



Share Deptt. & Investors' Grievances Cell
Head Office

Ref. No. HO/SD/539

Dated: 19.02.2016

Ms. Pramilla D'souza
Deputy Manager-Listing Compliance
National Stock Exchange of India Ltd.
Exchange Plaza, Bandra- Kurla Complex
Bandra East,
Mumbai-400 051

Dear Sir,

Subject: Further Clarification on downward revision of Credit Rating by CRISIL Ltd. for Bank's Outstanding Basel-III compliant Tier 2 Bonds and Basel-II compliant Perpetual Tier 1, Upper Tier 2 and Lower Tier 2 Bonds rated by CRISIL Ltd.

In continuation of our letter No. HO/SD/531 dated 16.02.2016 and with reference to your email of date on the captioned matter, we have to submit that the Rating Rationale for downward revision of Rating of our captioned Bonds provided to us by CRISIL Ltd. is already available in the public domain i.e. on the website of CRISIL Ltd. As per the said Rating Rationale of CRISIL Ltd. (copy enclosed) the ratings downgrade reflect higher-than-expected deterioration in Bank's asset quality and profitability during the first nine months of 2015-16. Furthermore, CRISIL believes that the Bank's asset quality will remain under pressure over the next few quarters, because of the asset quality review exercise. This will result in increased pressure on the bank's already weak profitability.

This is for your information and records please.

Yours faithfully,

(A.K. Goel)
General Manager (F&A),
CFO and Compliance Officer

Encl. As stated above

Rating Rationale



February 16, 2016
Mumbai

Allahabad Bank

**Ratings downgraded to 'CRISIL AA/CRISIL AA-/Negative';
'CRISIL A/Negative' assigned to Tier-I Bond Issue (under Basel III)**

Rs.10.0 Billion Tier I Bonds (under Basel III)	CRISIL A/Negative (Assigned)
Rs.10.0 Billion Tier II Bonds (under Basel III)	CRISIL AA/Negative (Downgraded from 'CRISIL AA+/Negative')
Rs.5.0 Billion Tier II Bonds (under Basel III)	CRISIL AA/Negative (Downgraded from 'CRISIL AA+/Negative')
Lower Tier II Bonds (under Basel II) Aggregating Rs.24.5 Billion	CRISIL AA/Negative (Downgraded from 'CRISIL AA+/Negative')
Upper Tier II Bonds (under Basel II) Aggregating Rs.10 Billion	CRISIL AA-/Negative (Downgraded from 'CRISIL AA/Negative')
Tier I Perpetual Bonds (under Basel II) Aggregating Rs.3.0 Billion	CRISIL AA-/Negative (Downgraded from 'CRISIL AA/Negative')

CRISIL has downgraded its ratings on Allahabad Bank's Lower Tier-II Bonds (under Basel II) and Tier II Bonds (Under Basel III) to '**CRISIL AA/Negative**' from 'CRISIL AA+/Negative', Tier-I Perpetual Bonds and Upper Tier-II Bonds (hybrid instruments; under Basel II) to '**CRISIL AA-/Negative**' from 'CRISIL AA/Negative'. CRISIL has also assigned its '**CRISIL A/Negative**' rating to the bank's Rs.10.0-billion Tier I bond issue (under Basel III).

The ratings downgrade reflect higher-than-expected deterioration in Allahabad Bank's asset quality and profitability during the first nine months of 2015-16 (refers to financial year, April 1 to March 31). Furthermore, CRISIL believes that the bank's asset quality will remain under pressure over the next few quarters, because of the asset quality review exercise. This will result in increased pressure on the bank's already weak profitability.

The ratings, nevertheless, continue to factor in CRISIL's belief that Allahabad bank will continue to receive support from its majority owner, the Government of India (GoI), both on an ongoing basis and in the event of distress, and will maintain adequate capitalisation and adequate resource profile.

The distinguishing features of non-equity Tier-I capital instruments (under Basel III) are the existence of coupon discretion at all times, high capital thresholds for likely coupon non-payment, and principal write-down (on breach of a pre-specified trigger). These features increase the risk attributes of non-equity Tier-I instruments, over those of Tier-II instruments under Basel III, and capital instruments under Basel II. To factor in these risks, CRISIL notches down the rating on these instruments from the bank's corporate credit rating. The rating on Allahabad Bank's Tier-I Bonds (under Basel III) has, therefore, been lowered by three notches from its corporate credit rating to '**CRISIL A/Negative**' in line with CRISIL's criteria (refer to 'CRISIL's rating criteria for BASEL III-compliant instruments of banks'). The rating reflects CRISIL's belief that Allahabad Bank's asset quality, profitability, and capital coverage for unprovided weak assets¹ will remain under significant pressure. This is because of the expectation of continued increase in the bank's gross non-performing assets (NPAs) over the next few quarters, which will exert pressure on its profitability. This may result in significant losses over the next few quarters, as witnessed during the quarter ended December 2015, and lower the bank's current revenue reserves and credit balance in the profit and loss account, which relatively increases the risk of any potential coupon non-payment (refer to Annexure for key features of the instrument). The factors that could trigger a default event for non-equity Tier-I capital instruments (under Basel III) resulting in non-payment of coupon include: i) the bank exercising coupon discretion; ii) inadequacy of revenue reserves to honour coupon payment if the bank reports losses or low profits; or iii) the bank breaching the minimum regulatory Common Equity Tier-1 (CET I; including Capital Conservation Buffer) ratio. Moreover, given the additional risk attributes, the rating transition for non-equity Tier-I capital instruments (under Basel III) can potentially be higher than that for Tier-II instruments.

The distinguishing feature of Tier-II capital instruments under Basel III is the existence of the point of non-viability (PONV) trigger, the occurrence of which may result in loss of principal to the investor, and hence, to default on the instrument by the issuer. According to the Basel III guidelines, the PONV trigger will be determined by the Reserve Bank of India (RBI). CRISIL believes the PONV trigger is a remote possibility in the Indian context, given the robust regulatory and supervisory framework and the systemic importance of the banking sector. The inherent risk associated with the PONV feature is adequately factored into the rating on the instrument.

Allahabad Bank's asset quality has deteriorated significantly over the past few quarters, and is expected to witness further pressure in the near term. Gross NPA increased to 6.4 per cent as on December 31, 2015 (5.5 per cent as on March 31, 2015) primarily because of slippage of relatively large exposures in the large corporate and mid-corporate segments. Slippages to NPAs increased sharply to 4.9 per cent (annualised) for the nine months ended December 31, 2015, from 3.6 percent in 2014-15. Allahabad Bank also had a high proportion of restructured standard assets (RSAs), at 9.1 per cent of gross advances, as on December 31, 2015 (10.9 per cent as on March 31, 2015). Allahabad Bank's large proportion of gross NPAs and RSAs translate into high level of weak assets of around 10.0 per cent as on December 31, 2015 (at a similar level as on March 31, 2015). CRISIL believes Allahabad Bank's asset quality will remain under pressure over the next few quarters, because of the on-going asset quality review exercise which will result in sizeable proportion of slippages of advances to NPAs. This is likely in the backdrop of sizeable exposure to vulnerable sectors such as infrastructure, construction, and iron and steel, amidst weak commodity price cycle and inability of leveraged players to sell assets. The bank's ability to contain deterioration in its asset quality, and hence profitability, remains a key monitorable.

Allahabad Bank's earning profile has also weakened sharply because of the deterioration in asset quality. The bank reported a net loss of Rs.1.6 billion for the nine months ended December 31, 2015, compared to a net profit of Rs.6.2 billion for the full year 2014-15. This is mainly on account of the sharp increase in provisioning costs to around 1.63 percent (annualised) of average total assets in the nine months of 2015-16 from 1.27 per cent for 2014-15. Provisioning costs are likely to remain high over the next few quarters given expected increase in gross NPAs and provisioning requirements on stressed exposures. The net interest margin (NIM) for the nine months of 2015-16 declined to 2.8 percent from 3.1 percent for 2014-15 and is expected to remain under pressure primarily on account of interest reversals on NPAs. CRISIL believes that such sharp weakening of asset quality will led to elevated level of provisioning costs and depress the already low NIMs and ROAs of the bank, and will continue to be a key rating sensitivity factor.

In its ratings on public-sector banks (PSBs), CRISIL continues to factor in the likelihood of strong support from GoI, both on an ongoing basis and in any event of distress. This is because GoI is both the majority shareholder in PSBs and the guardian of India's financial system. The stability of the banking sector is of prime importance to GoI, given the criticality of the sector to the economy, the strong public perception of sovereign backing for PSBs, and the severe implications of any PSB failure in terms of political fallout, systemic stability, and investor confidence in public sector institutions. CRISIL believes that the majority ownership creates a moral obligation on GoI to support the PSBs, including Allahabad Bank. Between 2008-09 and 2014-15, GoI has infused capital of around Rs.710 billion in PSBs. Further, under the Indradhanush plan announced recently by GoI, it has committed to infuse a minimum of Rs.700 billion into PSBs between 2015 and 2019, of which Rs.250 billion will be infused in 2015-16. GoI is also committed to maintain a safe capital buffer over the regulatory minimum in all PSBs. CRISIL believes that GoI will continue to provide distress support to all PSBs and not allow any of them to fail.

Allahabad Bank has adequate capitalisation, backed by continued GoI support. The bank's Tier-I and overall capital adequacy ratio (CAR; under Basel III) were 7.4 percent and 10.4 percent, respectively, as on December 31, 2015 (7.7 percent and 10.5 percent, respectively, as on March 31, 2015). Allahabad Bank received capital infusion of Rs.3.2 billion from GoI in 2014-15 and Rs.2.8 billion under the Indradhanush plan in 2015-16. Cumulatively, the bank has received equity capital of Rs.21.3 billion from GoI and Life Insurance Corporation of India over the past six years (including Rs.2.8 billion in 2015-16). Additionally, the bank has moderate flexibility to raise capital by diluting GoI stake's (62.7 percent as on December 31, 2015) over the long term. However, because of continued pressure on asset quality, it had weak networth coverage of net non-performing assets (NPAs) of 1.9 times as on December 31, 2015 (2.1 times as on March 31, 2015), which is lower than the industry average. Additionally, the high weak assets coupled with low internal accruals has impacted the bank's capital coverage for weak assets. It had low Tier I capital coverage for un-provided weak assets, at 1.0 times as on December 31, 2015.

Allahabad Bank has adequate resource profile, marked by higher-than-industry-average proportion of current account and savings account (CASA) deposits. CASA deposits has steadily increased to 35.4 percent of its total deposits as on December 31, 2015 from 33.5 percent as on March 31, 2015 and 31.3 percent as on March 31, 2014. The bank has reduced its reliance on wholesale deposits over the past few quarters and is focusing on mobilising retail deposits. Cost of deposits, at 6.7 percent for the nine months of 2015-16 (7.1 percent in 2014-15). CRISIL believes Allahabad Bank will maintain adequate resource profile over the medium term supported by its stable base of low-cost CASA deposits.

Outlook: Negative

CRISIL believes Allahabad Bank will continue to benefit from strong GoI support and will maintain adequate capitalisation over the medium term. The 'Negative' outlook reflects the continued high pressure on the bank's asset quality and earnings profile. The ratings may be downgraded in case of further significant deterioration in its asset quality or earnings profile. Conversely, the outlook may be revised to 'Stable' in case of a substantial and sustained improvement in Allahabad Bank's asset quality and earnings profile.

About the Bank

Founded in April 1865 by a group of Europeans in Allahabad (Uttar Pradesh), Allahabad Bank is a medium-sized PSB, with reported asset base of Rs.2255.2 billion and network of 3183 branches as on December 31, 2015.

For 2014-15, Allahabad Bank's total income (net of interest expenses) and profit after tax (PAT) were Rs.81.7

billion and Rs.6.2 billion, respectively, against Rs.74.8 billion and Rs.11.7 billion, respectively, for 2013-14. For the nine months ended December 31, 2015, total income (net of interest expenses) and net loss were Rs.59.8 billion and Rs.1.6 billion, respectively, against total income and net profit of Rs.61.5 billion and Rs.4.2 billion, respectively, for the corresponding period of the previous year.

Annexure: Key features of Allahabad Bank's Rs.10.0-Billion Tier-I Bonds Issue (under Basel III)

- The Tier-I bonds are non-convertible, perpetual, unsecured, and Basel III-compliant.
- Coupon payments shall be annual and non-cumulative.
- The bank has full discretion at all times to cancel coupon payments.
- The coupon is to be paid out of current-year profits. However, if current-year profits are insufficient, and payment of coupon may result in losses during the year, coupon payment can be made out of revenue reserves (subject to the bank meeting minimum regulatory requirements for CET-I, Tier-I, and total capital ratios at all times as prescribed by the Reserve Bank of India [RBI], and subject to the requirements of capital buffer frameworks, or credit balance in profit and loss account.
- The loss-absorption features as per RBI's BASEL-III norms are applicable.
 - Instrument will be temporarily written-down upon CET I breaching the pre-specified trigger of 5.5 percent before March 31, 2019, and 6.125 percent on or after March 31, 2019
 - The instrument may be permanently written off at the option of RBI on occurrence of point of non-viability (PONV) trigger.
 - The PONV trigger shall be determined by RBI.

[1] Weak assets is CRISIL's measure for assessing banks' asset quality. Weak assets = Gross NPAs + 35 per cent of outstanding restructured standard advances (excluding state power utilities) + 75 per cent of investments in

security receipts (from NPAs sold to asset reconstruction companies)+ 15 per cent of loans structured under 5/25 (flexible structuring of long-term project loan

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