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## Research Update:

# Bank of Ireland Ratings Raised To 'BBB-/A-3' On Improving Capitalization And Reducing Industry Risks; Outlook Positive

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## Research Update:

# Bank of Ireland Ratings Raised To 'BBB-/A-3' On Improving Capitalization And Reducing Industry Risks; Outlook Positive

## Overview

- We have observed significant improvement in Bank of Ireland's (BOI's) capitalization on the back of improved retained earnings and issuance of additional Tier 1 (AT1) securities.
- The Irish macroeconomic environment and property price recovery will continue to support sustainable organic capital build through retained earnings, in our view.
- We expect BOI's market position to remain stable as the largest player in a mainly domestically focused banking system with relatively few banks.
- We are therefore raising our long- and short-term counterparty credit ratings on BOI to 'BBB-/A-3' from 'BB+/B'.
- The positive outlook indicates that we may raise the ratings on BOI over the next one to two years if we expect that capitalization, as indicated by the risk-adjusted capital ratio, will comfortably and sustainably exceed 7%.

## Rating Action

On July 20, 2015, Standard & Poor's Ratings Services raised its long- and short-term counterparty credit ratings on Bank of Ireland (BOI) to 'BBB-/A-3' from 'BB+/B'. The outlook is positive. At the same time, we raised the issue ratings on BOI's junior subordinated debt to 'B+' from 'B-' and its nondeferrable subordinated debt to 'BB' from 'B+'.

## Rationale

The upgrade of BOI reflects our view of a significant improvement in capitalization, as measured by our risk-adjusted capital (RAC) ratio. The ratio was 4.9% at end-December 2014--a material increase from around 3.9% at end-2013. This was the result of sound retained earnings and continued deleveraging.

BOI successfully issued €750 million additional tier 1 (AT1) securities in June 2015. In accordance with our criteria, these securities are eligible for "intermediate" equity content in total adjusted capital (TAC), the numerator of the RAC ratio (see "Bank of Ireland's Proposed Additional Tier 1 Securities Assigned 'B-' Rating," June 12, 2015). As a result of both the AT1 issuance and our view that the Irish macroeconomic recovery will continue to support

steady internal capital generation, we now expect the bank's RAC ratio will increase to around 6.5% at end-2015 and increase further to the 7.0%-7.5% range by end-2016. As a result, we have improved our assessment of BOI's capital and earnings to "moderate" from "weak," as our criteria define these terms. We take a more conservative approach and assess capital and earnings as "moderate" and not "adequate," despite our forecast for the RAC ratio of around 7%. A higher assessment may be possible once we have a clearer line of sight on BOI's steady-state quality of capital and earnings, the future evolution of loan growth, and its dividend policy.

Our updated RAC forecast makes the following assumptions:

- Ongoing contraction of the loan book in 2015 as redemptions outpace new lending (albeit at a slower rate) along with some asset sales. We also assume modest net loan growth in 2016. Standard & Poor's risk-weighted assets (RWAs) broadly follow the same trend.
- Higher revenues owing to substantial increases in net interest margin (NIM) over the past two years, primarily due to the lower cost of deposits and declining eligible liabilities guarantee (ELG) fees. Nevertheless, we expect only modest increases in NIM over the forecast horizon as deposit re-pricing has substantially run its course and some asset margin pressure is beginning to emerge, in our view.
- Our expectation that we may not see the same extent of provision releases as in 2014, but that underlying asset quality will remain firmly on an improving trend. This translates to an increase in the headline loan impairment charge (defined as new loan loss provisions-to-average customer loans) to around 60-65 bps in 2015 from a low 52 bps in 2014.

The upgrade also reflects our view of BOI's leading market position in Ireland in the context of decreasing banking industry risks. We believe that improvements in banking system profitability and lower risk appetite will prove enduring. It also reflects our view that the structure of the Irish banking industry will remain broadly stable with relatively few players and a primary focus on domestic retail and business banking.

As a result of our view of reduced industry risks in the Republic of Ireland, we have revised upward our anchor--the starting point in assigning an issuer credit rating to a bank--for BOI to 'bbb-' from 'bb+'. BOI's anchor benefits from its greater geographic diversification than Irish peers with approximately 40% of its gross loans and advances in the U.K., which we view as having a better economic risk profile than domestic Irish exposures. We have therefore revised up our view of the bank's stand-alone credit profile (SACP) to 'bbb-' from 'bb+'.

The upgrade also reflects our view that the likelihood of extraordinary government support available to the senior unsecured bondholders will probably diminish by end-2015. We therefore incorporate a negative adjustment in the rating, thereby eliminating the uplift of the ratings attributable to extraordinary sovereign support.

## Outlook

The positive outlook indicates that we may raise the ratings on BOI over the next one to two years if we expect that capitalization, as indicated by the RAC ratio, will comfortably and sustainably exceed 7%. This could, for example, result from an improvement in our view of macroeconomic risks that BOI faces, which in turn would lower the Standard & Poor's risk weights that we apply to its exposures.

An upgrade might also follow if we include a notch of support for additional loss-absorbing capacity (ALAC) if we deem the resolution regime in Ireland to be effective, and if we expect BOI's subordinated buffers to meet a required threshold over a two-year horizon, or potentially longer. Although less likely, an upgrade could also follow if we consider that potential extraordinary government support for BOI's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability.

We could revise the outlook back to stable if we perceive that BOI's dividend policy, longer-term growth in Standard & Poor's RWAs, and risk appetite do not warrant an upward revision of the bank's SACP.

## Ratings Score Snapshot

Issuer Credit Rating	BBB-/Positive/A-3
SACP	bbb-
Anchor	bbb-
Business Position	Strong (+1)
Capital and Earnings	Moderate (-1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	-1

## Related Criteria And Research

### Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And

Assumptions, Jan. 29, 2015

- Group Rating Methodology, Nov. 19, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010

## Related Research

- Ireland Long-Term Rating Raised To 'A+' On Government Debt Reduction; Outlook Stable, June 5, 2015

## Ratings List

### Upgraded

	To	From
Bank of Ireland		
Counterparty Credit Rating	BBB-/Positive/A-3	BB+/Positive/B
Certificate Of Deposit	BBB-	BB+
Bank of Ireland		
Senior Unsecured	BBB-	BB+
Subordinated	BB	B+
Junior Subordinated	B+	B-
Preference Stock	B+	B-
Commercial Paper	A-3	B
Bank of Ireland U.K. Holdings PLC		
Junior Subordinated	B+	B-

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