

Share Deptt. & Investors' Grievances Cell
Head Office

Ref. No. HO/SD/434

Dated: 10.11.2016

Ms. Charmi Dharod
Asst. Manager-Listing Compliance
National Stock Exchange of India Ltd.
Exchange Plaza, Bandra- Kurla Complex
Bandra East,
Mumbai-400 051

Dear Sir,

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

In continuation of our letter No. HO/SD/429 dated 09.11.2016 and with reference to your email dated 09.11.2016 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. Furthermore, CRISIL believes that the Bank's asset quality will remain under pressure over the next few quarters until a substantial pick up in the economy and may lead to further pressure on Bank's already weak profitability.

This is for your information and records please.

Yours faithfully,

(S. L. Jain)

General Manager (F&A),
CFO and Compliance Officer**Encl.** As stated above

Rating Rationale

November 04, 2016 | Mumbai

Allahabad Bank

Ratings downgraded to 'CRISIL AA-/CRISIL A+/CRISIL A-/Negative'

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.10.0 Billion	CRISIL A+/Negative (Downgraded from 'CRISIL AA-/Negative')
Tier I Perpetual Bonds (Under Basel II) Aggregating Rs.3.0 Billion	CRISIL A+/Negative (Downgraded from 'CRISIL AA-/Negative')
Rs.10.0 Billion Tier I Bonds (Under Basel III)	CRISIL A-/Negative (Downgraded from 'CRISIL A/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 A+/Negative**' from '**CRISIL AA-/Negative**', and Tier I bond issue (under Basel III) to '**CRISIL A-/Negative**' from '**CRISIL A/Negative**'.

The ratings downgrade reflect higher-than-expected deterioration in Allahabad Bank's asset quality and profitability. Continuation of the negative outlook reflects CRISIL's belief that the asset quality will remain stressed over the next few quarters until a substantial pick-up in the economy, and may lead to further 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 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) is lower by three notches from the bank's corporate credit rating, which is 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 profitability and capital coverage for un-provided weak assets¹ will remain under significant pressure because of continued pressure on asset quality over the next few quarters. Allahabad Bank's revenue reserve are adequate as on date, however any further asset quality deterioration, will exert pressure on profitability and may result in decrease in revenue reserve, thus increasing 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 reserve to honour coupon payment if the bank reports low profits or loss, or iii) the bank breaching the minimum regulatory common equity Tier (CET) I, including counter cyclical buffer (CCB), ratio. Moreover, given their 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. As per the Basel III guidelines, the PONV trigger will be determined by the Reserve Bank of India. 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 had deteriorated significantly during the six months through June 30, 2016. Gross NPAs increased to 12.3% as on June 30, 2016 from 6.4% as on December 31, 2015 primarily because of slippage of relatively large exposures in the large corporate and mid-corporate segments. Though there has been no further increase in gross NPAs in the quarter ended September 30, 2016, the same remains elevated at 12.3%. Proportion of restructured standard assets (RSAs) for the bank also remains sizable at 4.3% as on June 30, 2016. Large proportion

of gross NPAs and RSAs translate into high level of weak assets of around 14.5% as on June 30, 2016 increased from 12.3% as on March 31, 2016 (8.7% as on March 31, 2015). CRISIL believes Allahabad Bank's asset quality will remain under pressure in the near term and its gross NPA will remain elevated. The cash recovery is also likely to be gradual in the backdrop of sizeable exposure to vulnerable sectors such as infrastructure, construction, and iron and steel, weak commodity price cycle and inability of leveraged players to sell assets. The bank's ability to contain further deterioration in its asset quality remains a key rating 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 5 billion during the half year ended September 30, 2016 as against a net profit of Rs 3.24 billion in the corresponding period previous year. The profitability has been significantly impacted during the six months through June 30, 2016 due to deterioration in the bank's asset quality. The bank incurred a net loss of Rs 5.65 billion during the quarter ended June 30, 2016 and a net loss of Rs 7.4 billion for fiscal 2016. This was mainly on account of the sharp increase in provisioning costs to around 2.3% of average total assets in fiscal 2016 from 1.3% for fiscal 2015. Provisioning costs remained high at 2.3% (annualised) for the quarter ended June 30, 2016 and may remain high over the next few quarters given the provisioning requirements on stressed exposures. Although the bank has reported a net profit of Rs 0.65 billion for the quarter ended September 30, 2016, it is less than Rs 1.77 billion reported during the corresponding period of the previous year. CRISIL believes that Allahabad Bank's profitability will remain modest over the medium term and remains a key rating sensitivity factor.

In its ratings on public sector banks (PSBs), CRISIL continues to factor in the likelihood of strong government support as the central government 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 the government given the criticality of the sector to the economy, the strong public perception of sovereign backing for PSBs, and the severe implications of failure of any PSB in terms of political fallout, systemic stability, and investor confidence in public sector institutions. CRISIL believes majority ownership creates a moral obligation on government to support PSBs, including Allahabad Bank. As part of the Indradhanush programme, government has pledged to infuse at least Rs 700 billion in PSBs between 2015 and 2019, of which Rs 250 billion was infused in fiscal 2016. Allahabad Bank received Rs 9.73 billion equity capital from government in fiscal 2016 and Rs 0.33 billion in August 2016 (of the allocated Rs 0.44 billion capital for fiscal 2017, the remaining portion will be based on the bank's performance). CRISIL believes government will continue to provide distress support to all PSBs and will not allow any of them to fail, and will ensure that they meet Basel III capital regulations.

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 8.09% and 10.49%, respectively, as on September 30, 2016 (7.3% and 10.7%, respectively, as on March 31, 2016). As per regulatory requirement the bank will have to maintain a Tier I capital of 8.25% and overall CAR of 10.25% by end of March 31, 2017. Allahabad Bank cumulatively has received equity capital of Rs 30.4 billion from GoI and Life Insurance Corporation of India over the past seven years (including Rs 10.3 billion in fiscal 2016). Additionally, the bank has moderate flexibility to raise capital by diluting GoI stake's (67% as on June 30, 2016) over the long term. However, because of continued pressure on asset quality, it had weak networth coverage of net NPAs of 1.1 times as on September 30, 2016 (2.5 times as on September 30, 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 0.8 times as on June 30, 2016.

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 38.5% of its total deposits as on September 30, 2016 from 35.2% as on September 30, 2015. 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 6.2% for the fiscal 2016 (6.7% in fiscal 2015). 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's asset quality and profitability will remain under pressure over the medium term. The ratings may be downgraded in case of a sharper-than-expected deterioration in the bank's asset quality, resulting in further weakening of profitability. The outlook may be revised to 'Stable' in case of a substantial and sustained improvement in asset quality and earnings.

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 2.36 trillion and network of 3209 branches as on March 31, 2016.

For fiscal 2016, Allahabad Bank reported a total income (net of interest expenses) of Rs 78.1 billion and net loss of Rs 7.43 billion, against a total income (net of interest expenses) of Rs 81.7 billion and PAT of Rs 6.2 billion for fiscal 2015. For the half year ended September 30, 2016, the bank reported a total income (net of interest expenses) of Rs 39.2 billion and net losses of Rs 5.0 billion, against total income (net of interest expenses) of Rs 41.5 billion and a PAT of Rs 3.2 billion for the corresponding period of the previous year.

Annexure: Key features of Tier-I Bonds Issue (under Basel III)

- * Non-Convertible Perpetual Unsecured subordinated Basel III-compliant Tier-I Bonds.
- * Coupon payments are on an annual basis and are non-cumulative.
- * The bank has full discretion at all times to cancel coupon payment (in full or in part).

* Coupon is to be paid out of the current year's profit. However, if the current year's profit is not sufficient, that is, payment of coupon is likely to result in a loss during the current year, the coupon payment can be made out of revenue reserve (subject to the bank meeting minimum regulatory requirements for common equity Tier I [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) and/or credit balance in the profit and loss account.

* Loss-absorption features as per RBI's BASEL III norms are applicable

* Instrument will be temporarily written down on CET I breaching the pre-specified trigger of 5.5% before March 31, 2019, and 6.125% on and after March 31, 2019.

* Instrument may be permanently written down at the option of RBI on occurrence of trigger event called 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 + 40% of outstanding restructured standard advances (excluding state power utilities) +75% of investments in security receipts (from NPAs sold to asset reconstruction companies)+ 15% of loans structured under 5/25 (flexible structuring of long-term project loan)

Links to related criteria
Rating Criteria for Banks and Financial Institutions
CRISILs criteria for rating Basel III compliant non-equity capital instruments of Banks
Criteria for Notching up Stand Alone Ratings of Entities Based on Government Support
Rating Criteria for Hybrid Capital in Banks

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