November 22, 2022(Revised)

Punjab National Bank: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier I Bonds	4,000.00	4,000.00	[ICRA]AA (Stable); reaffirmed
Fixed Deposits	-	-	[ICRA]AA+ (Stable); reaffirmed
Infrastructure Bonds	3,000.00	3,000.00	[ICRA]AA+ (Stable); reaffirmed
Basel II Lower Tier II Bonds	1,200.00	1,200.00	[ICRA]AA+ (Stable); reaffirmed
Basel III Tier II Bonds	3,000.00	3,000.00	[ICRA]AA+ (Stable); reaffirmed
Certificates of Deposit	60,000.00	60,000.00	[ICRA]A1+; reaffirmed
Total	**71,200.00**	**71,200.00**	

**Instrument details are provided in Annexure I*

Rationale

The ratings reaffirmation continues to factor in Punjab National Bank's (PNB) sovereign ownership and the demonstrated track record of capital support from the Government of India (GoI). While the bank is adequately capitalised and likely to remain self-sufficient for its capital requirements, ICRA expects it to continue receiving support, if required. PNB's systemic importance in the Indian banking sector remains high with a market share of 6.23% in advances and 7.06% in total deposits as on June 30, 2022. Moreover, it is the fourth largest public sector bank (PSB) and the sixth largest bank in the Indian financial system in terms of net advances. The ratings further remain supported by the bank's strong deposit franchise, resulting in a high share of retail deposits and a strong liquidity profile.

While there has been a relative improvement in the headline asset quality metrics over the last few years, leading to an improvement in the solvency[1] profile, slippages remain at elevated levels. Going forward, the ability to contain slippages from the stressed book, primarily comprising restructured advances, as well as the overdue book (SMA-1 and SMA-2)[2], will be critical from an asset quality and profitability perspective. Over and above this, the impact of rising borrowing costs and high inflation on the relatively more vulnerable borrowers will be a monitorable. Nevertheless, ICRA expects the bank to significantly absorb the credit provisions from its operating profits if any of the aforementioned stress materialises. While PNB has been profitable over FY2021-H1 FY2023, the return metrics remain relatively modest as it has been increasing the provision cover on its legacy stressed assets. Backed by the stronger credit growth, recoveries and increasing provision cover, we expect overall internal capital regeneration to improve steadily from the current level during the next year. A sustained improvement in the solvency profile while ensuring an improvement in the profitability will be key from a credit perspective.

The Stable outlook reflects ICRA's expectation of limited capital dependence of the bank for targeted growth and its strong liability franchise. While we expect further improvement in the asset quality, solvency, and profitability, the same may remain lower than the thresholds vis-à-vis the positive rating triggers in the near term.

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[1] *Solvency ratio = Net stressed assets / Core capital; net stressed assets include NNPAs, net non-performing investments and net security receipt*

[2] *Special mention accounts (SMA) are overdue loans with SMA-0 reflecting an overdue status of up to 30 days, SMA-1 reflecting an overdue status of 31-60 days and SMA-2 reflecting an overdue status of 61-90 days*

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – The GoI remains PNB's largest shareholder, accounting for a 73.15% equity stake as on September 30, 2022, down from 85.59% as on September 30, 2020 after two rounds of equity capital raising of Rs. 5,588 crore from the markets in FY2021 and FY2022. This follows the meaningful capital support received by PNB and other amalgamating banks from the GoI during FY2018-FY2020 (Rs. 55,274 crore). This helped improve the provision levels on the stressed assets and drove down its net non-performing advances (NNPA) level and restored its capital position to better levels. While the bank has raised capital over the last two years and internal capital generation is expected to improve, thereby limiting its capital dependence on the GoI, ICRA expects it to continue receiving support from the GoI if required.

Adequate capitalisation levels; solvency profile improves – The bank's core equity capital (CET-I) and Tier I capital stood at 10.88% and 12.20%, respectively, as on September 30, 2022 (11.58% and 12.50%, respectively, as on September 30, 2021). While the capitalisation profile was supported by infusions in the past, PNB remained profitable over FY2021-H1 FY2023 after incurring huge losses in prior years, which led to capital erosion. With the profitability still at a modest level and given the growth in the risk-weighted assets, the capitalisation profile moderated on a sequential basis. The bank raised Rs. 2,658 crore of additional Tier-I bonds in H1 FY2023 (net of maturities) and has board approval to raise a further Rs. 2,842 crore in H2 FY2023.

With the gradual decline in the NNPA stock, the overall solvency profile improved steadily to 45.51% as on September 30, 2022 from 57.28% as on September 30, 2021. Going forward, ICRA expects the bank to sustain the improvement in the solvency level, which will also be key from a credit perspective.

Well-developed deposit franchise – PNB's overall deposit base grew by ~7% year-on-year (YoY) to Rs. 11.93 lakh crore as on September 30, 2022. The share of PNB's deposits in the banking system stood at 7.06% as on June 30, 2022, which was supported by its extensive network of 10,038 branches. Further, its current account and savings account (CASA) base stood at 43.94% (domestic CASA – 44.91%) of the total deposits as on September 30, 2022, in line with the PSB average of 42-43% during this period.

Besides a reasonably high share of CASA deposits, the share of the top 20 depositors in total deposits remained low at 3.67% as on March 31, 2022. The granular deposit base and the high share of CASA deposits continue to impart strong resource and liquidity profile to the bank while keeping the overall cost of interest-bearing funds in line with the PSB average at 3.75% (annualised) in Q1 FY2023 (PSB average – 3.73%) and 3.94% in FY2022 (PSB average – 3.84%). Given its strong core deposit base, widespread branch network, and robust retail franchise, ICRA expects PNB to continue maintaining a strong liquidity profile.

High systemic importance as fourth largest PSB and sixth largest bank in Indian banking system in terms of net advances – PNB's market share stood at 6.2% of advances and 7.5% of total deposits as on June 30, 2022, signifying its increased systemic importance in the Indian banking system after the amalgamation of two other PSBs from April 1, 2020. While it is not classified as a domestic systemically important bank (D-SIB) at present, PNB's classification in this category would lead to additional capital requirements vis-à-vis the regulatory minimum levels. Going forward, ICRA expects PNB's liability profile to remain a significant positive for supporting its credit growth while maintaining strong liquidity and profitability.

Credit challenges

Asset quality remains a monitorable – The annualised fresh NPA generation remained elevated at 3.6% of opening standard advances in H1 FY2023, although it was lower compared to 3.9% in FY2022 (4.6% in FY2021 and 5.2% in FY2020). While the moderation in NPA generation in H1 FY2023 was led by the easing of the impact of the Covid-19 pandemic, the overall asset quality was also supported by various regulatory forbearances since the onset of the pandemic. Further, PNB's headline asset quality metrics have seen a steady improvement, which was supported by high recoveries, upgrades and sizeable write-offs.

As a result, the gross NPA (GNPA)% and NNPA% stood at 10.48% and 3.79%, respectively, as on September 30, 2022 (13.63% and 5.49%, respectively, as on September 30, 2021).

While PNB's stressed pool has seen a gradual moderation, the standard restructured book stood at 1.87% of standard advances as on September 30, 2022 (3.56% as on September 30, 2021). In addition, the total SMA-1 and SMA-2 loan book stood at 2.67% of standard advances as on September 30, 2022. The performance of the stressed pool, which stood at 45.51% of the core equity capital as on September 30, 2022, and the impact of rising interest rates and high inflation levels on the servicing abilities of many borrowers will be key monitorable factors where the asset quality is concerned.

Modest earnings profile, although expected to improve – With reducing slippages and consequently lower interest reversals, and the improving scale, PNB's operating profit improved steadily to 1.70% of average total assets (ATA) in H1 FY2023 from 1.4% in FY2022 and 1.49% in FY2021, and was largely comparable with the PSB average of 1.6% in FY2022. Despite this, the overall return on assets (RoA) remained relatively modest at 0.11% (annualised) in H1 FY2023. Given the high recoveries required to offset the impact of slippages in H1 FY2023, incremental credit costs could remain high in the near term as the bank is looking to further improve its provision cover on the stressed assets and reduce its NNPA levels. As a result, the profitability levels could remain modest in the near term but improve from the current levels in FY2024. We expect the RoA to remain modest at 0.09-0.21% in FY2023 and gradually surpass the positive trigger thresholds in FY2024.

Liquidity position: Strong

The bank continues to have a strong liquidity profile as depicted by the positive cumulative mismatches of 8% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement for August 31, 2022. This is supported by the high share of core deposits and the excess statutory liquidity ratio (SLR) position of 8.17%. The liquidity coverage ratio remained strong at 165% (daily average for Q1 FY2023) while the reported net stable funding ratio (NSFR) stood at 140.25% against the regulatory requirement of 100% in Q1 FY2023. Supported by its sovereign ownership, healthy liabilities profile and excess SLR holdings, ICRA expects PNB to continue to maintain a strong liquidity profile.

Rating sensitivities

Positive factors – The outlook could be changed to Positive or the long-term rating could be upgraded if the bank is able to improve its solvency with net stressed assets/core capital below 40% on a sustained basis while maintaining Tier I capital cushions of more than 100 basis points (bps) over the regulatory levels (9.5% including capital conservation buffer). Additionally, an improvement in the profitability with an RoA of over 0.5% will be a positive trigger.

Negative factors – The ratings will be reassessed in case of a change in the sovereign ownership. ICRA could also change the outlook to Negative or downgrade the ratings if the bank's solvency profile weakens with net stressed assets/core capital exceeding 60% on a sustained basis. A sharp deterioration in the profitability, leading to a weakening in the distributable reserves (DRs) eligible for the coupon payment on the Additional Tier I bonds (AT-I bonds), will be a negative trigger for the rating on the AT-I bonds.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating Rating approach – Consolidation
Parent/Group support	The ratings factor in PNB's sovereign ownership and the demonstrated track record of capital infusions by the GoI. ICRA expects the GoI to support the bank with capital infusions, if required.
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of PNB. However, in line with ICRA's limited consolidation approach, the capital requirement of the PNB Group's key subsidiaries/associates/joint ventures, going forward, has been factored in.

About the company

Incorporated in 1894, Punjab National Bank merged with erstwhile United Bank of India (e-UB) and erstwhile Oriental Bank of Commerce (e-OBC) on April 1, 2020 to form the fourth largest PSB and the sixth largest bank in the Indian banking system in terms of net advances as on June 30 , 2022. The bank had a market share of 6.2% and 7.1% in net advances and total deposits, respectively, as on June 30, 2022, with the GoI holding a majority stake (73.15% as on September 30, 2022). It has a network of 10,038 branches and 12,966 ATMs as on September 30, 2022.

Key financial indicators (standalone)

Punjab National Bank	FY2021	FY2022	H1 FY2022	H1 FY2023
Net interest income$	30,546	28,694	13,587	15,813
Profit before tax	3,480	4,316	2,180	1,250
Profit after tax	2,022	3,457	2,129	720
Net advances (Rs. lakh crore)	6.74	7.28	6.73	7.73
Total assets* (Rs. lakh crore)	12.53	13.08	12.58	13.67
CET-I	10.62%	10.56%	11.58%	10.88%
Tier I	11.50%	11.73%	12.50%	12.20%
CRAR	14.32%	14.50%	15.20%	14.74%
Net interest margin / Average total assets	2.43%	2.24%	2.16%	2.37%
Net profit / Average total assets	0.16%	0.27%	0.34%	0.11%
Return on net worth	2.50%	4.02%	4.97%	1.62%
Gross NPAs	14.11%	11.78%	13.63%	10.48%
Net NPAs	5.72%	4.79%	5.49%	3.79%
Provision coverage excl. technical write-offs	63.06%	62.24%	63.17%	66.28%
Net NPA / Core equity	59.95%	55.04%	53.92%	43.27%

**Total assets and net worth exclude revaluation reserves; Amount in Rs. crore unless mentioned otherwise*
Source: PNB, ICRA Research
^ Annualised
$Numbers restated by the bank during Q2 FY2022 results
All calculations as per ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)					Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Date & Rating in FY2023		Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
			(Rs. crore)	(Rs. crore)	Nov-22-2022	Jun-08-2022	Nov-26-2021	Nov-03-2021	Nov-20-2020	Aug-14-2020	Sep-19-2019
1	Certificates of Deposit Programme	ST	60,000.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Fixed Deposits Programme	LT	-	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	MAAA (Stable)	MAAA (Stable)	MAA+ (Stable)	MAA (Stable)	MAA%
3	Infrastructure Bonds Programme	LT	3,000.00	1,800.00^	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- %
4	Basel II Lower Tier II Bonds Programme	LT	1,200.00	1,025.00^	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	-
5	Basel III Tier II Bonds Programme	LT	3,000.00	3,000.00	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA(hyb) (Stable)	[ICRA]AA- (hyb) (Stable)	[ICRA]AA- (hyb)%
6	Basel III AT-I Bonds	LT	4,000.00	2,658.00^	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-	-	-	-

^Balance yet to be placed

% Rating Watch with Positive Implications

LT – Long term; ST – Short term

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fixed Deposits	Very Simple
Infrastructure Bonds	Very Simple
Basel II Lower Tier II Bonds	Simple
Basel III Tier II Bonds	Highly Complex
Basel III AT-I Bonds	Highly Complex
Certificates of Deposit	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE160A08019	**Basel III Tier II Bonds**	Feb-24-2014	9.65%	Feb-24-2024	1,000.00	[ICRA]AA+ (Stable)
INE141A08019	**Basel III Tier II Bonds**	Oct-27-2014	9.20%	Oct-27-2024	1,000.00	[ICRA]AA+ (Stable)
INE141A08035	**Basel III Tier II Bonds**	Oct-26-2015	8.34%	Oct-26-2025	1,000.00	[ICRA]AA+ (Stable)
INE160A08209	**Basel III Tier I Bonds**	Dec-09-2021	8.40%	Dec-09-2026^	2,000.00	[ICRA]AA (Stable)
INE160A08209	**Basel III Tier I Bonds**	Sep-21-2022	8.30%	Sep-21-2023^	658.00	[ICRA]AA (Stable)
Unplaced	**Basel III Tier I Bonds**	-	-	-	1,342.00	[ICRA]AA (Stable)
INE141A09132	**Basel II Lower Tier II Bonds**	Nov-30-2012	8.93%	Nov-30-2022	1,025.00	[ICRA]AA+ (Stable)
Unplaced	**Basel II Lower Tier II Bonds**	-	-	-	175.00	[ICRA]AA+ (Stable)
INE160A08084	**Infrastructure Bonds**	Mar-24-2015	8.35%	Mar-24-2025	1,800.00	[ICRA]AA+ (Stable)
Unplaced	**Infrastructure Bonds**	-	-	-	1,200.00	[ICRA]AA+ (Stable)
-	**Fixed Deposits**	-	-	-	-	[ICRA]AA+ (Stable)
INE160A16MM2	**Certificates of Deposit**	Aug- 25-2022	6.75%	Aug- 24-2022	250.00	[ICRA]A1+
INE160A16MN0	**Certificates of Deposit**	Aug-26-2022	5.88%	Nov-25-2022	2,720.00	[ICRA]A1+
INE160A16MP5	**Certificates of Deposit**	Sep-09-2022	5.92%	Nov-11-2022	4,600.00	[ICRA]A1+
INE160A16MO8	**Certificates of Deposit**	Sep-09-2022	6.82%	Sep-07-2023	1,505.00	[ICRA]A1+
Unplaced	**Certificates of Deposit**	-	-	-	50,925.00	[ICRA]A1+

Source: Punjab National Bank
^Call option due date

Key features of rated debt instruments

The servicing of the Basel III Tier II bonds, infrastructure bonds and certificates of deposit is not subject to any capital ratios and profitability. However, the Basel III Tier II Bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

The rated Basel III Tier I Bonds (AT-I bonds) have the following loss-absorption features that make them riskier:

- Coupon payments are non-cumulative and discretionary, and the bank has full discretion at all times to cancel coupon payments. Cancellation of discretionary payments shall not be an event of default.
- Coupons can be paid out of the current year's profits. However, if the current year's profit is not sufficient or if the payment of the coupon is likely to result in a loss, the coupon payment can be made through the reserves and surpluses created through the appropriation of profits (including statutory reserves). However, the coupon payment is subject to the bank meeting the minimum regulatory requirements for CET-I, Tier I and total capital ratios (including capital conservation buffer, CCB) at all times as prescribed by the RBI under the Basel III regulations.

These Tier I bonds are expected to absorb losses through the write-down mechanism at the objective prespecified trigger point fixed at the bank's (CET-I) ratio as prescribed by the RBI, i.e. 6.125% of the total RWAs of the bank or when the PONV trigger is breached in the RBI's opinion.

Given the above distinguishing features of the AT-I bonds, ICRA has assigned a one notch lower rating on these than the rating on the Tier II instruments. The DRs that can be used for servicing the coupon in a situation of inadequate profit or a loss during the year, stood at a comfortable 6.50% of RWAs as on September 30, 2022. The rating on the Tier I bonds continues to be supported by the bank's capital profile (CET-I: 10.88%, Tier I: 12.20% and CRAR: 14.74% as on September 30, 2022), which is likely to remain comfortable, given its healthy capital-raising ability and the expectation that it will remain profitable.

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership^	Consolidation Approach
PNB Cards & Services Ltd.	100.00%	Limited Consolidation
PNB Investment Services Ltd.	100.00%	Limited Consolidation
PNB International Ltd.	100.00%	Limited Consolidation
PNB Insurance Broking Pvt. Ltd.	81.00%	Limited Consolidation
PNB Gilts Ltd.	74.07%	Limited Consolidation
Druk PNB Bank Ltd.	51.00%	Limited Consolidation
JSC Tengri Bank	41.64%	Limited Consolidation
Dakshin Bihar Gramin Bank, Patna	35.00%	Limited Consolidation
Sarva Haryana Gramin Bank, Rohtak	35.00%	Limited Consolidation
Himachal Pradesh Gramin Bank, Mandi	35.00%	Limited Consolidation
Punjab Gramin Bank, Kapurthala	35.00%	Limited Consolidation
Prathama UP Gramin Bank, Moradabad	35.00%	Limited Consolidation
Assam Gramin Vikas Bank, Guwahati	35.00%	Limited Consolidation
Bangiya Gramin Vikash Bank, Murshidabad	35.00%	Limited Consolidation
Manipur Rural Bank, Imphal	35.00%	Limited Consolidation
Tripura Gramin Bank, Agartala	35.00%	Limited Consolidation
PNB Housing Finance Ltd.	32.64%	Limited Consolidation
PNB Metlife India Insurance Ltd.	30.00%	Limited Consolidation
Canara HSBC OBC Life Insurance Ltd.	23.00%	Limited Consolidation
India SME ARC Ltd. (ISARC)	20.90%	Limited Consolidation
Everest Bank Ltd.	20.03%	Limited Consolidation

Source: PNB, ICRA Research; ^ Ownership as on March 31, 2022

Corrigendum

Rationale dated November 22, 2022, has been revised with changes as below:

Addition of "Rating Approach- Consolidation" in the analytical approach section

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