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The Vice President – Listing Department, National Stock Exchange of India Ltd., Exchange Plaza, Bandra Kurla Complex, Bandra East, <u>Mumbai 400 051.</u>	The Vice-President – Listing Department, BSE Ltd., 25, P.J. Towers, Dalal Street, <u>Mumbai 400 001.</u>

महोदय/महोदया Dear Sir/Madam,

Rating Action by Fitch Ratings

In Compliance of Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, this is to inform that Fitch Ratings has vide its rating release dated 03 December 2020 has affirmed Bank of India's Ratings as under:

Long –Term Issuer Default Ratings (IDR)	`BBB-' / Negative Outlook
Bank's Viability Rating (VR)	`b+'

A copy of the Rating release is enclosed.

धन्यवाद Thanking you,

भवदीय Yours faithfully,

(राजीव भाटिया Rajeev Bhatia)
कंपनी सचिव Company Secretary



RATING ACTION COMMENTARY

Fitch Affirms Bank of India at 'BBB-'; Outlook Negative

Thu 03 Dec, 2020 - 7:22 AM ET

Fitch Ratings - Singapore - 03 Dec 2020: Fitch Ratings has affirmed Bank of India's (BOI) Long-Term Issuer Default Rating (IDR) at 'BBB-', with a Negative Outlook. The agency has also affirmed the bank's Viability Rating (VR) at 'b+', Support Rating Floor at 'BBB-' and Support Rating at '2'. A full list of rating actions is at the end of this commentary.

The Negative Outlook on the IDR mirrors the outlook on India's sovereign rating of 'BBB-', which was revised to Negative from Stable on 18 June 2020 due to the impact of the escalating coronavirus pandemic on India's economy. For more details on the sovereign rating action, please see "Fitch Revises India's Outlook to Negative, Affirms IDR at 'BBB-'" at <https://www.fitchratings.com/site/pr/10126674>.

The operating environment for Indian banks remains challenging despite a moderate revival in economic activity due to gradual easing of the lockdown since May 2020. Fitch revised India's real GDP growth for the fiscal year ending March 2021 (FY21) to -10.5% from -5% in September 2020, but expects real GDP to return to growth of 11% in FY22, but largely as a result of the low base.

The economic contraction is likely to result in protracted weakness in banks' asset-quality cycle, which could be manifested in much higher stressed loans and ultimately, more write-offs over the next few years, even though Indian banks' 2QFY21 earnings present a more benign picture (see "Indian Banks to Face Tough Times" at <https://www.fitchratings.com/site/re/10137748>).

Fitch believes that a speedy economic recovery is critical for banks to rebound meaningfully, absent which we expect weak prospects for new business and revenue for the Indian banking sector in 2021.

KEY RATING DRIVERS

IDRS, SUPPORT RATING AND SUPPORT RATING FLOOR

BOI's Long-Term IDR of 'BBB-' is driven by its Support Rating of '2' and Support Rating Floor of 'BBB-'. It reflects Fitch's expectation of a high probability of extraordinary government support, if required, due to the bank's high systemic importance and state linkages. This is driven by its significant market share (nearly 4% of sector loans and deposits), pan-India franchise and 89.1% state ownership.

Large state-owned banks, such as BOI, also play an important policy role in furthering the state's social lending objectives and are important for financial inclusion. Fitch believes that a default by a large bank like BOI would result in a general loss of confidence in the sector and pose high reputational risks for the state. The Negative Outlook on the bank's IDR mirrors that on India's sovereign IDR.

VIABILITY RATING

BOI's 'b+' VR is two notches below our assessment of the banking system's operating environment score. There is a negative bias on the VR due to BOI's above-average levels of impaired assets and less-than-satisfactory capital buffers, which are vulnerable to even moderate stress. BOI's weak intrinsic risk profile also factors in its weak profitability, evident from its high impaired loans and persistent losses between FY20-FY15, which could threaten its

moderate capitalisation if asset-quality stress rises significantly due to adverse changes in business and economic conditions.

The bank's common equity Tier 1 (CET1) ratio is now 167 bp above the regulatory minimum requirement of 8%, which has been deferred to April 2021 due to the pandemic. Core capital is vulnerable to even moderate shocks, which is evident from its net impaired loans/CET1 ratio of 36%, even though it is off a high of 113% in FY18. We have a negative outlook on the capitalisation score because income headroom is not sufficient to absorb heightened credit costs, which could lead to more losses. BOI's plan to raise INR25 billion, or 84 bp of 1HFY21 risk-weighted assets, is also modest, and can be difficult to achieve due to its discounted equity valuation (0.3 times). If successful, the proposed amount is unlikely to meaningfully improve capital buffers in the medium term, leaving BOI highly dependent on the state, its majority shareholder, for its capital needs.

The impaired-loan ratio improved to 13.8% in 1HFY21 from 14.9% at FY20, driven by lower slippages partly due to the moratorium on loan repayment and sharp increase in write-offs. Nonetheless, asset quality does not truly reflect the economic realities because the bank had a high 33% of loans under moratorium at end-1HFY21. Fitch believes it is highly likely that asset quality will deteriorate over the medium term, although not all stressed assets will be recognised as impaired loans. The one-time loan restructuring scheme for COVID-19 impacted loans and availability of refinancing from banks could structurally delay recognition of potential stress over the next two years. However, Fitch will treat restructured loans as stressed loans, as we have done in the past.

Risks are heightened in retail and SME loans, which formed 18% and 15%, respectively, of total loans at end-1HFY21. A material share of retail loans is vulnerable due to recent vintage after high growth in FY19 and FY20, while structural demand challenges and cashflow disruptions in SME loans make them vulnerable to stress, although immediate stress may have been averted due to refinancing under government-sponsored schemes.

There is also high risk from exposure to stressed corporate sectors, such as non-bank financial institutions, infrastructure, auto, construction, real estate, and engineering, which together made up about 38% of total loans in 1QFY21.

Vulnerabilities in corporate loans can be also gauged from loans locally rated below investment grade, which accounted for 17% of corporate loans at 1HFY21. The bank says that borrowers of 1.3% of loans applied for restructuring in 1HFY21. BOI's loan-loss cover improved to 81% by end-1HFY21 from 73% at FYE20: 73%, but provisions related to the pandemic amounted to an additional cover of just 1.8%, implying that the bank's loan-loss cover would fall if slippages exceed the bank's benign expectations, which we believe is likely.

BOI's operating profit/risk-weighted assets rebounded to 1.4% in 1HFY21 (FY20: -1.6%) mainly due to lower loan impairment charges (1HFY21: 1.4%; FY20: 3.7%). However, this followed five years of significant losses that damaged capitalisation and business prospects. Fitch believes that the nascent recovery may not be sustained if there is a reversal in the credit cost trend due to rising slippages. The available buffer is not sufficient because loan and securities impairment charges were equivalent to 64% of pre-provision profits at 1HFY21. It reflects structural weakness in earnings, which is likely to persist in the foreseeable future.

The VR also factors in BOI's stable nation-wide franchise and funding profile, which is underpinned by its large size and reach as well as close government links, although their influence on the VR is lower than the financial profile factors above. BOI's deposit share has remained steady in the current uncertain environment, which reflects continued depositor confidence driven by its strong state linkages. Low-cost deposits accounted for 34% of deposits in 1HFY21, down from 36% in FY20, while the stable liquidity profile reflects in its liquidity coverage ratio of 261%.

SENIOR DEBT

BOI's senior debt rating is at the same level as its IDR, as the debt represents its unsecured and unsubordinated obligations.

RATING SENSITIVITIES

IDRS, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR DEBT

Factors that could, individually or collectively, lead to negative rating

action/downgrade: The Support Rating and Support Rating Floor are most sensitive to Fitch's assessment of the government's propensity and ability to support the bank, based on its size, systemic importance and linkage to the state. Weakening of the government's ability to provide extraordinary support - reflected in negative action on India's sovereign ratings - would lead to negative action on the IDRs. Negative action on the IDR is likely should Fitch perceive any reduction in the government's propensity to extend timely support, in which case the agency will reassess the Support Rating and Support Rating Floor, and in turn, the bank's IDR and senior debt ratings, although that is not our base case. The senior debt ratings would be downgraded if the bank's Long-Term IDR is downgraded. Factors that could, individually or collectively, lead to positive rating action/upgrade: A revision of the Outlook on the sovereign rating to Stable would lead to a corresponding change in the Outlook on BOI's IDR, provided the sovereign's propensity to support remains unchanged. An upgrade to BOI's Support Rating Floor could occur in the event of a sovereign upgrade if Fitch believes that the sovereign's ability and propensity to support the bank has improved. However, an upgrade of the sovereign rating is unlikely in the near term as the rating is on Negative Outlook. A downward revision in the VR is unlikely to affect the IDR since the IDR is four notches above the VR. The senior debt ratings would be upgraded if the bank's Long-Term IDR is upgraded.

VIABILITY RATING Factors that could, individually or collectively, lead to negative rating action/downgrade: BOI's VR will be downgraded if the bank's asset quality weakens by more than expected, as reflected in the stressed loan ratio (impaired loans + restructured loans). Another protracted deterioration in the bank's asset quality, with stressed loan ratio closer to 20% (from 13.8% impaired loan ratio in 1HFY21), could lead to higher-than-expected losses and weaker capitalisation, which has high influence on the VR, and this could lead to a downgrade of the VR to 'b'. However, a downgrade of the VR to the 'ccc' category would be in order if poor earnings and weak asset quality (stressed asset ratio well above 20%) compromised the bank's core capital position (CET1 ratio dropping below 8%) and increased the need for extraordinary support on a last-resort basis. However, that is not our base case as we believe that there is a high likelihood the state will provide fresh capital to the bank well ahead of any breach of regulatory requirements. Factors that could, individually or collectively, lead to positive rating action/upgrade: A VR upgrade is unlikely in the near term in light of the risks to the bank's intrinsic profile from rising external pressures, which could ease if the economic

recovery is quicker and stronger than envisaged, as this may result in the bank's asset quality and capitalisation returning to stability. The CET1 ratio moving towards 12%, the impaired-loan ratio approaching 5% (from 13.8% impaired loan ratio in 1HFY21), and earnings improving to levels commensurate with a higher VR will be important before a VR upgrade can be considered.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

BOI has an ESG Relevance Score of '4' for Governance Structure. This reflects our assessment that key governance aspects, in particular board independence and effectiveness, ownership concentration, and protection of creditor or stakeholder rights have a moderate influence on the Viability Rating. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors. Fitch views governance to be less developed, which is evident from weak underwriting resulting in high levels of poorly performing loans and credit losses. The board is dominated by government appointees while its business model often focuses on supporting

government strategy with lending directed towards promoting socio-economic and macroeconomic policies that may include lending to government-owned companies. These factors also drive our view on the bank's state linkages, which affect support prospects that drive the long-term ratings.

BOI has an ESG Relevance Score of '4' for Financial Transparency. This reflects our assessment that the quality and frequency of financial reporting and the auditing process are a moderate influence on the Viability Rating. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors. These factors have become more prominent in the past few years because of the sharp financial deterioration at state banks as well as the wide divergences in reported non-performing loan recognition between the banks and the regulator, although the gap has narrowed recently. However, financial transparency is viewed critical for general business and depositor confidence and can lead to significant reputational damage if not managed well.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Bank of India	LT IDR	BBB- Rating Outlook Negative	Affirmed	BBB- Rating Outlook Negati
	ST IDR	F3	Affirmed	F3
	Viability	b+	Affirmed	b+
	Support	2	Affirmed	2



[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

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