

February 23, 2023

Punjab & Sind Bank: Basel III Tier I Bonds ratings upgraded, outlook revised to Stable and withdrawn; Certificate of Deposit rating reaffirmed.

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier I Bonds	1,000.00	-	[ICRA]A (Stable); Upgraded from [ICRA]A- (Negative); outlook revised to Stable from Negative and withdrawn
Certificates of Deposit	10,000.00	10,000.00	[ICRA]A1+; reaffirmed
Total	11,000.00	10,000.00	

*Instrument details are provided in Annexure I

Rationale

The rating upgrade factors in the sustained improvement in Punjab & Sind Bank's (P&SB) solvency level, supported by the reduction in stressed assets and the improved capital position. The ratings also remain supported by the sovereign ownership and the Government of India's (GoI) demonstrated track record of capital infusion, which has helped shore up the capital cushions in recent years. The decline in the fresh non-performing advances (NPA) generation rate from the much higher levels seen in the past along with strong recoveries and upgrades helped the bank return to profitability. Besides this, the bank's overall potential stress book (comprising SMA-1¹, SMA-2 and restructured advances) has seen a moderation. Further, P&SB's established presence and branch network in North India along with 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. Furthermore, after the set-off of its accumulated losses against the share premium in August 2021, the bank's distributable reserves² (DRs) and its ability to service its Additional Tier I (AT-I) bonds have improved.

Going forward, the performance of the residual potential stress book will remain a near-to-medium-term monitorable as it remains high in relation to the 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. This will aid the core capital of the bank even in a scenario of weak profitability.

ICRA has withdrawn the rating assigned to the Rs. 1,000-crore Basel III Tier I Bonds as these bonds are fully redeemed and no amount is outstanding against the rated instrument. The rating was withdrawn in accordance with ICRA's policy on withdrawal. (click [here](#) for the policy).

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, 2022. The GoI has infused Rs. 11,672 crore in the bank over FY2018-

¹ Special mention accounts: SMA-1 are overdue by 31-60 days and SMA-2 are overdue by 61-90 days

² Calculated as per the amendment in the Basel III capital regulations for AT-I bonds by the Reserve Bank of India (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

FY2022, which was meaningfully supportive in helping shore up the capital position 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 satisfactory with the CET-I at 12.79% as on December 31, 2022 (after factoring in the fair valuation of the ZCBs) along with an overall improvement in the solvency³ profile to 22.00% from 113.34% as on September 30, 2020. This was supported by the capital infusion and the gradual moderation in the bank's net NPA (NNPA) level.

Established presence in North India – P&SB has a long and established presence in North India, depicted by its network of 1,528 branches as on December 31, 2022 against 1,530 branches as on March 31, 2022 (1,531 branches as on March 31, 2021). The branch expansion has remained limited over the last couple of years because of the constrained credit growth, given the high stressed book and weak capital position.

P&SB continues to witness steady growth in term deposits (~8% year-on-year (YoY) as on December 31, 2022) and a higher growth in low-cost current and savings account (CASA) deposits (~11% YoY as on December 31, 2022). With the strong growth in CASA deposits, its share in total deposits remained stable at 33.30% as on December 31, 2022 (33.81% as on March 31, 2022, and 32.63% as on December 31, 2021). Nevertheless, the same remains below the public sector bank (PSB) average of ~44%, thereby translating into a relatively higher cost of interest-bearing funds for the bank. P&SB's cost of interest-bearing funds stood at 4.21% compared to the PSB average of 3.81% in H1 FY2023, which also results in relatively lower net interest margins and operating profitability for the bank. Despite the improvement in the CASA share, the reliance on bulk deposits remains high with the share of the top 20 depositors in overall deposits at 18.33% as on March 31, 2022, even though the same declined from 26.2% as on March 31, 2018.

Improved capitalisation and solvency – Supported by periodic capital infusions by the GoI, the bank's overall capitalisation profile improved, with Tier-I of 12.79% and CRAR of 15.57% as on December 31, 2022, against the regulatory requirement of 9.5% and 11.5%, respectively. The reported capital metrics factor in the fair valuation of the ZCBs. While these bonds do not carry any coupon and will therefore be a drag on the bank's reported interest income, 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 remains to be seen. Furthermore, its solvency profile has improved as the NNPA stock has moderated.

Credit challenges

Asset quality remains monitorable – The annualised fresh NPA generation moderated to 2.03% of standard advances in 9M FY2023 from 3.53% in FY2022 (5.07% in 9M FY2022). Further, P&SB's headline asset quality metrics have improved steadily, supported by high recoveries, upgrades and write-offs. As a result, the gross NPA (GNPA)% and NNPA% declined to 8.36 and 2.02%, respectively, as on December 31, 2022 (12.17% and 2.74%, respectively, as on March 31, 2022). The stressed pool has also seen a gradual moderation and the standard restructured book declined to 3.29% of standard advances as on December 31, 2022 (6.00% as on December 31, 2021). In addition, the SMA-1 and SMA-2 (Rs. 5 crore and above) loan book declined to 0.8% of standard advances as on December 31, 2022 (1.5% as on December 31, 2021). The performance of the potential stressed pool, which stood at 42% of the core equity capital as on December 31, 2022, 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), which stood at 0.92% of the average total assets (ATA) in FY2022, improved to 1.01% in 9M FY2023 on an annualised basis. However, the operating profitability remains weaker compared to the PSBs' average of 1.51% in FY2022. This is 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 FY2022-9M FY2023, the net profitability levels were supported by strong recoveries and upgrades,

³ (NNPAs + Net non-performing investments + Net security receipts) / Core capital

although recoveries and upgrades could slow down from these levels going forward. While the bank has seen a pick-up in the growth momentum in FY2023, 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

Given the service-oriented nature of its business, bank's direct exposure to environmental risks is not material, though it faces asset quality risks from regulatory changes that affect its borrowers. The bank's business strategy encompasses efforts and investments towards energy conservation, carbon management, water conservation, waste reduction and reuse.

Bank is guided by RBI-prescribed guidelines on priority sector lending and government-led initiatives to improve the access of disadvantaged, vulnerable and marginalised stakeholders to financial services. Performance-related evaluation of various initiatives is conducted at regular intervals and the initiatives are fine-tuned based on the findings.

Liquidity position: Strong

P&SB's liquidity profile is supported by its excess statutory liquidity ratio (SLR) holdings of 4-7% of total deposits during September-November 2022, driving a strong liquidity coverage ratio (LCR) of 244.80% for Q2 FY2023 (daily average) against the regulatory requirement of 100%. The bank reported a net stable funding ratio (NSFR) of 127.12% in Q2 FY2023 against the regulatory requirement of 100%. It can also avail liquidity support from the Reserve Bank of India (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 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 ICRA's Policy on Withdrawal of Ratings
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. 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% in the bank as on December 31, 2022. As on December 31, 2022, the bank had a well-established network of 1,528 branches.

P&SB reported a profit after tax of Rs. 856 crore in 9M FY2023 and Rs. 1,039 crore in FY2022. Its asset quality indicators, i.e. GNPA% and NNPA%, stood at 8.36% and 2.02%, respectively, as on December 31, 2022 compared to 12.17% and 2.74%, respectively, as on March 31, 2022. The capitalisation metrics, i.e. Tier-I and CRAR, stood at 12.79% and 15.57%, respectively, as on December 31, 2022 compared to 12.77% and 18.54%, respectively, as on March 31, 2022.

Key financial indicators (standalone)

Punjab & Sind Bank	FY2021	FY2022	9M FY2022	9M FY2023
Net interest income	2,262	2,651	1,954	2,290
Profit before tax	-3,404	1,187	738	1,027
Profit after tax	-2,733	1,039	693	856
Net advances	60,942	63,627	58,908	72,784
Total assets*	1,09,563	1,20,148	1,13,330	1,34,535
CET-I	12.05%	12.77%	12.34%	12.79%
Tier-I	13.98%	14.80%	14.41%	12.79%
CRAR	17.06%	18.54%	17.82%	15.57%
Net interest margin / Average total assets	2.16%	2.31%	2.34%^	2.40%^
Net profit / Average total assets	-2.61%	0.90%	0.83%^	0.90%^
Return on net worth	-36.71%	7.94%	11.86%^	8.44%^
Gross NPAs	13.76%	12.17%	14.44%	8.36%
Net NPAs	4.04%	2.74%	3.01%	2.02%
Provision coverage excl. technical write-offs	73.62%	79.66%	81.60%	77.40%
Net NPA / Core equity	39.44%	27.62%	29.80%	21.20%

*Total assets and net worth exclude revaluation reserves; Amount in Rs. crore

Source: P&SB, ICRA Research; all calculation as per ICRA

^ Annualised

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)			Date& rating in FY2023 Feb-23- 2023	Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)		Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
						Feb-28- 2022	May-21- 2021	Apr-23- 2020	May-16- 2019
1	Basel III Tier I Bonds	LT	1,000.00	-	[ICRA]A (Stable); withdrawn	[ICRA]A- (Negative)	[ICRA]A- (hyb) (Negative)	[ICRA]A- (hyb) (Negative)	[ICRA]A+(hyb) (Negative)
2	Basel II Lower Tier II Bonds	LT	-	-	-	-	-	[ICRA]AA- (Negative); withdrawn	[ICRA]AA (Negative)
			-	-	-	[ICRA]AA- (Negative); withdrawn	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA (Negative)
3	Certificates of Deposit	ST	10,000.00	1,200.00@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

[@] Outstanding as on January 31, 2023; LT – Long term; ST – Short term

Complexity level of the rated instrument

Instrument	Complexity Indicator
Basel III 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: [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
INE608A08025	Basel III Tier I Bonds	May-08-2017	10.90%	May-07-2022	1,000.00	[ICRA]A (Stable); withdrawn
INE608A16PO9	Certificates of Deposit	Dec-23-2022	-	Dec-23-2023	500.00	[ICRA]A1+
INE608A16PP6	Certificates of Deposit	Dec-29-2022	-	Mar-27-2023	700.00	[ICRA]A1+
Unplaced	Certificates of Deposit	-	-	-	8,800.00	[ICRA]A1+

Source: Punjab & Sind Bank

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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