Research Update:

Bank of Ireland Upgraded To 'A-' On Stronger Bail-Inable Debt Cushion; Holding Company Rating Affirmed; Outlook Stable

December 24, 2019

Overview

- The Bank of Ireland group has made significant progress in building a substantial buffer of loss-absorbing instruments to protect the senior creditors of the operating bank, Bank of Ireland.
- As a result we now incorporate two notches of ALAC uplift, from one notch, into the long-term rating on Bank of Ireland (BOI), the main operating entity of the BOI group.
- We are therefore raising our long-term issuer credit ratings on Bank of Ireland to 'A-' from 'BBB+'. We are affirming the short-term ratings at 'A-2'.
- We are also revising to stable from positive our outlook on nonoperating holding company (NOHC) Bank of Ireland Group PLC and affirming the ratings at 'BBB-/A-3'.
- The revision of the outlook to stable from positive indicates that we consider a further strengthening of the ratings to be unlikely over the next two years. We anticipate that it will be challenging for the bank to achieve much stronger returns given the lower-for-longer interest rate environment or for it to align its asset quality metrics with those of higher-rated peers despite BOI's huge progress so far in reducing nonperforming exposures.

PRIMARY CREDIT ANALYST

Anastasia Turdyeva
Dublin
(353) 1-568-0622
anastasia.turdyeva
@spglobal.com

SECONDARY CONTACT

Letizia Conversano
Dublin
353 1 568 0615
letizia.conversano
@spglobal.com

Rating Action

On Dec. 24, 2019, S&P Global Ratings raised its long-term issuer credit ratings on Bank of Ireland (BOI) to 'A-' from 'BBB+' and affirmed its short-term ratings at 'A-2'. The outlook is stable. We also raised our long- and short-term resolution counterparty ratings on BOI to 'A/A-1' from 'A-/A-2'.

At the same time, we revised to stable from positive our outlook on BOI's nonoperating holding company (NOHC), Bank of Ireland Group PLC (BOI Group). We affirmed the ratings on BOI Group at 'BBB-/A-3'.

Rationale

The upgrade of Bank of Ireland, the main operating company of BOI Group, reflects our recognition of enlarged additional loss-absorbing capacity (ALAC) after taking into account issuance of a total of €1.55 billion of bail-inable instruments over the second half of 2019. As a result, we believe our ALAC ratio has improved to 8.4% at year-end 2019 from 5.5% at year-end 2018.

Management has plans for further issuances in 2020 in order to meet its 27.09% MREL (minimum requirement for own funds and eligible liabilities) by the January 2021 deadline. We incorporate this plan into our forecast and envisage this metric will improve further, remaining at around 10%, sufficiently above our 8% threshold to qualify for two notches of uplift in the ratings on the main operating bank.

We do not incorporate notches for ALAC support in our ratings on Bank of Ireland Group PLC, the group's NOHC, as the build-up of bail-in buffers only benefits the creditors of the operating entity. As a result, the ratings on NOHC remain one notch below the 'bbb' group stand-alone credit profile (SACP).

The outlook revision to stable on BOI Group reflects our expectation that the group's creditworthiness will no longer improve such that we would revise upward the 'bbb' group SACP. We no longer expect this to improve over the next 12-24 months given the difficulties we consider that the bank will face in delivering its profitability targets. In our view, it will be challenging to achieve targeted 10% return on equity in a lower-for-longer interest rate environment, and with a still-high cost base. Moreover, the profitability targets were partly based on strong growth plans, targeting a 20% loan book increase by 2021, that are also lagging behind, with only 1.4% growth over the first half of 2019. Loan book growth is reliant upon a step-up in customer loan demand in Ireland. BOI Group's strong focus upon improvements to systems, the customer experience, and efficiency, sensibly addresses some of the key requirements for any bank as the banking industry adjusts to rapidly changing customer preferences. However, the changes the group is undergoing will take time to deliver better results.

Although adequately diversified by business and geography, we note that approximately three-quarters of the group's revenues are interest-sensitive, and the proportion of more resilient fees and commissions is lower than what we typically see at other national champions. This poses a risk to the group's future earnings.

BOI has a solid capital base (with a common equity Tier 1 ratio of 14.9% at mid-2019) that will improve only moderately in the next several years, in our view, given earnings are under intensifying pressure. As of end-2018, BOI's risk-adjusted capital (RAC) ratio stood at 11.2%, and we project BOI's RAC ratio to improve modestly to 12.0%-12.7% through end-2021. We base our projection on the following key assumptions: slight net interest margin decline from 2.16% as of mid-2019; some improvements in fee and commission income and lower operating expenses, with a cost-to-income ratio of about 65% by 2021 compared with 71% at mid-2019 by our measures; gradual ramping up of dividends towards the bank's target of 50% payout ratio; and credit costs coming to a new normal of around 20 bps-25 bps.

BOI Group was the first among domestic players to reduce its nonperforming exposure (NPE) ratio to below its target of 5% and we expect to see further improvements in the years ahead. However, the favorable macroeconomic environment in Ireland and investor appetite also helped domestic peers to work out their legacy problematic exposures, reducing the differences among them, so we do not consider BOI Group's metrics to be superior. Compared to international peers, BOI Group's asset quality remains weaker and we still doubt that its metrics will approach international standards over the next year or two.

Outlook

Bank of Ireland Group PLC

The stable outlook reflects our expectation that Bank of Ireland Group PLC will continue to proactively reduce its nonperforming loans (NPLs) and maintain its domestic market position over the two-year outlook horizon. We believe the bank will likely miss its profitability and growth targets. We rather expect return on equity to stand at around 6%.

We are unlikely to raise the ratings over the next 12 months, but we could consider doing so if BOI Group improves its returns from both its domestic and international operations, while maintaining its risk appetite. Less likely, we could also raise the ratings if BOI reduces NPLs to align with higher rated peers, while maintaining its current capital strength. If we revised the group's SACP upward, we would raise the ratings on the NOHC and the group's hybrid debt.

We are unlikely to lower the ratings at this time, but we could consider doing so if BOI Group adopted a more aggressive capital policy than we assume, or asset quality weaknesses reappeared if an adverse economic scenario emerges in the U.K., which would then likely hinder growth in the Irish economy.

Bank of Ireland

The stable outlook on Bank of Ireland, the main operating bank, mirrors that on BOI Group. It also incorporates our belief that BOI will be able to maintain a buffer of bail-inable instruments comfortably above 8.0% of projected S&P Global Ratings risk-weighted assets (RWAs) over the next 24 months.

We could lower the ratings on BOI if the ALAC buffer protecting senior creditors does not remain above 8.0% of S&P Global Ratings' RWAs over the outlook horizon. This could happen, for example, because of a more aggressive capital policy than we currently expect.

We could lower or raise the ratings if we revised the group SACP downward or upward.

Ratings Score Snapshot

Bank of Ireland Group Ratings Score Snapshot

Group SACP	bbb
Anchor	bbb
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding	Average
and Liquidity	and Adequate (0)
Support	+2
ALAC Support	+2

Bank of Ireland Group Ratings Score Snapshot (cont.)

GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Group SACP--The group stand-alone credit profile of the Bank of Ireland group.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Bank of Ireland Group PLC, Aug. 30, 2019
- Bank of Ireland Upgraded To 'BBB+' On Growing ALAC Buffer; Holding Company Ratings Affirmed; Outlook Remains Positive, Oct. 3, 2018

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
Bank of Ireland		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Positive/A-2
Ratings Affirmed; Outlook Action		
	To	**From**
Bank of Ireland Group PLC		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Positive/A-3
Upgraded		
	To	**From**
Bank of Ireland		
Resolution Counterparty Rating	A/--/A-1	A-/--/A-2
Certificate Of Deposit		
Foreign Currency	A-	BBB+
Bank of Ireland		
Senior Unsecured	A-	BBB+
Ratings Affirmed		
Bank of Ireland Group PLC		
Senior Unsecured	BBB-	
Subordinated	BB	
Bank of Ireland		
Subordinated	BB+	
Junior Subordinated	BB-	
Preference Stock	BB-	
Commercial Paper	A-2	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.