February 23, 2024

Punjab & Sind Bank: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificates of Deposit	10,000.00	10,000.00	[ICRA]A1+; reaffirmed
Total	**10,000.00**	**10,000.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating reaffirmation continues to factor in Punjab & Sind Bank's (P&SB) sovereign ownership and the Government of India's (GoI) demonstrated track record of capital infusions, which has helped shore up the capital cushions in recent years. The rating also continues to consider the strong capitalisation profile along with the steady improvement in the solvency level. Further, P&SB's established presence and branch network in North India, its stable deposit base, strong liquidity coverage ratio (LCR) and excess statutory liquidity ratio (SLR) holdings, in relation to the average net demand and time liabilities (NDTL), remain a strength.

While the bank's asset quality improved steadily, its overall potential vulnerable book, comprising overdues and the restructured book, remains elevated in relation to the core capital. This continues to be a key challenge as P&SB's core operating profitability is likely to remain weak because of the sizeable share of non-earning assets {zero-coupon bonds (ZCBs) for recapitalisation by GoI} in the overall assets and the relatively higher cost of funds. This limits the ability to absorb credit provisions against operating profit. However, as these ZCBs were marked down on a fair value basis in Q4 FY2022 for inclusion in core capital, the discount on the face value of these bonds is likely to decline every year as they near maturity, which will aid the core capital even in a scenario of weak profitability.

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – P&SB has majority sovereign ownership with the GoI's equity stake in the bank at 98.25% as of December 31, 2023. The GoI infused Rs. 11,672 crore in the bank during FY2018-FY2022, which helped shore up the capital position significantly after several years of losses due to high slippages. Of the total capital infusion, Rs. 10,100 crore was infused through ZCBs, which are redeemable at face value. Hence, the inclusion of the same in the bank's core capital is relatively lower and is done on a fair value basis.

P&SB's reported capital ratio remained strong with the CET I at 13.75% as on December 31, 2023 (after factoring in the fair valuation of the ZCBs) along with an overall improvement in the solvency[1] profile to 17.86% as on September 30, 2023 from 113.34% as on September 30, 2020. This was supported by the capital infusion and the gradual moderation in the bank's net non-performing advances (NNPAs).

Established presence in North India – P&SB has a long and established presence in North India, depicted by its network of 1,561 branches as on December 31, 2023 (1,553 branches as on March 31, 2023, 1,530 branches as on March 31, 2022). Branch expansion has remained limited over the last few years because of the constrained credit growth, given the high stressed book and weak capital position.

[1] *(NNPAs + Net non-performing investments + Net security receipts) / Core capital*

P&SB continues to witness steady growth in term deposits (~8% year-on-year (YoY) as on December 31, 2023), though the growth rate of the low-cost current and savings account (CASA) deposits is slow (~6% YoY as on December 31, 2023). The share of CASA deposits in total deposits stood at 32.77% as on December 31, 2023 (33.59% as on March 31, 2023 and 33.30% as on December 31, 2022), which remains lower than public sector banks' (PSB) average, thereby translating into a relatively higher cost of interest-bearing funds for P&SB. The bank's cost of interest-bearing funds stood at 5.56% compared to the PSBs' average of 4.80% in H1 FY2024, leading to a relatively lower net interest margin and operating profitability. Despite the low CASA deposit base, the granularity of deposits has improved, with the share of the top 20 deposits declining to 12.30% as on March 31, 2023 from 18.33% as on March 31, 2022.

Improved capitalisation and solvency – The bank's core equity capital (CET I)/ Tier I capital stood at 13.75% (excluding 9M FY2024 profit) as on December 31, 2023 (12.79% as on December 31, 2022). While the capitalisation profile was supported by infusions in the past, P&SB remained profitable during FY2022-9M FY2024, supporting its capital ratios despite the growth in assets. The reported capital metrics, as on December 31, 2023, factor in the fair valuation of the ZCBs for 9M FY2024. While these bonds do not carry any coupon and will therefore be a drag on the bank's reported interest income and hence operating profit, the discount on the face value will keep declining each year as the bonds approach maturity and would be capital accretive. P&SB remains well positioned on the capitalisation front to meet its near-to-medium-term growth requirements, although a meaningful improvement in internal capital generation is yet to be seen. Furthermore, the improvement in the bank's capitalisation profile led to an overall improvement in its solvency to 17.30% as of December 2023 from 21.66% as of December 2022.

The Reserve Bank of India (RBI) recently issued a discussion paper for transitioning to the expected loss framework for credit exposures. As highlighted by ICRA, banks with a high share of overdue/restructured loans could see a one-time impact on their capital position upon transitioning. While the RBI has proposed that these provisions should be spread over a five-year period for the computation of the regulatory capital ratios, the impact on the capital position (without taking regulatory forbearance) will remain monitorable.

Credit challenges

Asset quality remains monitorable – The annualised fresh NPA generation moderated to 1.83% of standard advances in 9M FY2024 from 2.03% in 9M FY2023. Apart from this, the bank's gross NPAs (GNPAs) declined to 5.70% as on December 31, 2023 from 8.36% as on December 31 2022 on account of healthy recoveries/upgrades and write-offs in FY2023 and 9M FY2024. However, the lack of incremental provisioning on the NPA stock led to a limited improvement in the NNPA, which stood at 1.80% as on December 31, 2023 (2.02% as on December 31, 2022).

As on December 31, 2023, the bank's standard restructured book declined to 2.55% of standard advances (3.29% as on December 31, 2022) and the SMA-1 and SMA-2[2] (Rs. 5 crore and above) loan book declined to 0.5% of standard advances (0.8% as on December 31, 2022). Nevertheless, the performance of the potential vulnerable pool, which stood at 29% of the core equity capital as on December 31, 2023, will be a key monitorable where the asset quality is concerned.

Earnings profile likely to remain suboptimal – P&SB's core operating profit (excluding gains on bond portfolio) declined to 0.76% of the average total assets (ATA) in 9M FY2024 from 1.03% in 9M FY2023 because of provisioning towards wage revision arrears as well as moderation in recoveries from past NPAs. Further, its operating profitability of 0.83% remained weaker than the PSBs' average of 1.71% in H1 FY2024. This was attributable to the relatively high cost of interest-bearing funds, lower non-interest income vis-à-vis the sector average, and the high level of non-earning assets (ZCBs). During FY2023-9M FY2024, the net profitability levels were supported by strong recoveries from written-off accounts and limited incremental provisioning on the stock of NNPAs. Accordingly, P&SB reported a return on assets of 0.43% in 9M FY2024 (0.89% in 9M FY2023). Going

[2] SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as an NPA as per the extant RBI guidelines; SMA-1 accounts are overdue by 31-60 days while SMA-2 accounts are overdue by 61-90 days. The SMA-level data is for the entire bank including exposures below Rs. 5 crore

forward, the ability to keep slippages and credit costs at lower levels will also remain key for ensuring a sustained improvement in the return metrics.

Environmental and social risks

While banks like P&SB do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses, to which banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, it could translate into credit risks for banks. However, such risk is not material for P&SB as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively fewer downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. P&SB has not faced material lapses over the years. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. P&SB has been making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

P&SB's liquidity profile is supported by its excess statutory liquidity ratio (SLR) holdings of 4-8% of total deposits during March-September 2023. In addition, the bank reported a strong LCR of 123.58% for Q3 FY2024 (daily average) against the regulatory requirement of 100%. It reported a net stable funding ratio (NSFR) of 121.54% in Q3 FY2024 against the regulatory requirement of 100%. P&SB can also avail liquidity support from the RBI (through repo against excess SLR investments and marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating will be reassessed in case of a change in the sovereign ownership of the bank. ICRA could downgrade the rating if there is a sustained breach in the regulatory capital ratios with the capital-to-risk weighted assets ratio (CRAR) declining below 9.0%.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group support	The rating factors in P&SB's sovereign ownership and the demonstrated track record of capital infusions by the GoI. ICRA expects the GoI to support P&SB with capital infusions, if required.
Consolidation/Standalone	To arrive at the rating, ICRA has considered the standalone financials of P&SB. P&SB does not have any subsidiaries.

About the company

Established in 1908, P&SB is a public sector bank (PSB) with the GoI holding an equity stake of 98.25% as on December 31, 2023. As on December 31, 2023, the bank had a well-established network of 1,561 branches.

P&SB reported a profit after tax of Rs. 456 crore in 9M FY2024 and Rs. 1,313 crore in FY2023. Its asset quality indicators, i.e. GNPA and NNPA, stood at 5.70% and 1.80%, respectively, as on December 31, 2023 compared to 6.97% and 1.84%, respectively, as on March 31, 2023. The capitalisation metrics, i.e. Tier I and CRAR, stood at 13.75% and 16.13%, respectively, as on December 31, 2023 compared to 14.32% and 17.10%, respectively, as on March 31, 2023.

Key financial indicators (standalone)

Punjab & Sind Bank	FY2022	FY2023	9M FY2024
Total income	3,340	3,927	2,969
Profit after tax	1,039	1,313	456
Total assets	1,20,148	1,35,542	1,44,351
CET I	12.77%	14.32%	13.75%*
CRAR	18.54%	17.10%	16.13%*
PAT/ATA	0.90%	1.03%	0.43%^
Gross NPA	12.17%	6.97%	5.70%
Net NPA	2.74%	1.84%	1.80%

Total income includes net interest income and non-interest income
Total assets exclude revaluation reserves; Amount in Rs. crore
Source: P&SB, ICRA Research; All calculations as per ICRA Research
*^ Annualised; *Excluding interim profits and including fair valuation of zero coupon bonds*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024) Type	Current Rating (FY2024) Amount Rated (Rs. crore)	Current Rating (FY2024) Amount Outstanding (Rs. crore)	Current Rating (FY2024) Date& rating in FY2024 Feb-23-2024	Chronology of Rating History for the Past 3 Years: Date& rating in FY2023 Feb-23-2023	Date & Rating in FY2022 Feb-28-2022	Date & Rating in FY2022 May-21-2021	Date & Rating in FY2021 Apr-23-2020
1	Basel III Tier I Bonds	LT		-		[ICRA]A (Stable); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (hyb) (Negative)	[ICRA]A- (hyb) (Negative)
2	Basel II Lower Tier II Bonds	LT	-		-	-	-	-	[ICRA]AA- (Negative); withdrawn
			-	-	-	-	[ICRA]AA- (Negative); withdrawn	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)
3	Certificates of Deposit	ST	10,000.00	7,300.00@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

@Outstanding as on January 31, 2024; LT – Long term; ST – Short term
In compliance with the circular issued by the Securities and Exchange Board of India (SEBI) on July 16, 2021 for standardising the rating scales used by credit rating agencies, ICRA has discontinued its practice of affixing the (hyb) suffix alongside the rating symbols for hybrid instruments

Complexity level of the rated instrument

Instrument	Complexity Indicator
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	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE608A16QK5	**Certificates of deposit**	Jan-24-2023	7.90%	Apr-25-2024	1,500.00	[ICRA]A1+
INE608A16QJ7	**Certificates of deposit**	Dec-18-2023	7.55%	Mar-15-2024	1,000.00	[ICRA]A1+
INE608A16QF5	**Certificates of deposit**	Aug-31-2023	7.34%	Feb-09-2024	800.00	[ICRA]A1+
INE608A16PZ5	**Certificates of deposit**	Jun-19-2023	7.43%	Mar-14-2024	750.00	[ICRA]A1+
INE608A16QE8	**Certificates of deposit**	Aug-11-2023	7.60%	Jun-13-2024	1,500.00	[ICRA]A1+
INE608A16QE8	**Certificates of deposit**	Aug-10-2023	7.60%	Jun-13-2024	500.00	[ICRA]A1+
INE608A16PZ5	**Certificates of deposit**	Jul-18-2023	7.34%	Mar-14-2024	500.00	[ICRA]A1+
INE608A16PZ5	**Certificates of deposit**	Jul-17-2023	7.34%	Mar-14- 2024	500.00	[ICRA]A1+
INE608A16QA6	**Certificates of deposit**	Jun-21-2023	7.40%	Mar-11-2024	250.00	[ICRA]A1+
Unplaced	**Certificates of deposit***	-	-	-	2,700.00	[ICRA]A1+

*Source: Punjab & Sind Bank; * As on January 31, 2024*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not applicable	-	-

Source: Punjab & Sind Bank, ICRA Research

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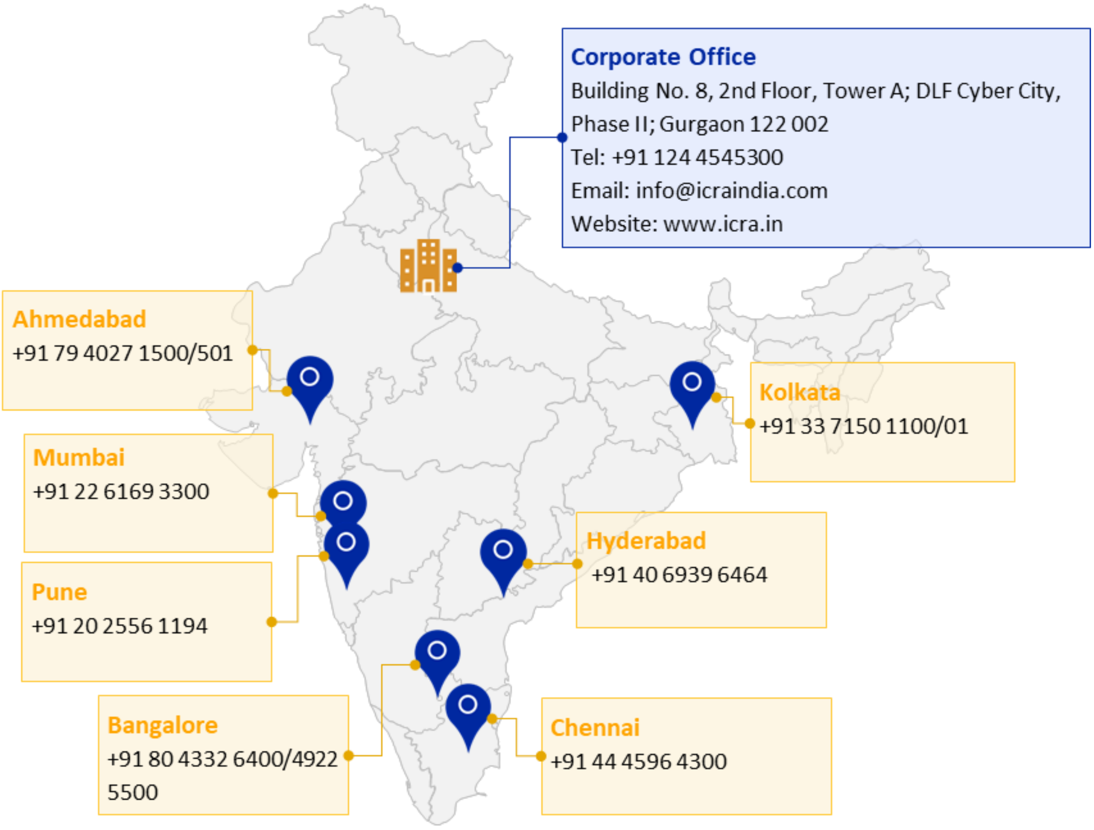

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