

May 21, 2021

## Punjab & Sind Bank: Ratings reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel II Lower Tier II Bonds	300.00	300.00	[ICRA]AA- (Negative); reaffirmed
Basel III Additional Tier I Bonds	1,000.00	1,000.00	[ICRA]A-(hyb) (Negative); reaffirmed
Certificates of Deposit	10,000.00	10,000.00	[ICRA]A1+; reaffirmed
<b>Total</b>	<b>11,300.00</b>	<b>11,300.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The ratings reaffirmation takes into account Punjab & Sind Bank's (P&SB) sovereign ownership and the Government of India's (GoI) demonstrated track record of capital infusion into the bank. In this regard, the GoI has infused equity capital of Rs. 7,072 crore into the bank during FY2018-FY2021 through recapitalisation bonds including the recent infusion of Rs. 5,500 crore in November 2020. The reaffirmation further considers P&SB's established presence and branch network in North India along with its stable deposit base, comfortable liquidity coverage ratio (LCR) and excess statutory liquidity ratio (SLR) holdings in relation to the average net demand and time liabilities (NDTL).

The Negative outlook, however, takes into account the continued weakness in the bank's asset quality with proforma<sup>1</sup> net non-performing advances (NNPAs) of 5.86% (2.84% reported by the bank) and SMA<sup>2</sup> 1 and SMA 2 advances of 3.68% of standard advances as on December 31, 2020. Moreover, P&SB's operating profitability remains weak with the core operating profit being lower than the public sector banks' (PSBs) average because of the relatively higher cost of funds and the high level of non-earning assets. As a result, the credit provisions are likely to remain elevated in relation to the operating profits even in FY2022. Moreover, unlike the past, the recapitalisation bonds issued in FY2021 have zero coupon with maturity at face value. As a result, while the near-term capital requirements stand addressed, the bank's profitability is expected to remain weak because of these non-earning investments.

The Negative outlook on the Additional Tier I (AT-I) bonds factors in the complete erosion of the distributable reserves (DRs) because of the high losses generated in 9M FY2021. These reserves are critical to service the coupon on these bonds in a year of loss. With the expectation of continued losses in FY2022, P&SB's ability to service the coupon on these bonds remains a monitorable.

### Key rating drivers and their description

#### Credit strengths

**Sovereign ownership with demonstrated capital support** – P&SB has majority sovereign ownership with the GoI's equity stake in the bank at 97.07% as of March 25, 2021. P&SB received Rs. 5,500 crore of equity capital from the GoI in FY2021 as a part of the Rs. 20,000-crore recapitalisation plan for PSBs. The bank received ~Rs. 1,572 crore between FY2018 and FY2020 as a part of the GoI's recapitalisation package for PSBs. Given the sizeable infusion in FY2021, ICRA expects the incremental capital

<sup>1</sup> In the absence of a standstill on asset classification as directed by Hon'ble Supreme Court

<sup>2</sup> Special mention accounts; SMA 1 are overdue by 31-60 days and SMA 2 are overdue by 61-90 days

requirement for the bank to remain limited despite the expectation of losses in FY2022. However, as P&SB still has a sizeable quantum of stressed assets, the capital requirement may increase if it chooses to accelerate the provision on these assets. ICRA expects the GoI to provide the requisite capital support to maintain the regulatory levels as demonstrated in the past.

**Established presence in North India** – P&SB has a long and established presence in North India, depicted by its network of 1,529 branches and 1,087 ATMs as on December 31, 2020 against 1,521 branches as on December 31, 2019 (1,518 branches as on December 31, 2018). Given the limited credit growth because of capital constraints, branch expansion has remained limited over the last couple of years. However, given its retail presence, P&SB has witnessed good growth in retail deposits (~10% YoY as on December 31, 2020) and a strong increase in low-cost current and savings account (CASA) deposits (~15% YoY as on December 31, 2020). With the strong growth in CASA deposits, the share of such deposits in total deposits improved to 32.4% as on December 31, 2020 (29.6% as on March 31, 2020 and 27.6% as on December 31, 2019). Nevertheless, the same remains below the PSB average of 40% as on December 31, 2020, thereby translating into a relatively higher cost of interest-bearing funds for the bank. P&SB's cost of interest-bearing funds stood at 5.16% compared to the PSB average of 4.36% in 9M FY2021, which also results in relatively lower net interest margins and operating profitability for the bank. Despite an improvement in the CASA share, the reliance on bulk deposits remains high with the share of the top 20 depositors in overall deposits at 16.1% as on March 31, 2020 even though the same has improved from 25.3% as on March 31, 2019.

## Credit challenges

**Continued weakness in asset quality; slippages to remain elevated** – P&SB's asset quality remains weak with gross fresh slippages of Rs. 2,536 crore (4.7% of standard advances) on a proforma basis in the absence of a standstill on asset classification. This is subsequent to the high gross fresh slippages of Rs. 2,909 crore seen in FY2020 (slippage rate of 4.5% of standard advances in FY2020 compared to 5.9% in FY2019). Despite the high proforma slippages, the SMA 1 and SMA 2 accounts were high at 3.68% of standard advances as on December 31, 2020, which is over and above certain other vulnerable exposures.

Despite the elevated credit provisions of 4.6% of advances in 9M FY2021, the proforma slippages in 9M FY2021 translated into a high level of NNPA's of 5.86% as on December 31, 2020 (2.84% reported by the bank in the absence of proforma slippages) compared to 8.0% as on March 31, 2020. P&SB expects a Covid-19 restructuring of 2.60% of advances as allowed by the Reserve Bank of India (RBI), a large portion of which is likely to be in the corporate segment. The restructuring is largely to be from the proforma NPAs as well as the SMA pool accounts. The overall stressed pool of assets including NNPA's, SMA 1 and 2 borrowers is itself estimated at 9.91% of standard advances, which is over and above the other potential vulnerable accounts in the corporate loan book. This is likely to keep the fresh slippages as well as credit provisions high even in FY2022. ICRA expects the NNPA's to remain near 4.5% by the end of FY2022 unless P&SB accelerates the provisions on these assets, which, in turn, will depend on the availability of profits and capital.

**Weak operating profitability and elevated credit costs to translate into losses in FY2022 as well** – P&SB's core operating profit (excluding gain on bond portfolio) stood at 0.73% of the average total assets (ATA) in FY2020 and 0.41% in 9M FY2021 (1.47% and 1.45%, respectively, for PSBs). This, in turn, was because of the relatively high cost of interest-bearing funds and the declining loan book translating into a sub-optimal scale of operations and the high level of non-earning assets.

With a sizeable capital infusion of Rs. 5,500 crore in FY2021, the bank accelerated the provisions on its stressed assets to reduce its NNPA's to below the 6.0% threshold of the RBI's prompt corrective action (PCA) framework. As a result of these accelerated provisions and the resulting weak operating profitability, the losses before tax generated by the bank increased to Rs. 3,574 crore (or -3.8% of ATA) from losses before tax of Rs. 1,522 crore (or -1.0% of ATA) in FY2020. With elevated levels of stressed assets, the credit costs are likely to continue to surpass the bank's operating profitability, which, in turn, has been weakening because of the declining loan book and high slippages (resulting in income reversals). Along with this, the recent capital infusion by the GoI in FY2021 has been done through zero-coupon recapitalisation bonds, which will add to P&SB's non-earning assets and further translate into weak operating profitability for the bank in future.

**Modest capitalisation and solvency profile** – With a capital infusion of Rs. 5,500 crore by the GoI in November 2020, P&SB's core equity capital ratio improved to 11.45% as on December 31, 2020 from 5.98% as on September 30, 2020 (7.59% as on March 31, 2020). While the core capital ratio has improved, the expectation of continued losses in FY2022 is likely to further reduce the bank's core capital in the coming periods unless supported by a fresh capital infusion. P&SB's solvency<sup>3</sup> position improved post the recent capital infusion to 59.9% as on December 31, 2020 on a proforma NPA basis from 134.5% as on March 31, 2020. ICRA expects the incremental capital requirements for the bank to remain limited over FY2022-2023 at Rs. 1,000-1,600 crore with NNPA's of nearly 3.5% unless the bank decides to further increase the provisions on its stressed assets.

While P&SB's capital ratio and solvency position have improved, the regulator has expressed concerns regarding the recapitalisation of PSBs through zero-coupon bonds. ICRA notes that in the absence of any coupon, the present value of these bonds will be relatively lower and the capital and solvency numbers will be much weaker for the bank on an adjusted basis. Any regulatory directive on these bonds could adversely impact P&SB's capital and solvency position, given that these recapitalisation bonds accounted for 94% of its reported CET as on December 31, 2020.

**Complete erosion of DRs weakens the ability to service AT-I bonds** – With losses of Rs. 2,894 crore in 9M FY2021, P&SB is estimated to have depleted its entire DRs during this period (DRs of Rs. 1,252 crore or 2.5% of risk-weighted assets (RWAs) as on March 31, 2020). As per the covenant for the AT-I bonds, in the event of a loss, the bank could service the coupon on the AT-I bonds though these DRs created out of past profits provided it meets the minimum regulatory capital ratios {including the capital conservation buffer (CCB)}. Given the likelihood of losses even in FY2022, the DRs are unlikely to improve in the near future which could, in turn, constrain the bank's coupon-servicing ability on the AT-I bonds.

While [multiple PSBs have improved their servicing ability on AT-I bonds by setting off accumulated losses against share premium](#), thereby increasing their DRs, P&SB has not adopted a similar approach yet. Hence, the ability to pay the coupon on these AT-I bonds remains a key monitorable.

## Liquidity position: Strong

The bank has negative cumulative mismatches of 10.2% of the total outflows (due to high outflows in the 6 months – 1-year bucket for term loans) in the up to 1-year maturity bucket, as per its structural liquidity statement for March 08, 2021. However, P&SB's liquidity profile remains supported by the high SLR and reverse repo balances driving a strong liquidity coverage ratio (LCR) of 210.37% for Q3 FY2021 (daily average) against the regulatory requirement of 100% from January 1, 2019. As on December 31, 2020, P&SB maintained excess SLR to the tune of 2.3% of NDTL apart from reverse repo balances of 4.0% of NDTL. Supported by its sovereign ownership and deposit franchise, ICRA expects P&SB to roll over its deposits upon maturity and maintain its liquidity profile.

## Rating sensitivities

### Triggers for Lower Tier II bonds

**Positive factors** – Given the Negative outlook on the rating at present, the rating is unlikely to be upgraded. However, the rating outlook could be changed to Stable if the bank is able to maintain its solvency (NNPA/core equity) at less than 65-70% while keeping the capital ratios (including CCBs) above the regulatory levels.

**Negative factors** – The rating will be reassessed in case of a change in the sovereign ownership. ICRA could downgrade the rating if the bank is unable to raise sufficient capital, resulting in a breach of the regulatory capital ratios (including the CCB) on a sustained basis.

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<sup>3</sup> Net stressed assets / Core capital; net stressed assets include NNPA's, net NPIs and net security receipts

### Triggers for Additional Tier I bonds

**Positive factors** – ICRA could revise the rating outlook to Stable if the bank’s DRs improve and it is able to continue maintaining the capital ratios (including CCB) above the regulatory levels. Additionally, the visibility on the profitability should improve with a positive return on assets (RoA) for the bank on a sustained basis.

**Negative factors** – The rating could be downgraded if the bank continues to report losses and its DRs remain negative. Additionally, a breach of the regulatory capital ratios (including CCB) on a sustained basis will be a negative for the rating on the AT-I bonds.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">ICRA’s Rating Methodology for Banks</a> <a href="#">Impact of Parent or Group Support on an Issuer’s Credit Rating</a>
Parent/Group Support	The ratings factor 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 ratings, ICRA has considered the standalone financials of P&SB.

### About the company

Established in 1908, P&SB is a public sector bank (PSB) with the GoI holding an equity stake of 97.07% in the bank as on March 25, 2021 (83.06% as on March 31, 2020). As on December 31, 2020, the bank had a well-established network of 1,529 branches and 1,087 ATMs.

P&SB reported a loss after tax of Rs. 2,894 crore in 9M FY2021 against a loss after tax of Rs. 754 crore in 9M FY2020. Its asset quality indicators, i.e. GNPA% and NNPA% stood at 16.7% and 5.9%, respectively, as on December 31, 2020 on a proforma basis compared to 13.6% and 8.7%, respectively, as on December 31, 2019. The capitalisation metrics, i.e. CET-I and Tier-I, stood at 11.5% and 13.4%, respectively, as on December 31, 2020 compared to 7.6% and 9.4%, respectively, as on December 31, 2019.

## Key financial indicators

Punjab & Sind Bank	FY2019	FY2020	9M FY2020	9M FY2021
Net interest income (Rs. crore)	2,280	2,058	1,553	1,767
Profit before tax (Rs. crore)	(859)	(1,522)	(1,134)	(3,574)
Profit after tax (Rs. crore)	(543)	(991)	(754)	(2,894)
Net advances (Rs. crore)	69,176	58,412	62,243	57,766
Total assets* (Rs. crore)	1,08,052	99,580	1,02,123	1,04,052
% CET-I	7.80%	7.59%	7.61%	11.45%
% Tier I	9.50%	9.58%	9.37%	13.40%
% CRAR	10.93%	12.76%	12.04%	16.39%
% Net interest margin / Average total assets	2.06%	1.98%	1.97%	2.31%
% Net profit / Average total assets	(0.49%)	(0.95%)	(0.96%)	(3.79%)
% Return on net worth	(10.75%)	(20.98%)	(20.93%)	(64.57%)
% Gross NPAs	11.8%	14.2%	13.6%	16.7%^
% Net NPAs	7.2%	8.0%	8.7%	5.9%^
% Provision coverage excl. technical write-offs	42.0%	47.2%	39.3%	68.9%^
% Net NPA / Core equity	109.4%	123.1%	125.3%	57.8%^

\*Total assets and net worth exclude revaluation reserves

Source: Punjab & Sind Bank, ICRA research

^ Proforma numbers including proforma NPAs and standstill slippages as directed by the Hon'ble Supreme Court

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 (FY2022)			Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2022	FY2021	FY2020	FY2019		
					May-21-21	Apr-23-20	May-16-19	Mar-13-19	Jun-01-18	May-18-18
1	Basel III Additional Tier I Bonds	LT	1,000.00	1,000.00	<b>[ICRA]A-(hyb) (Negative)</b>	[ICRA]A-(hyb) (Negative)	[ICRA]A+(hyb) (Negative)	[ICRA]A+(hyb) (Negative)	[ICRA]A+(hyb) (Stable)	[ICRA]A+(hyb) (Stable)
2	Basel II Lower Tier II Bonds	LT	200.00	0.00	-	[ICRA]AA-(Negative); withdrawn	[ICRA]AA (Negative)	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
			300.00	300.00	<b>[ICRA]AA-(Negative)</b>	[ICRA]AA-(Negative)	[ICRA]AA (Negative)	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Certificates of Deposit@	ST	10,000.00	3,050.00	<b>[ICRA]A1+</b>	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

@ Certificates of deposit outstanding as on May 16, 2021

LT – Long term; ST – Short term

## Complexity level of the rated instrument

Instrument	Complexity Indicator
Basel II Compliant Lower Tier II Bonds	Simple
Basel III Compliant Additional Tier 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: [www.icra.in](http://www.icra.in)

### Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE608A09130	Basel II Lower Tier II Bonds	Jun-24-2011	9.73%	Oct-24-2021	300.00	[ICRA]AA- (Negative)
INE608A08025	Basel III Additional Tier I Bonds	May-08-2017	10.90%	Perpetual <sup>#</sup>	1,000.00	[ICRA]A-(hyb) (Negative)
INE608A16OW5	Certificates of Deposit <sup>@</sup>	Mar-12-2021	-	Jun-14-2021	1,500.00	[ICRA]A1+
INE608A16OX3		Mar-15-2021	-	May-25-2021	1,000.00	[ICRA]A1+
INE608A16OY1		Mar-15-2021	-	Jun-15-2021	300.00	[ICRA]A1+
INE608A16OZ8		Mar-17-2021	-	Jun-17-2021	250.00	[ICRA]A1+
Unplaced		Unplaced	-	Unplaced	6,950.00	[ICRA]A1+

<sup>#</sup> Call option on May 07, 2022

<sup>@</sup> Certificates of deposit outstanding as on May 16, 2021

Source: Punjab & Sind Bank

### Key features of the rated instruments

The servicing of the Basel II Lower Tier II Bonds and certificates of deposit is not subject to any capital ratios and profitability and solely driven by the liquidity of the bank.

The rated Basel III compliant Tier I bonds (Additional Tier I or 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. The coupon once skipped, is non-cumulative.
- 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 payment can be made through reserves and surpluses<sup>4</sup> created through the appropriation of profits (including statutory reserves). The coupon payment is subject to the bank meeting the minimum regulatory requirements for the CET I, Tier I and total capital ratios (including CCB) at all times, as prescribed by the RBI under 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 – 5.5% till September 30, 2021, and thereafter 6.125% of the total RWAs of the bank or when the point of non-viability trigger (PONV) is breached in the RBI's opinion.

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 loss severity vis-à-vis conventional debt instruments.

Given the above distinguishing features of the Tier I bonds, ICRA has assigned a three 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 profits or a loss during the year, were negative (-Rs. 1,642 crore or -3.21% of RWA) as on December 31, 2020.

### Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not applicable	-	-

Source: Punjab & Sind Bank, ICRA research

<sup>4</sup> Calculated as per the amendment in the Basel III capital regulations for AT-I bonds by the RBI, vide its circular dated February 2, 2017; as per the amended definition, DRs include all reserves created through appropriations from the profit and loss account

## ANALYST CONTACTS

**Mr. Karthik Srinivasan**

+91 22 6114 3444

[karthiks@icraindia.com](mailto:karthiks@icraindia.com)

**Mr. Anil Gupta**

+91 124 4545 314

[anilg@icraindia.com](mailto:anilg@icraindia.com)

**Mr. Hemant Sultania**

+91 124 4545 386

[hemant.sultania@icraindia.com](mailto:hemant.sultania@icraindia.com)

**Mr. Aayush Behal**

+91 124 4545 300

[aayush.behal@icraindia.com](mailto:aayush.behal@icraindia.com)

## RELATIONSHIP CONTACT

**Mr. L. Shivakumar**

+91 22 6114 3406

[shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

[info@icraindia.com](mailto:info@icraindia.com)

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## ICRA Limited



### Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



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