Bank of India – Additional Tier I Instrument (Basel III) Rating
August 6, 2014, Bangalore

BWR has assigned AAA rating for the current issue of Additional Tier-I instrument (AT1) of Bank of India. In this regard, we have received feedback from certain market participants to elucidate on our perspectives on the rating assigned. This press release is meant to serve the objective of informed decision making by investors.

I. Additional Tier-I Instruments (Basel III) are hybrid in nature and different from regular bonds

1. The AT1 issue rated by BWR is the first instrument of this nature that has been raised by a Public Sector Bank in India.

2. The instrument features provided in the term sheet for the investors of the issue are summarized below for ready reference:

a) **Perpetual in Nature:** While the Bank can have a call option that can be exercised after ten years, they can do so with the prior permission of the Reserve Bank of India (RBI) and only if they can replace this with the same or higher quality capital. No guarantees/assurances/expectations can be made on the exercise of this option.

b) **Discretionary Nature of the Coupon**: The coupon payment by the Bank on the instrument is discretionary in nature. The Bank has every right to cancel the payments and such an action will not be construed as an Event of Default. The coupon payments are not cumulative.

c) **Loss Absorption:** The AT1 instrument is meant to function as a "going-concern" loss absorption instrument. There are two trigger levels set for this:

- ✓ The first Trigger level is set when Common Equity Tier I (CET I) capital ratio falls below 6.125% of Risk Weighted Assets
- ✓ The second Trigger is set on reaching the Point of Non Viability (PONV)

Loss Absorption can be done via

a) Conversion of the AT1 principal amount to equity of the Bank
b) Write-down of the principal and coupon amounts

The PONV Trigger event is the earlier of:

- ➢ A decision that a conversion or temporary/permanent write-off without which the firm would become non-viable, is necessary, as determined by the Reserve Bank of India; or

- The decision to make a public sector injection of capital, or equivalent without which the firm would have become non-viable, as determined by the relevant authority.

In case of the breach of Point of Non Viability (PONV level will be determined by the RBI) and if there is a need for public injection of funds, the amount will be written off completely.

The incorporation of the above features makes them in hybrid in nature and hence it is different from regular bonds in the market place.

II. BWR Rating Considerations

BWR considers such features and analyses them before assigning rating to such instruments.

1) **Coupon Discretion**: As per the terms of issue, payment of coupon is discretionary and non-payment cannot be considered as an event of default and BWR also considers in a similar manner.

2) **Trigger for CET I and PONV:** The set trigger levels allow for conversion or write-down/write-off of the principal amount on breaching of these triggers. BWR has assigned the rating based on the probability of the breach of the higher trigger, i.e., CET I level.

3) Unlike the AT1 bonds, a typical bond would be assigned ratings based on the probability of default (PD) of the issuer on coupon and principal payments. For the AT 1 instrument, BWR has aligned its rating to estimation of the probability of the loss event occurring, which is the breach of CET I (if CET I falls below 6.125%). This probability will depend on the Government of India polices for PSU banks from time to time, regulatory scenario and several macro factors.

   In addition, while considering the rating for Bank of India (which is the third largest public sector bank in India), BWR considered the following:

   a) Current financial performance and capital adequacy levels.

   b) Projections of capital requirement based on scenarios created, including
      i. Growth of the portfolio of the Bank
      ii. Portfolio quality of the Bank which can affect the Risk Weighted Assets
      iii. Potential Capital infusion by QIP at appropriate time (Government of India currently holds 66.7% in Bank of India and thus gives head room for further providing scope for further dilution)
      iv. Profitability of the Bank and accrual of internal earnings
      v. Other Sources of capital like monetization of assets

c) BWR also held management discussions with the Bank to determine the strategy on growth and capitalization.

The criteria that are used in rating such instruments by BWR can be accessed at http://www.brickworkratings.com/criteria-basel3compliant-instrument.html

Key Rating Sensitivities:

The strategy and ability of the Government of India in infusing funds and maintaining required capital levels in PSU banks is a crucial sensitivity factor. The ability of the Bank in consolidating its growth, improving asset quality and maintaining overall profitability are key rating sensitivities. Further the Government of India polices for PSU banks from time to time, regulatory scenario and several macro factors are sensitive factors in the long run.

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