Punjab National Bank

May 22, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds	1,000.00	1,000.00	[ICRA]AA-(hyb) (Negative) Downgraded from [ICRA]AA+(hyb)@
Infrastructure Bonds Programme	3,000.00	3,000.00	[ICRA]AA- (Negative) Downgraded from [ICRA]AA+@
Fixed Deposit Programme	-	-	MAA (Negative) Downgraded from MAAA@
Certificate of Deposits	60,000.00	60,000.00	[ICRA]A1+, Reaffirmed
Total	64,000.00	64,000.00	

@ -rating watch with negative implications

Rating action

ICRA has downgraded the long-term rating for Punjab National Bank's (PNB)[1] Rs. 1,000-crore Tier II bonds and Rs. 3,000-crore infrastructure bonds to [ICRA]AA- (pronounced ICRA double A minus) from [ICRA]AA+ (pronounced ICRA double A plus). ICRA has also downgraded the medium-term rating on the bank's fixed deposit programme to MAA (pronounced M double A) from MAAA (pronounced M triple A). ICRA has reaffirmed the short-term rating on the Rs. 60,000-crore certificate of deposit programme at [ICRA] A1+ (pronounced ICRA A one plus). The rating watch with negative implications stands removed on the long-term and medium-term ratings and a Negative outlook has been assigned.

The letters "hyb" in parenthesis suffixed to a rating symbol stand for "hybrid", indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss severity vis-à-vis conventional debt instruments. The rated Tier II bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

Rationale

The rating downgrades consider the significant capital erosion of the bank and sizeable capital requirements in the immediate future to meet the regulatory capital ratios. Had the bank not taken benefit of the various regulatory dispensations[2], the capital ratios would have been further adversely impacted. With sizeable provisions to be accounted for in FY2019, PNB is likely to report capital adequacy ratio (CAR) below the regulatory CAR of 9.00%[3], unless it raises capital immediately. In the near term, CAR below the regulatory level will also constrain the bank from servicing its debt capital instruments[4], while adhering to the covenants for these instruments. In the medium- to long-term, because of its large capital requirements and the impairment in its ability to raise capital from markets, the bank's dependence on the Government of India (GoI) for its capital requirements has also increased.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

[2] *The bank has deferred provisions totalling Rs. 10,140 crore, which is equivalent to 2.24% of risk-weighted assets on March 31, 2018*

[3] *Does not includes capital conservation buffer (CCB) required of 1.875% as on March 31, 2018 and 2.5% as on March 31, 2019*

[4] *Such as Upper Tier II instruments and Tier I instruments issued under Basel II and Tier I instruments under Basel III*

Further, the bank's net non-performing assets (NNPA) have consistently remained above the regulatory threshold of 6.00% for inclusion into the prompt corrective action (PCA) framework. With reported CAR and Common Equity Tier I (CET I) also below the PCA inclusion threshold of 10.25% and CET of 6.75%, the likelihood of the bank being included under PCA has increased further. The inclusion of the bank under PCA may also trigger a regulatory event leading to the early recall of its Basel III Tier I bonds, thereby worsening the capital ratios further and increasing the CET I requirements. PCA will also restrict certain banking activities related to lending and deposit-taking operations. Any restriction may further hamper the bank's recovery and capital-raising ability.

The bank's internal capital generation is expected to remain weak because of high NPA levels (GNPA of 18.38% and NNPA of 11.24% as on March 31, 2018), thereby resulting in credit provisioning surpassing the core operating profits (excluding treasury income/divestments) during FY2019. Hence, the bank will also require capital in the near term to offset these losses.

PNB is majorly owned by the GoI with a 62.2% shareholding as on March 31, 2018 and has received consistent capital support from the GoI in the past. However, given its large capital requirements and the need to maintain minimum GoI shareholding of 51%, it has high dependence on capital infusion from the GoI. In the absence of requisite capital infusion from the GoI, PNB's ability to maintain regulatory capital ratios including CCBs may be constrained in future.

Supported by its strong franchise, including a large network of branches across India, PNB is the second-largest public sector bank (PSB) and the fourth-largest bank in the Indian banking sector as on December 31, 2017. PNB continues to have a stable and high CASA deposit base resulting in lower cost of interest-bearing funds.

Outlook: Negative

In ICRA's view, the bank's external capital requirements are significant even under the scenario in which it divests some of its investments in subsidiaries or associates. Further, its ability to raise capital from the market also stands impaired, thereby posing high dependence on capital infusion by the GoI. Accordingly, the rating may be revised downwards further, in case PNB is unable to raise sufficient capital to restore capital ratios above regulatory levels (including CCBs). Inclusion of the bank under PCA may also worsen its capital position and prolong its recovery and, hence, will be a rating negative. Conversely, if the bank can raise sufficient capital to offset the impact of losses as well as the PCA event, the rating outlook will be made Stable.

Key rating drivers

Credit strengths

Sovereign ownership; however, impaired ability to raise capital poses high dependence on GoI to meet regulatory capital ratios – PNB is majorly owned by the GoI with a 62.2% shareholding as on March 31, 2018 and has received consistent capital support from the GoI in the past. During FY2018, the GoI infused Rs. 5,473 crore capital under the PSB recapitalisation programme. PNB also received equity capital of Rs. 2,112 crore in FY2017 and Rs. 1,732 crore in FY2016 from the GoI. Additionally, PNB raised Rs. 5,000 crore of capital through equity issuance during Q3 FY2018 and ~Rs. 1,231 crore through the divestment of its 5.9% stake in its associate, PNB Housing Finance (rated [ICRA] AA+ (Stable)). As of March 31, 2018, PNB had a 32.96% stake in PNB Housing.

However, given its large capital requirements and the need to maintain minimum GoI shareholding of 51%, it is highly dependent on capital infusion from the GoI even in a scenario of divestment of identifiable non-core assets. In the absence of requisite capital infusion from the GoI, PNB's ability to maintain regulatory capital ratios including CCBs may be constrained in future. In an event PNB is unable to raise sufficient capital to restore capital ratios above regulatory levels (including CCBs), the rating may be further revised downwards.

Strong franchise with widespread branch network; healthy proportion of CASA deposits leads to lower cost of funds - Supported by its strong franchise, including a large network of branches across India, PNB is the second-largest PSB and the fourth-largest bank in the Indian banking sector, accounting for 5.4% of advances and 5.8% of deposits as on December 31, 2017. Supported by its wide branch network, PNB has a stable and high CASA deposit base. The bank's CASA deposits accounted for 41% of its total deposits as on March 31, 2018 (42% as on March 31, 2017). The vast retail franchise also results in granularity in the deposit base, as reflected in the bank's top 20 deposits accounting for 3.29% of total deposits as on March 31, 2017 (4.12% as on March 31, 2016), which compares favourably with peers. The granular deposit base and high share of CASA also results in lower cost of interest-bearing funds for the bank; PNB's cost of interest bearing funds stood at 4.84% in FY2018 (5.06% in FY2017).

Credit challenges

Significant capital erosion and sizeable capital requirement in immediate future to meet regulatory capital ratios – During Q4 FY2018, the bank reported a loss before tax of Rs. 20,800 crore, thereby significantly eroding its capital ratios despite a capital infusion by the GoI during the quarter. PNB reported CET of 5.95% as on March 31, 2018 as against 8.05% as on December 31, 2017 and a regulatory minimum of 7.375% (including CCB) as on March 31, 2018.

The losses were driven by a fraud amounting to Rs. 14,536.84 crore at one of its branches. The bank has made 50% provision against the fraud, i.e. Rs. 7,178.42 crore in its FY2018 financials and the balance will be provided during FY2019. In addition to the aforesaid provisions, elevated slippages (~Rs. 30,991 crore during Q4 FY2018 vs Rs. 44,274 crore in FY2018), after the inclusion of the above fraud and a revision in guidelines for the resolution of stressed assets issued by Reserve Bank of India (RBI) in February 2018, also increased the slippages and losses for the bank during Q4 FY2018.

Apart from the deferment of 50% of the provisions against the fraud, the bank has opted for other forbearances deferring the provisioning requirements in its FY2018 reported financials, which if adjusted, will result in further erosion in the reported capital ratios. These deferments of provisions include a) reduced provisioning of 40% (instead of minimum 50%) on accounts referred under the Insolvency and Bankruptcy Code (IBC) 2016, thereby lowering provision requirements by Rs. 1,684.14 crore though the same will be required to be provided for in Q1 FY2019, b) amortisation of mark-to-market losses on the bond portfolio amounting to Rs. 1,088.28 crore and c) deferment of gratuity liability of Rs. 190 crore after enhancement in gratuity limits. Had the bank not deferred these provisions, aggregating Rs. 10,140 crore, the losses would have been higher, and the reported CET and Tier 1 would have been lower by 2.24% (based on risk-weighted assets as on March 31, 2018). Hence, the bank's adjusted capital ratios are significantly weaker in relation to minimum regulatory requirements[5] under Basel III of CET-I, Tier I and CAR of 7.375%, 8.875% and 10.875%, respectively.

With the above provisions required to be made during FY2019, the likelihood of the bank reporting a CAR below the regulatory CAR of 9.00%[6] is high, unless it raises capital immediately. In case reported CAR is below the regulatory level, it will also constrain the bank from servicing its debt capital instruments[7], while adhering to the covenants for these instruments. With impaired ability to raise Tier I debt capital and expected losses during FY2019, as per ICRA's estimates, the bank will require an equity capital of Rs. 23,000-25,000 crore (115-125% of market capitalisation) to meet the

---

[5] *Including capital conservation buffer (CCB) of 1.875%*
[6] *Does not include CCB required of 1.875% as on March 31, 2018 and 2.5% as on March 31, 2019*
[7] *Such as Upper Tier II instruments and Tier I instruments issued under Basel II and Tier I instruments under Basel III*

regulatory Tier I ratio of 9.5% as on March 31, 2019. The Tier I capital will increase further in case the bank is placed under PCA and it exercises an early recall of its AT1 bonds, which currently stand at Rs. 5,250 crore (~1.15% of RWA as on March 31, 2018), else risk a coupon skip on the same.

Even in a scenario of complete divestment of identifiable non-core assets, the bank's capital requirements are expected to remain high, posing huge dependence on the GoI to infuse capital to maintain its majority shareholding. Given the size of capital requirement, ICRA expects the bank to report weak capital ratios in the medium- to long-term, thereby impacting business growth in the near term.

Weak capital ratios heighten the risk of inclusion in PCA framework - PNB's net NPA has consistently remained above the regulatory threshold of 6.00% for inclusion in the prompt corrective action (PCA) framework for the last nine quarters. PNB's net NPA increased to Rs. 48,684 crore (11.22%) as on March 31, 2018 as against Rs. 32,702 crore (7.80%) as on March 31, 2017 and is likely to remain elevated and above the PCA threshold over the near term.

Further, with reported CAR and CET I of 9.20% and 5.95%, respectively, as on March 31, 2018 also remaining below the PCA inclusion threshold of 10.25% and CET of 6.75%, the likelihood of the bank being included under PCA has increased further. The bank's ability to service its AT1 instruments has decreased following the weakening of the capital position. Recently, RBI has also restricted certain banking activities related to lending and deposit-taking operations of PCA banks; any such restriction on PNB will further hamper its recovery and capital-raising ability.

Expected losses during FY2019 on account of high NPAs; solvency levels to remain weak – PNB's reported asset quality worsened further as it reported fresh slippages of Rs. 44,274 crore during FY2018 and fresh NPA generation rate of 11.2% (Rs. 22,415 crore and 5.7% during FY2017). Of the slippages in FY2018, ~70% were during Q4 FY2018 because of the fraud amount being classified as NPA and RBI's revised guidelines for the resolution of stressed assets.

With the bank's gross and net NPAs at 18.38% and 11.24%, respectively, as on March 31, 2018 (12.53% and 7.81% as on March 31, 2017), the bank's internal capital generation is expected to remain weak during FY2019. The credit provisioning (even excluding the balance fraud provisioning) is expected to surpass core operating profits (excluding treasury income/divestments) during FY2019. Hence, the bank will require capital in the near term to offset these losses. The provision cover, at 43.80% as on March 31, 2018 (excluding write-offs), is expected to be weaker than PSB averages. With the increase in NPA levels, despite the capital raisings during FY2018, the solvency levels, i.e. net NPAs/net worth[8] deteriorated to ~136% as on March 31, 2018 as against ~86% as on March 31, 2017. With the resolution of cases under the IBC expected in FY2019, the recovery and upgrades may improve during FY2019. However, despite the recoveries, elevated levels of net NPAs and the weak capital position will continue to exert pressure on the solvency profile.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

ICRA Rating Methodology for Banks

[8] *Net worth excluding revaluation reserves*

About the company:

Punjab National Bank (PNB) was incorporated as Punjab National Bank Limited in 1894 and commenced operations from Lahore in April 1895. Upon nationalisation in 1969, the bank was renamed Punjab National Bank. As on March 31, 2018, the GoI held 62.2% equity in the bank. PNB operated 6,983 branches and 9,668 ATMs as on March 31, 2018. The bank has a strong presence in rural and semi-urban areas, where around 62% of its branches were located as on March 31, 2018. During FY2018, the bank reported a net loss of Rs. 12,282 crore on a total asset base of Rs. 7.60 lakh crore as on March 31, 2018 as against a net profit of Rs. 1,325 crores on a total asset base of Rs. 7.16 lakh crore as on March 31, 2017. PNB's gross and net NPAs stood at 18.38% and 11.24% as on March 31, 2018. The bank reported Tier I capital of 7.12% and CRAR of 9.20% as on March 31, 2018.

Key financial indicators (audited) (standalone)

	FY2017	FY2018	Q4FY2017	Q4FY2018
Net interest income	14,993	14,922	3,684	3,063
Profit before tax	2,011	-19,575	478	-20,800
Profit after tax	1,325	-12,282	262	-13,416
Net advances	419,493	433,735	419,493	433,735
Total assets (Excluding Revaluation Reserves)	716,580	760,442	716,580	760,442
% CET	7.87%	5.95%	7.87%	5.95%
% Tier 1	8.91%	7.12%	8.91%	7.12%
% CRAR	11.66%	9.20%	11.66%	9.20%
% Net interest margin / Average total assets	2.17%	2.02%	2.07%	1.61%
% Net profit / Average total assets	0.19%	-1.66%	0.15%	-7.04%
% Return on net worth	3.48%	-33.18%	2.73%	-135.32%
% Gross NPAs	12.53%	18.38%	12.53%	18.38%
% Net NPAs	7.81%	11.24%	7.81%	11.24%
% Provision coverage excl. technical write offs	40.94%	43.80%	40.94%	43.80%
% Net NPA/ Net worth	85.84%	126.54%	85.84%	126.54%

Amount in Rs. Crore. Networth and total assets are excluding Revaluation Reserves

Source: PNB; ICRA research

All ratios are as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sr. No.	Name of Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years						
		Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. Crore)	May 2018	FY2018				FY201		FY2015
						Mar 2018	Feb 2018	June 2017	April 2017	Feb 2016	August 2015	March 2015
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AA- (hyb) (Negative)	[ICRA] AA+ (hyb)@	[ICRA]AA+ (hyb)@	[ICRA]AA+ (hyb) (stable)	[ICRA]AA+ (hyb) (stable)	[ICRA] AA+ (hyb) (stable) Downgraded	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)
2	Infrastructure Bonds Programme	Long Term	3,000	1,800^	[ICRA]AA- (Negative)	[ICRA] AA+ @	[ICRA]AA+ @	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable) Downgraded	[ICRA] AAA (stable)	[ICRA] AAA (stable)
3	Certificate of Deposits Programme	Short Term	60,000	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Term Deposits Programme	Medium Term	NA	NA	MAA (Negative)	MAAA @	MAAA@	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)	MAAA (stable)

^Rs. 1,200 crore of bonds yet to be placed
@ Ratings on watch with Negative implications

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE160A08019	Basel III Compliant Tier II Bonds Programme	February 24, 2014	9.65%	February 24, 2024	1,000.00	[ICRA]AA- (hyb) (Negative)
INE160A08084	Infrastructure Bonds Programme	March 24, 2015	8.35%	March 24, 2025	1,800.00	[ICRA]AA- (Negative)
	Infrastructure Bonds Programme	Not Placed			1200.00	[ICRA]AA- (Negative)
NA	Certificate of Deposits Programme	-	-	7-365 days	60,000	[ICRA]A1+
NA	Term Deposits Programme	-	-	-	-	MAA (Negative)

Source: PNB

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Shashank Singh
+91 124 4545 386
shashank.singh@icraindia.com

Niraj Jalan
+91 33 7150 1146
niraj.jalan@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
naznin.prodhani@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 66069999