August 14, 2020

Punjab National Bank: Ratings assigned and reaffirmed; Stable outlook assigned

Summary of rating action

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) (Stable); Reaffirmed, removed from 'rating watch with positive implications' and Stable outlook assigned
Infrastructure Bonds	3,000.00	3,000.00	[ICRA]AA- (Stable); Reaffirmed, removed from 'rating watch with positive implications' and Stable outlook assigned
Fixed Deposits Programme	-	-	MAA (Stable); Reaffirmed, removed from 'rating watch with positive implications' and Stable outlook assigned
Certificates of Deposit Programme	60,000.00	60,000.00	[ICRA]A1+; Reaffirmed
Basel III Compliant Tier II Bonds^	NA	3,000.00	[ICRA]AA-(hyb) (Stable); Assigned
Basel II Compliant Lower Tier II Bonds^	NA	1,200.00	[ICRA]AA- (Stable); Assigned
Total	**64,000.00**	**68,200.00**	

**Instrument details are provided in Annexure-1*

^ These instruments were originally issued by erstwhile Oriental Bank of Commerce (e-OBC), now merged with Punjab National Bank

Rationale

The rating reaffirmation takes into account the conclusion of the merger between Punjab National Bank (PNB), erstwhile Oriental Bank of Commerce (e-OBC) and erstwhile United Bank of India (e-UBI), with the merger being effective from April 1, 2020 (the merged entity is hereafter referred to as PNB-M). With the conclusion of the merger, PNB-M's systemic importance has increased further as it accounts for a share of ~7.2% in the net advances and 8.2% in the total deposits of the banking system as on April 1, 2020 compared to ~4.8% and ~5.4%, respectively, on a standalone basis. The merger has created the second largest public-sector bank (PSB) and the third largest bank in the Indian banking system.

The ratings continue to be supported by the established retail franchise of the merged entity with a strong geographical presence, thereby imparting a strong liability profile and a robust liquidity profile. The share of low-cost current account and savings account (CASA) deposits remains strong at 42.02% as on April 1, 2020 (38.70% for PSBs and 44.05% for PNB (standalone) as on March 31, 2020). The ratings also remain supported by the bank's sovereign ownership (the Government of India (GoI) had an equity stake of 85.59% in PNB-M as on April 1, 2020). The GoI has demonstrated a track record of capital support and ICRA expects continued support to the bank, given its increased importance in the Indian banking system.

The ratings continue to be constrained by the high share (~22%) of PNB-M's loan book under moratorium as on May 31, 2020, including 1.2%[1] of the loans where the bank has taken forbearance on the classification of non-performing assets (NPA) because of the moratorium. With the recent announcement of the Reserve Bank of India (RBI) allowing banks to restructure loans while maintaining the same as 'standard', the slippages could be lower. However, this leads to increased uncertainty regarding the asset quality profile of the bank.

Supported by the large capital infusion in FY2020 and the provisions made by PNB-M on its stressed loans, the stock of net NPAs declined to 5.45% as on April 1, 2020 from an estimated 6.61% as on March 31, 2019, which also led to an improvement in the solvency profile[2] to 70.3% as on April 1, 2020 from 99.3% as on March 31, 2019. However, despite the improvement, the solvency profile remains weak against the PSB average of ~60%, especially given the uncertainty regarding the future asset quality.

The progress made by the bank in reducing its book under moratorium will drive its capital requirements. Fresh gross slippages of >4.0-4.5% (5.5% estimated in FY2020 and 6.1% estimated in FY2019 for PNB-M) will pose additional capital requirements for the bank even for a nominal credit growth of 3-4%. While the GoI has not budgeted for any capital infusion in FY2021 for PSBs, the bank has approved an equity capital raise of Rs. 7,000 crore for FY2021 and the ability to raise the same needs to be monitored. The uncertainty regarding the asset quality and the weak solvency profile following the merger are the key reasons for removing the rating Watch with Positive Implications.

The outlook on the long-term ratings is Stable, reflecting a high likelihood that the bank will be able to maintain its solvency and capital position at the current levels even in a scenario of gross slippages of 4.0-4.5%. A higher slippage will lead to the weakening of both these parameters unless supported by fresh capital raise. Given the systemic importance of the bank, ICRA expects the GoI to support PNB-M for its capital requirements if the capital position deteriorates in the backdrop of higher-than-expected stress.

Key rating drivers and their description

Credit strengths

Sovereign ownership with demonstrated capital support – The GoI remains the largest shareholder of the merged bank, accounting for an 85.59% equity stake as on April 1, 2020. PSBs, including PNB and the amalgamated banks (e-OBC and e-UBI), have received sizeable capital support from the GoI during FY2018-FY2020 amounting to ~Rs. 2.65 lakh crore of which ~Rs. 70,000 crore was infused in FY2020. The GoI infused Rs. 17,757 crore in PNB-M in FY2020 (Rs. 16,091 crore in PNB and Rs. 1,666 crore in e-UBI). Supported by this, PNB-M recorded a substantial reduction in its net NPA stock (below the threshold of 6% for inclusion in the RBI's prompt corrective action (PCA) framework) while shoring up the capital ratios above the regulatory minimum. The bank has sufficient headroom to raise capital from market sources while maintaining the GoI shareholding above 51%. While the GoI has not budgeted for any capital infusion for FY2021 in PSBs, the bank has approved an equity capital raise of Rs. 7,000 crore for FY2021 and its ability to raise the same needs to be monitored.

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[1] *Largely SMA-2 accounts that were overdue by 61 to 90 days as on February 28, 2020*

[2] *Solvency = (Net NPA + Security Receipts + Non-performing Investments)/Core Equity*

High systemic importance as second largest PSB and third largest bank in Indian banking system in terms of advances/deposit base – Prior to the merger, PNB was the third largest PSB and sixth largest bank in the Indian banking system with a market share of 5.0% in the net advances and 5.6% in the total deposits of the banking system as on March 31, 2019. The merger, with effect from April 1, 2020, has created the second largest PSB and third largest bank in the Indian banking system with a share of 7.2% in net advances and 8.2% in total deposits as on April 1, 2020. Given the material increase in the size of the bank post-merger, ICRA expects it to hold systemic importance in the Indian banking system. While PNB-M is currently not classified as a domestic systemically important bank (D-SIB), its classification in this category would pose additional capital requirements vis-à-vis the regulatory minimum levels. Moreover, given the sovereign ownership, ICRA expects strong support from the GoI if required. The management expects to complete the consolidation/integration of the merger by March 31, 2021.

Healthy CASA deposits share aids strong liabilities profile and competitive cost of funds – The merger has further strengthened the bank's franchise, as depicted by a pan-India network of 10,910 branches and 13,530 ATMs as on March 31, 2020 (second largest for any bank in India). The established retail franchise and geographical presence aids a healthy resource profile as depicted by the low-cost steady CASA deposits share of 42.02% (domestic) for the merged entity as on April 1, 2020 against the average CASA share of 38.7% for PSBs and 44.05% for PNB (standalone) as on March 31, 2020. The deposit base for the merged entity remains granular with the top 20 depositors accounting for 3.69% of the total deposits as on March 31, 2020 compared to 3.23% for PNB (standalone) as on March 31, 2019. The granular deposit base and high share of CASA deposits, apart from imparting strong liquidity, led to a competitive cost of funds on a merged basis with the cost of interest-bearing funds for PNB-M estimated at 4.9% in FY2020 against 5.0% for PSBs in FY2020. Given PNB-M's widespread network, steady core deposit base and robust retail franchise, ICRA expects the merged entity to maintain its strong liabilities profile.

Credit challenges

Increased uncertainty on asset quality with high share of loan book under moratorium – Given the Covid-19 pandemic-induced stress on the debt-servicing ability of the borrowers, the bank had provided a moratorium on debt servicing to its borrowers during March-August 2020 as allowed by the regulator.

A high share (~22% as on May 31, 2020) of the bank's loan book is under moratorium including 1.2% of the loans where the bank has taken forbearance on the classification of NPAs because of the moratorium. Although the book under moratorium has declined subsequently, the management has indicated that 10-15% of the moratorium book (or 2.2-3.3% of the overall loan book) would remain under a strict watchlist.

Recently, the RBI has also allowed banks to restructure loans while maintaining the same as 'standard'. While the near-term slippages could be lower, this would lead to increased uncertainty regarding the asset quality profile of the bank. The progress made by the bank in reducing its book under moratorium will drive its capital requirements. Fresh gross slippages of >4.0-4.5% (5.5% estimated in FY2020 and 6.1% estimated in FY2019 for PNB-M) will pose additional capital requirements for the bank even for a nominal credit growth of 3-4%.

PNB's fresh slippages rate remained elevated at 6.1% in FY2020 compared to 6.3% in FY2019, attributable to a few large-ticket slippages in its corporate book (top 5 slippages accounted for 16% of the gross slippages in FY2020), apart from slippages in the agriculture book. The asset quality remains weak across segments with gross NPAs even in the relatively better retail segment at 4.2% as on March 31, 2020 compared to ~2.0% for the banking sector.

On a merged basis, the asset quality remains weak with GNPA% and NNPA% at 13.76% and 5.45%, respectively, as on March 31, 2020 compared to 14.94% and 6.61%, respectively, as on March 31, 2020.

Elevated credit provisions to weigh on earnings profile in FY2021 – On a standalone basis, PNB reported a weak profitability with a marginal net profit of Rs. 336 crore (0.04% of average total assets - ATA) in FY2020 compared to a net loss of Rs. 9,976 crore (-1.30% of ATA) in FY2019. This was mainly due to the continued high slippages, which led to elevated credit costs of 1.81% of ATA in FY2020 though the same was lower than the credit costs of 3.18% of ATA in FY2019.

On a merged basis, as per ICRA's estimates, the bank reported a loss before tax of 0.7% of ATA in FY2020 due to the sizeable losses of the merging banks. Apart from the high credit costs because of the harmonisation of the asset quality across the merging banks, the sizeable wage and pension related provisions made by the merging banks in Q4 FY2020 resulted in high losses for the merged entity.

Given the expectations of asset quality pressure as well as the elevated level of net NPAs, the credit provisions are expected to remain high. As highlighted earlier, the bank's ability to absorb fresh slippages is limited at ~4.0-4.5% of the loan book, which is much lower than its loan book under moratorium. The bank's ability to reduce the loan book under moratorium will be a critical driver of its profitability as well as capital requirements. Given the current asset quality, PNB-M's ability to report profits will be a challenge and the internal capital generation is likely to remain weak.

Weak capital cushions and solvency profile despite sizeable capital infusion; unlikely to improve in the near term – PNB-M's capitalisation profile remains modest with limited capital cushions, especially at the Tier I level, despite the sizeable capital infusion of Rs. 16,091 crore in PNB and Rs. 1,666 crore in e-UBI by the GoI in FY2020. The bank's capital metrics i.e. CET I%, Tier I% and CRAR% stood at 9.17%, 9.97% and 12.32%, respectively, as on April 1, 2020, compared to the regulatory requirement of 8.00%, 9.50% and 11.50%, respectively, as on September 30, 2020. Supported by the large capital infusion in FY2020 and the lower stock of net NPAs, the solvency profile improved to 70.3% as on April 1, 2020 from 99.3% as on March 31, 2019. However, despite the improvement, it remains weak (PSB average of ~60%). Assuming no capital raise and weak internal capital generation, an improvement in the capital position and solvency profile from the current levels is considered unlikely by ICRA.

The bank plans to raise Tier I capital of Rs. 10,000 crore (including Rs. 3,000 crore through Additional Tier-I bonds). As the GoI has not budgeted for any capital infusion for FY2021 in PSBs, the bank's ability to raise capital needs to be monitored.

Liquidity position: Strong

The merged entity continues to have a strong liquidity profile as depicted by the favourable cumulative mismatches of 2.7% of the total outflows in the up to 1-year maturity bucket, as per its structural liquidity statement (merged basis) for March 31, 2020, supported by a steady core deposits profile. The liquidity coverage ratio remains strong at 182.02% (daily average for Q4 FY2020 for PNB (standalone)), which is well above the minimum regulatory requirement of 100%. Moreover, the bank has been maintaining sizeable excess SLR investments, which further aids its liquidity profile. As per ICRA's estimates, on a fortnightly average basis, PNB-M's excess SLR holdings stood at 10.0% of the average net demand and time liabilities (NDTL) during April 2020-

May 2020. Supported by its sovereign ownership, healthy liabilities profile and excess SLR holdings, ICRA expects the bank to maintain a strong liquidity profile.

Rating sensitivities

Positive triggers – The outlook could be changed to Positive or the ratings could be upgraded if the bank is able to improve its solvency (below 60%) on a sustained basis while maintaining capital cushions of more than 50-75bps over the regulatory levels.

Negative triggers – ICRA could assign a Negative outlook/and or downgrade the ratings if the solvency profile of the bank remains weak with net NPA/core capital exceeding 70% or if the regulatory capital ratios are breached on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The ratings factor in PNB's sovereign ownership and the demonstrated track record of capital infusion by the GoI.
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of PNB and the consolidated financials of PNB, e-OBC and e-UBI. 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 (including the entities taken over post-merger).

About the company

Punjab National Bank (PNB) was incorporated as Punjab National Bank Limited in 1894 and commenced operations in Lahore in April 1894. Upon nationalisation in 1969, the bank was renamed Punjab National Bank. As on March 31, 2020, the GoI held 85.59% equity in the bank. On a standalone basis, PNB reported a profit after tax of Rs. 336 crore in FY2020 on a total asset base of Rs. 8.26 lakh crore as on March 31, 2020 against a loss after tax of Rs. 9,975 crore in FY2019 on a total asset base of Rs. 7.71 lakh crore as on March 31, 2019. PNB's (standalone) gross and net NPAs stood at 14.21% and 5.78%, respectively, as on March 31, 2020. It reported a Tier I capital ratio of 11.90% and CRAR of 14.14% as on March 31, 2020.

On March 28, 2020, the Reserve Bank of India notified that the amalgamation of OBC and UBI into PNB Scheme, 2020 dated March 4, 2020, issued by the GoI will come into effect from April 1, 2020. As a result, all the branches and customers including the depositors of OBC and UBI will be treated as branches and customers of PNB. As on March 31, 2020, PNB-M had 10,910 domestic branches and 13,530 ATMs. PNB-M's gross and net NPAs stood at 13.76% and 5.45%, respectively, as on April 1, 2020, with a Tier I capital ratio of 9.97% and CRAR of 12.32%.

Key financial indicators (audited) – Punjab National Bank

	Standalone FY2019	Standalone FY2020	Merged^ April 1, 2020
Net interest income	17,156	17,438	NA
Profit before tax	-15,347	739	NA
Profit after tax	-9,975	336	NA
Net advances	4,58,249	4,71,828	6,96,849
Total assets	7,71,367	8,25,941	12,44,381
% CET I	6.21%	10.69%	9.17%
% Tier I	7.49%	11.90%	9.97%
% CRAR	9.73%	14.14%	12.32%
% Net interest margin	2.24%	2.18%	NA
% PAT / ATA	-1.30%	0.04%	NA
% Return on net worth	-25.39%	0.68%	NA
% Gross NPAs	15.50%	14.21%	13.76%
% Net NPAs	6.56%	5.78%	5.45%
% Provision coverage excl. technical write-offs	61.72%	62.96%	64.19%
% Net NPA/ CET	119.64%	61.70%	66.3%

Note: Amount in Rs. crore; All calculations are as per ICRA research
Total assets and net worth exclude revaluation reserves
Source: PNB, ICRA research
^ Merged financials for PNB, e-OBC and e-UBI as on April 1, 2020

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years						
		Type	Amount Rated	Amount O/S	Rating 14-Aug-2020	FY2020	FY2019		FY2018			
						19-Sep-2019	13-Mar-2019	22-May-2018	13-Mar-2018	19-Feb-2018	15-Jun-2017	26-Apr-2017
1	Basel III Compliant Tier II Bonds Programme	LT	1,000.00	1,000.00	[ICRA]AA- (hyb) (Stable)	[ICRA]AA- (hyb) %	[ICRA]AA- (hyb) (Stable)	[ICRA]AA- (hyb) (Negative)	[ICRA]AA+ (hyb)@	[ICRA]AA+ (hyb)@	[ICRA]AA+ (hyb) (Stable)	[ICRA]AA+ (hyb) (Stable)
2	Infrastructure Bonds Programme	LT	3,000.00	1,800.00^	[ICRA]AA- (Stable)	[ICRA]AA- %	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)	[ICRA]AA+ @	[ICRA]AA+ @	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Certificates of Deposit Programme	ST	60,000.00	NA	[ICRA]A1+	[ICRA]A1+ O/S	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Term Deposits Programme	MT	NA	NA	MAA (Stable)	MAA %	MAA (Stable)	MAA (Negative)	MAAA@	MAAA@	MAAA (Stable)	MAAA (Stable)
5	Basel III Compliant Tier II Bonds Programme	LT	3,000.00	3,000.00	[ICRA]AA- (hyb) (Stable); **Assigned**	-	-	-	-	-	-	-
6	Basel II Compliant Lower Tier II Bonds Programme	LT	1,200.00	1,025.00*	[ICRA]AA- (Stable); **Assigned**	-	-	-	-	-	-	-

^ Rs. 1,200 crore of bonds yet to be placed
% Rating on Watch with Positive Implications
@ Rating on Watch with Negative Implications
**Rs. 175 crore yet to be issued*
Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE160A08019	Basel III - Tier II Bonds Programme	24-Feb-2014	9.65%	24-Feb-2024	1,000.00	[ICRA]AA- (hyb) (Stable)
INE160A08084	Infrastructure Bonds	24-Mar-2015	8.35%	24-Mar-2025	1,800.00	[ICRA]AA- (Stable)
-	Infrastructure Bonds	Not placed	-	-	1,200.00	[ICRA]AA- (Stable)
NA	Certificates of Deposit Programme	-	-	7-365 days	60,000.00	[ICRA]A1+
NA	Term Deposits Programme	-	-	-	-	MAA (Stable)
INE141A08019^	Basel III - Tier II Bonds Programme	27-Oct-2014	9.20%	27-Oct-2024	1,000.00	[ICRA]AA- (hyb) (Stable)
INE141A08035^	Basel III - Tier II Bonds Programme	26-Oct-2015	8.34%	26-Oct-2025	1,000.00	[ICRA]AA- (hyb) (Stable)
INE141A08043^	Basel III - Tier II Bonds Programme	24-Jun-2016	9.05%	24-Jun-2026	1,000.00	[ICRA]AA- (hyb) (Stable)
INE141A09132^	Lower Tier II Bonds Programme	30-Nov-2012	8.93%	30-Nov-2022	1,025.00	[ICRA]AA- (Stable)
-^	Lower Tier II Bonds Programme	Yet to be issued	-	-	175.00	[ICRA]AA- (Stable)

Source: PNB
^ Reflects the instruments of e-OBC

Annexure-2: List of entities considered for limited consolidation analysis

S. No.	Name	Ownership	Consolidation Approach
1.	PNB Investment Services Ltd.	100.00%	Limited Consolidation
2.	PNB International Limited	100.00%	Limited Consolidation
3.	PNB Gilts Ltd.	74.07%	Limited Consolidation
4.	Druk PNB Bank Ltd.	51.00%	Limited Consolidation
5.	JSC Tengri Bank, Kazakhstan	41.64%	Limited Consolidation
6.	Dakshin Bihar Gramin Bank	35.00%	Limited Consolidation
7.	Sarva Haryana Gramin Bank	35.00%	Limited Consolidation
8.	Himachal Pradesh Gramin Bank	35.00%	Limited Consolidation
9.	Punjab Gramin Bank	35.00%	Limited Consolidation
10.	Prathama UP Gramin Bank	35.00%	Limited Consolidation
11.	PNB Housing Finance Ltd.	32.65%	Limited Consolidation
12.	PNB MetLife India Insurance Co. Ltd.	30.00%	Limited Consolidation
13.	Everest Bank Ltd.	20.03%	Limited Consolidation
	Entities Taken Over Post Merger		
14.	Assam Gramin Vikash Bank	35.00%	Limited Consolidation
15.	Bangiya Gramin Vikash Bank	35.00%	Limited Consolidation
16.	Manipur Rural Bank	35.00%	Limited Consolidation
17.	Tripura Gramin Bank	35.00%	Limited Consolidation
18.	Canara HSBC Oriental Bank of Commerce Life Insurance Co Ltd.	23.00%	Limited Consolidation

Source: PNB, e-OBC, e-UBI and ICRA research

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