24-12-21	CRISIL A1+	31-07-20	CRISIL A1+	CRISIL A1+
			--		--		--	31-07-21	CRISIL A1+		--	--
Fixed Deposits	LT	200000.0	CRISIL AA/Positive		--	29-06-22	CRISIL AA/Stable	24-12-21	F AA/Positive	31-07-20	F AA/Stable	F AA/Stable
			--		--		--	31-07-21	F AA/Stable		--	--

Lower Tier-II Bonds (under Basel II)	LT		--		--		--	31-07-21	Withdrawn	31-07-20	CRISIL A+/Stable	CRISIL A+/Stable
Perpetual Tier-I Bonds (under Basel II)	LT		--		--		--		--	31-07-20	Withdrawn	CRISIL A-/Stable
Tier II Bonds (Under Basel III)	LT	800.0	CRISIL AA-/Positive		--	29-06-22	CRISIL AA-/Stable	24-12-21	CRISIL A+/Positive	31-07-20	CRISIL A+/Stable	CRISIL A+/Stable
			--		--		--	31-07-21	CRISIL A+/Stable		--	--
Upper Tier-II Bonds (under Basel II)	LT		--		--		--	31-07-21	Withdrawn	31-07-20	CRISIL A-/Stable	CRISIL A-/Stable

All amounts are in Rs.Cr.

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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