# Outlooks On Two Largest Irish Banks Revised To Stable On Easing Profitability Pressure; Ratings Affirmed

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PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

**Letizia Conversano**
Paris
+ 353 (0)1 568 0615
letizia.conversano@spglobal.com

ADDITIONAL CONTACT

**Financial Institutions EMEA**
Financial_Institutions_EMEA_Mailbox@spglobal.com

- Irish banks are delivering on their cost reduction and earnings diversification strategies, while ongoing industry consolidation and rising interest rates will also help banks in their efforts to improve profitability.
- The reduction of Irish banks' legacy nonperforming exposures (NPEs) continues, and we consider potential asset quality problems yet to emerge from the pandemic and the Russia-Ukraine military conflict as manageable, given Ireland's solid growth prospects, low private sector indebtedness, and banks' prudent underwriting standards.
- We revised our outlook on Bank of Ireland Group PLC and AIB Group PLC (and its U.K. subsidiary, AIB Group (U.K.) PLC) to stable from negative and affirmed the ratings.
- We also affirmed our ratings on Ulster Bank Ireland DAC. The outlook remains stable.

DUBLIN (S&P Global Ratings) May 16, 2022--S&P Global Ratings today revised its outlooks on the two largest Irish banks to stable, reflecting our view that profitability pressure for Irish banks is easing.

We acknowledge Irish banks' delivery on core operating cost reduction, such as staff and property expenses. That said, the cost-to-income ratio remains elevated at about 70%, above the average level in Europe. We think Irish banks will remain focused on operational improvement and further digital transformation, aiming to bring efficiency metrics in line with European peers. We also think Irish banks are on track to grow their revenue streams after widening their product offering and diversifying revenue sources over the past year by cooperating more closely with insurance companies and stockbrokers. Moreover, anticipated sector consolidation following NatWest's and KBC's exit from the Irish market, along with rising interest rates, should further support banks' topline results, in our view.

We also see reduced economic risks for banks in Ireland due to solid economic growth prospects, declining private sector leverage, and ongoing asset quality improvement. The Russia-Ukraine conflict's impact on the economy and some residual tail risks from the pandemic result in some risk to our base-case scenario. However, we think economic growth will continue in Ireland and any potential negative impact on the banking system will be manageable. We forecast that the underlying domestic economy will grow by about 4% over the next two years and wealth per capita will stay above $52,000. For growth and wealth estimates, we use gross national income (GNI*). We consider this a better measure of Ireland's national wealth and debt sustainability than GDP because Ireland's economic output includes more activities with limited domestic links than most other economies and, therefore, overstates the size of the domestic economy by about 40%.

Following years of leverage reduction efforts, the country's total private sector debt as a percentage of GNI* decreased to below 75%. We do not expect an increase in leverage over the medium term because domestic credit growth remains subdued and economic growth is dynamic. We also note that households' debt-servicing capacity has been improving over the past several years, with household debt as a proportion of disposable income falling just below 100% at year-end 2021, the lowest in 20 years. We are mindful that the persistence of inflation and consequently higher rates could weaken this metric, but we expect the interest rate hikes to be gradual and moderate, and thus generally affordable for borrowers.

Actual losses were muted over 2020-2021 and asset quality performed better than we had expected at the pandemic's inception. Despite growing slightly in 2020, NPEs declined in 2021 below 2019 levels as the sale of NPEs continued. We think asset quality will further improve over the next couple of years thanks to continuous balance sheet cleanups and healthy underwriting standards for new loan generation. We expect NPE levels to decrease from 5.2% currently to about 3.0%, closer to the average of other European banking systems, with credit costs normalizing at about 25-35 basis points in 2022-2023. Although pandemic-related asset quality problems may yet appear, it is unlikely we will see a significant rise in banks' provisioning because Irish banks still have some management overlays left over, having set them aside earlier on in the pandemic.

We have also affirmed the ratings on Ulster Bank and the outlook remains stable, since we think its parent company will continue supporting a smooth wind-down.

We have not included Permanent TSB Group in this review because we revised its outlook to positive in December 2021 on potential asset quality improvement (see "Outlook On Permanent TSB Group Holdings PLC To Positive On Prospect Of Stronger Balance Sheet; Ratings Affirmed," published Dec. 21, 2021). We have also excluded KBC Ireland Bank (BBB/Stable/A-2) from this review because we reviewed the bank in January 2022 to reflect the impact of the materialization of the agreement with Bank of Ireland under the new criteria framework (see "Ratings On Three Ireland-Based Financial Institutions Affirmed Under Revised FI Criteria," published Jan. 26, 2022).

## OUTLOOKS

## AIB Group PLC (holdco) and Allied Irish Banks (opco)

Primary analyst: Letizia Conversano

The stable outlook on AIB Group PLC and Allied Irish Banks reflects our view that the group will continue to deliver on its strategy in 2022-2023, which we think will lead to a more efficient and diversified business model. In particular, we expect the bank to achieve its absolute cost target not exceeding €1.475 billion before extraordinaries and regulatory costs by 2023, while advancing on its digital agenda. Furthermore, we expect the bank to continue to diversify its product offering and revenue base by successfully leveraging on its acquisitions. Finally, we anticipate that the bank will maintain a strong capital base and that its asset quality will continue to benefit from the continuous workout of its legacy NPEs, as well as good lending and underwriting standards.

We continue incorporating two notches for additional loss-absorbing capacity (ALAC) into the ratings on Allied Irish Banks, the operating bank, because we forecast its ALAC ratio will stay comfortably above the 6% threshold over the next two years. This does not apply to the ratings on the holding company, AIB Group PLC, which are one notch lower than the group's stand-alone credit profile (SACP) to reflect its structural subordination.

### Upside scenario

We could raise our ratings on both the holding and operating companies if the bank's asset quality metrics further improved, reaching an NPE ratio comparable to other European peers', while delivering on the other major pillars of its strategy, ensuring stronger, stable financial performance.

### Downside scenario

We consider it unlikely that we would lower the ratings over the next 18-24 months. For that to happen, the bank would have to fail to deliver on its strategic plan, as per its public commitment.

Group stand-alone credit profile: bbb

- Anchor: bbb
- Business Position: Adequate (0)
- Capital and Earnings: Strong (+1)
- Risk Position: Moderate (-1)
- Funding and Liquidity: Adequate and adequate (0)
- Comparable Rating Analysis: 0

Support: +2

- ALAC Support: +2
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Additional Factors: 0

ESG Credit Indicators: E-2, S-2, G-2

## AIB U.K.

The stable outlook on AIB U.K. reflects that on its parent, Allied Irish Banks PLC (AIB; A-/Stable/A-2). We consider AIB U.K. to be strategically important to its parent, and cap the ratings one notch below our 'a-' group credit profile on AIB. Therefore, any positive or negative rating action on the parent would result in a similar action on AIB U.K.

### Upside scenario

We could raise the ratings if we took a similar action on the parent bank provided our view on potential support from the parent had not changed.

## Downside scenario

We could lower the ratings within the next 18-24 months if we took a similar action on the parent company. This could also follow a material underperformance of AIB U.K. compared with our base-case scenario, or a weakening of AIB U.K.'s strategic importance within the group.

Stand-alone credit profile: bb+

- Anchor: bbb+
- Business Position: Constrained (-2)
- Capital and Earnings: Strong (+1)
- Risk Position: Constrained (-2)
- Funding and Liquidity: Adequate and adequate (0)
- Comparable Rating Analysis: 0

Support: +3

- ALAC Support: 0
- GRE Support: 0
- Group Support: +3
- Sovereign Support: 0

Additional Factors: 0

ESG Credit Indicators: E-2, S-2, G-2

## Bank of Ireland Group (holdco) and Bank of Ireland (opco)

Primary analyst: Anastasia Turdyeva

The stable outlooks on both Bank of Ireland Group PLC and Bank of Ireland reflect our view that the group will continue its focus on operational efficiency and profitability improvement despite increasing inflationary pressure, ongoing investments into digitalization, and the recent announcement of its CEO's departure. We also expect the acquisition of Davy and KBC Ireland's portfolio, to be completed over the next 12 months, will further diversify its revenue base. We forecast that the group's capitalization will remain robust while absorbing upcoming inorganic transactions, and asset quality will continue to improve, with the NPE ratio decreasing to 4% over the next 18 months.

We continue incorporating two notches for ALAC into the ratings on Bank of Ireland, the operating bank, because we forecast its ALAC ratio will stay comfortably above the 6% threshold over the next two years. The latter does not apply to the ratings on holding company, which are one notch lower than the group's SACP to reflect its structural subordination.

## Upside scenario

We could consider raising the ratings on both the operating and holding companies over the next

18-24 months if we saw further progress on balance sheet cleanup, with an NPE ratio falling in line with the European peer average. However, an upgrade would also require the group to complete the integrations of Davy and KBC Ireland transactions as planned. The group would also need to follow its updated business model to become more sustainable, with stable and robust risk-adjusted returns through the cycle, in line with higher-rated peers.

### Downside scenario

Downside risks to ratings are limited. However, we could lower the ratings over the next 18-24 months if, following the CEO's departure, we saw considerable delays in strategic targets delivery, especially those on cost reduction and revenue diversification, with profitability metrics lagging behind those for peers.

Group stand-alone credit profile: bbb

- Anchor: bbb
- Business Position: Adequate (0)
- Capital and Earnings: Strong (+1)
- Risk Position: Moderate (-1)
- Funding and Liquidity: Adequate and adequate (0)
- Comparable Rating Analysis: 0

Support: +2

- ALAC Support: +2
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Additional Factors: 0

ESG Credit Indicators: E-2, S-2, G-2

## Ulster Bank

Primary analyst: Letizia Conversano

The stable outlook on Ulster Bank mirrors the outlook on its parent company, Natwest Group PLC, since we anticipate that the group will continue supporting its Irish subsidiary throughout the wind-down phase, which will take several years to complete. Therefore, any positive or negative rating action taken on the parent company will be directly reflected on Ulster Bank.

We discontinued the bank's 'bbb-' SACP, given the initiated wind-down process through the sale of portfolios of assets.

## BICRA Score Snapshot

### Ireland

| | To | From |
|---|---|---|
| BICRA group | 4 | 4 |
| Economic risk | 4 | 5 |
| Economic resilience | Low risk | Low risk |
| Economic imbalances | High risk | High risk |
| Credit risk in the economy | Intermediate risk | High risk |
| Economic risk trend | Stable | Positive |
| Industry risk | 4 | 4 |
| Institutional framework | Intermediate risk | Intermediate risk |
| Competitive dynamics | High risk | High risk |
| Systemwide funding | Low risk | Low risk |
| Industry risk trend | Stable | Negative |

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Sector And Industry Variables For Banking Industry Country Risk Assessment Published For April 2022, April 26, 2022
- Ratings On Three Ireland-Based Financial Institutions Affirmed Under Revised FI Criteria, Jan. 26, 2022

- Outlook On Permanent TSB Group Holdings PLC To Positive On Prospect Of Stronger Balance Sheet; Ratings Affirmed, Dec. 21, 2021
- Ireland, Nov. 29, 2021

## Ratings List

| | | |
|---|---|---|
| *************** AIB Group PLC *************** | | |
| **Ratings Affirmed** | | |
| **AIB Group (U.K.) PLC** | | |
| Resolution Counterparty Rating | A-/--/A-2 | |
| **Allied Irish Banks PLC** | | |
| Resolution Counterparty Rating | A/--/A-1 | |
| **Ratings Affirmed; Outlook Action** | | |
| | **To** | **From** |
| **AIB Group PLC** | | |
| Issuer Credit Rating | BBB-/Stable/A-3 | BBB-/Negative/A-3 |
| **AIB Group (U.K.) PLC** | | |
| Issuer Credit Rating | BBB+/Stable/A-2 | BBB+/Negative/A-2 |
| **Allied Irish Banks PLC** | | |
| Issuer Credit Rating | A-/Stable/A-2 | A-/Negative/A-2 |
| ************ Bank of Ireland Group PLC ************ | | |
| **Ratings Affirmed** | | |
| **Bank of Ireland** | | |
| Resolution Counterparty Rating | A/--/A-1 | |
| **Ratings Affirmed; Outlook Action** | | |
| | **To** | **From** |
| **Bank of Ireland Group PLC** | | |
| Issuer Credit Rating | BBB-/Stable/A-3 | BBB-/Negative/A-3 |
| **Bank of Ireland** | | |
| Issuer Credit Rating | A-/Stable/A-2 | A-/Negative/A-2 |
| ************** Ulster Bank Ireland DAC* ************** | | |
| **Ratings Affirmed** | | |
| **Ulster Bank Ireland DAC** | | |
| Issuer Credit Rating | A-/Stable/A-2 | |
| Resolution Counterparty Rating | A/--/A-1 | |

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