

FITCH AFFIRMS BANK OF IRELAND GROUP PLC; OUTLOOK STABLE

Fitch Ratings-London-13 November 2018: Fitch Ratings has affirmed Bank of Ireland Group plc's (BOIG) and Bank of Ireland's (BOI) Long-Term Issuer Default Ratings (IDRs) at 'BBB' and Viability Ratings (VRs) at 'bbb'. The Outlook on BOIG's Long-Term IDR is Stable. The Outlook on BOI's Long-Term IDR has been revised to Positive from Stable.

The agency has also affirmed Bank of Ireland (UK) plc's Long-Term IDR at 'BBB' and VR at 'bbb'. The Outlook is Stable.

A full list of rating actions is at the end of this rating action commentary.

The revision of the Outlook on BOI's Long-Term IDR reflects our expectation that BOI's reference liabilities, i.e. senior third-party creditors, will receive additional protection when the terms of the senior debt received by BOI from its parent holding company, BOIG, are amended so that the debt becomes junior to BOI's external senior obligations. We believe that senior debt issued by BOI to BOIG during 2018 to down-stream the proceeds of BOIG senior debt issuance, will be converted to non-preferred senior (NPS) debt, thereby protecting the bank's senior external creditors in case of failure and qualifying for internal minimum requirement for own funds and eligible liabilities (MREL), shortly after legislation is introduced in Irish law (expected to take place by the end of 2018). Once sufficient internally down-streamed qualifying junior debt (QJD) and NPS debt is in place, we expect to upgrade BOI's IDRs by one notch to 'BBB+'.

KEY RATING DRIVERS

IDRS, DERIVATIVE COUNTERPARTY RATING (DCR) AND SENIOR DEBT

BOI is the main operating bank of BOIG. The Positive Outlook on BOI's Long-Term IDRs and senior debt ratings reflects the large volumes of debt issued so far by both BOIG and BOI, which includes additional Tier 1 (AT1) instruments, Tier 2 debt and senior debt received by BOI from its parent holding company. BOIG will be subject to MREL requirements of 26.39% of risk-weighted assets (RWAs) by 1 January 2021, as communicated by the Single Resolution Board and the Bank of England.

In case of failure, we have assumed that the intervention for BOIG would be around its current minimum common equity Tier 1 (CET1) requirement of 6.75%. We have also assumed that BOIG would need to meet its minimum total capital requirements immediately after a resolution action, which on a fully loaded basis, including combined buffers, currently amounts to 14.25%. Fitch's view of the regulatory intervention point and post-resolution capital needs taken together suggest a QJD and holding company senior debt buffer of around 8% of RWAs could be required to restore viability without hitting senior creditors at the BOI level.

At end-3Q18, BOI's QJD and holding company senior debt buffer was EUR4 billion, estimated by Fitch to be around 8.6% of RWAs. In Fitch's opinion, this should be sufficient to recapitalise the group in a resolution scenario to meet its expected post resolution total capital requirement without hitting BOI senior debt.

BOI's DCR is rated at the same level as the Long-Term IDR because under Irish legislation, derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

The 'F2' Short-Term IDRs of BOIG and BOI are at the higher of the two possible Short-Term ratings mapped to a Long-Term IDR of 'BBB'. This reflects strong on-balance sheet liquidity and extensive contingency liquidity facilities through various central bank facilities.

BOIG's ratings reflect its role as the group holding company and are aligned with those of its main operating subsidiary, BOI. As a result, BOIG's ratings are driven by the same considerations that affect BOI's ratings. The equalisation of BOIG's ratings with BOI's reflects the continued absence of double leverage at the holding company level and no material restrictions to the transfer of capital and liquidity across the group, subject to the operating companies meeting regulatory capital and liquidity requirements. The Stable Outlook on BOIG's Long-term IDR reflects our expectation of Stable prospects for the group.

VR

BOI's, and therefore BOIG's, VRs are driven by improving asset quality, a strong domestic retail and corporate banking franchise, a diversified business model, sound profitability, improved capitalisation and a stable funding profile. The ratings also consider the group's significant, albeit reducing, exposure to low-yielding and non-performing Irish loans.

Asset quality continues to improve, driven by the successful work out of impaired and restructured loans, as well as low inflows of new problem loans. Asset quality indicators are better than domestic peers due to a larger proportion of well-performing UK mortgages and a better quality Irish mortgage book. BOIG's impaired loans ratio based on Stage 3 loans under IFRS 9 fell to 6.7% at end-1H18 from 7.7% on 1 January 2018, while allowances for Stage 3 loans were an adequate 39%. The bank remains well on track to meet its non-performing exposures (as defined by the EBA) target of 5% by end-2019 (end-1H18: 7.5% of gross loans), with the bank not ruling out selling selective non-performing portfolios to institutional investors, depending on market conditions.

Fitch considers BOIG's strong Irish franchise and diversified business model to be rating strengths. Our franchise assessment is underpinned by strong market positions across several businesses, providing BOI with deposit and loan pricing power. BOIG's Irish business is well diversified across product and client segments, offering a full range of retail, corporate, SME and wealth and insurance products across its multi-channel strategy. The group's UK subsidiary continues to provide a consistent source of revenue and loan book diversification.

Underlying profitability has strengthened in recent years, reaching more stable levels, supported by an improving loan mix, falling funding costs and low loan impairment charges. This has helped offset weak net loan growth and the bank's large exposure to non-performing and/or low-yielding legacy tracker mortgages. In the shorter term, Fitch expects further revenue and profitability improvements will remain challenged by increasing competition, lower loan loss allowance releases, higher regulatory-related costs and ongoing investments related to investment in technology and digitalisation. We see better longer-term profitability prospects supported by a pick-up in net loan growth, further improvements in the loan mix and better cost efficiency.

BOIG's ambitious strategy, announced in June 2018, includes significant Irish mortgage growth, increased mortgage lending in less-served segments in the UK, and its corporate lending in both countries. It also includes a step-up in its programme to improve operational efficiency following several years of under-investment in operations while it focused on rebuilding capital after the financial crisis. It is targeting a cost/income ratio of 50% by 2021, with loan growth an important driver of income in addition to a reduction in the absolute cost level. While the strategy adds risk, we do not expect loan growth to be heavily skewed to higher-risk sectors or materially outpace internal capital generation. If successfully executed, it should result in improved operating efficiency and profitability.

Capitalisation has improved in recent years, driven by deleveraging, sound organic capital generation and lower pension volatility. BOIG's Fitch Core Capital ratio has improved steadily and stood at 14.4% at end-1H18 (end-2017: 14.2%). In line with profitability, we expect capital improvements will slow due to higher investment costs as well as approximately 70bps reduction in the group's fully-loaded CET1 ratio related to the ECB's targeted review of internal models. Unreserved impaired loans have been falling, reducing BOIG's vulnerability to falling collateral prices although it remains elevated at 51% at the end-1H18.

Funding is a key strength for BOIG, with the group benefiting from a strong retail banking franchise and access to a stable and granular deposit base. Non-interest bearing current account balances make up a large proportion of total customer deposits, supporting a stable funding base. Access to the wholesale markets is strong and diversified with BOIG and BOI regular issuers in the secured and unsecured markets.

On-balance sheet liquidity is sound and largely in the form of cash and cash equivalents and high-quality liquid assets, supported by contingent access to liquidity through various central bank facilities. The group's liquidity coverage ratio was a sound 139% at end-1H18 (end-2017: 136%), comfortably above minimum requirements.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

BOIG's and BOI's SRs of '5' and SRFs of 'No Floor' reflect Fitch's view that senior creditors cannot rely on extraordinary support from the Irish authorities in the event that the bank becomes non-viable. In our opinion, the EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) provide a framework that is likely to require senior creditors to participate in losses for resolving the bank.

SUBSIDIARY AND AFFILIATED COMPANY

BOI UK's IDRs reflect the bank's standalone credit profile, as expressed by its VR. Prospects for BOI UK's standalone credit profile are stable, as reflected in its Stable Outlook.

Asset quality is sound, supported by a well-performing mortgage book and reduced exposure to higher risk legacy commercial loans. Residential mortgages make up over three-quarters of BOI UK's loan book and are performing well, supported by low interest rates and low unemployment. Our assessment of asset quality factors also considers an above-average exposure to sectors that we view as more vulnerable in an economic downturn, such as buy-to-let, while the bank is also targeting increased lending towards specialist segments of the UK residential market, which will add further risk. We expect underwriting standards within these segments to remain sound, with the bank continuing to focus on prime borrowers.

The ratings consider the bank's modest franchise and relatively undiversified business model, which is concentrated on the UK mortgage and savings market. The business model is also reliant on third party partnerships, the largest of which is the partnership with the Post Office, which accounts for the majority of the bank's revenue and funding. It also factors in the high level of integration with the parent's systems, processes and management.

Profitability is sound, supported by low funding costs and low loan impairment charges, although we expect both to gradually rise over the medium term. The bank's net interest margin compares well with peers, reflecting a higher than average exposure to higher margin segments of the retail market, including motor finance.

Funding is predominately sourced through retail deposits via the Post Office, with no reliance on funding from the parent. On-balance sheet liquidity is sound and is supported by contingent liquidity from the Bank of England, if required.

Capitalisation has improved in recent years, driven by reductions of the bank's legacy commercial property loans and sound profitability. The bank has been repatriating excess capital to its parent, although we expect regulatory capital ratios to be maintained with adequate buffers over minimum requirements.

In our view, BOI UK benefits from a high probability of support, if required, from its parent bank as reflected in the '2' Support Rating. Although we view BOIG's propensity to support its UK subsidiary as extremely high, driven by the large reputational risk it would face in case of a default by BOI UK, the ability to do so is somewhat constrained by the large size of BOI UK relative to the parent's own equity.

BOI UK's DCR is at the same level as the Long-Term IDR because under UK legislation, derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings on BOI's subordinated Tier 2 debt are notched down once from the bank's VR, reflecting larger loss severity relative to senior obligations given their subordinated status. No notching is applied for incremental non-performance risk as the write-down of the notes will only occur after the point of non-viability is reached and there is no prior coupon flexibility.

RATING SENSITIVITIES

IDRS, DCRS, VRs AND SENIOR DEBT

Fitch expects to upgrade BOI's IDR by one notch above its VR when debt received from BOIG becomes subordinated to BOI's other senior creditors, and provided that the amount together with its external QJD remains sufficient and sustainable and could be made available to protect third-party preferred senior obligations from default in case of failure, either under a resolution process or as part of a private-sector solution (ie distressed debt exchange) to avoid a resolution action.

The DCR is primarily sensitive to a change in BOI's Long-Term IDR. We expect to upgrade the DCR if BOI's Long-Term IDR is upgraded.

BOIG's and BOI's ratings could be upgraded if the bank makes progress in reducing the still high proportion of problem loans to levels more commensurate with higher rated peers while reducing capital encumbrance and a successful execution of its strategy to improve cost efficiency and profitability.

BOIG's and BOI's ratings could come under pressure if the economic effect of the UK's decision to leave the EU is particularly severe for either Ireland or the UK as it could negatively impact asset quality and capitalisation. Negative pressure on the VR, and hence the IDRs, would also arise if the bank increases its risk appetite, for example, by materially increasing its exposure to commercial real estate. Negative rating action could also arise from materially higher-than-expected investment costs that significantly erode profitability.

BOIG's ratings would be downgraded if there was a material increase in the holding company's double leverage, which we do not expect.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings of all subordinated instruments are primarily sensitive to a change in BOI's VR, or to changes in their notching in accordance with our criteria and assumptions on non-performance risk.

SUBSIDIARY AND AFFILIATED COMPANIES

Ratings upside for BOI UK's ratings is limited in the medium term, given the bank's appetite for more vulnerable segments of the mortgage market and a reliance on the Post Office partnership, which although long term in nature, exposes the bank to termination risk.

BOI UK's VR and IDRs are primarily sensitive to a material increase in exposure to higher risk segments of the mortgage market and/or commercial real estate through its Northern Irish business.

The ratings are also sensitive to structural deterioration in profitability, through tighter margins and higher loan impairment charges and weaker asset quality. This could be caused by a material weakening of the operating environment in the UK if the economic effect of the UK's decision to leave the EU on the bank's business model is particularly severe. We believe that in an adverse Brexit scenario, the ratings will have low headroom because of its relatively modest franchise and fairly undiversified business model, although we believe that its vulnerability to a no-deal Brexit scenario is moderate, reflecting its stable and overall low-risk business model. It is also exposed to any stress on its Irish parent, given the high level of integration of systems and processes.

BOI UK's IDRs would only be upgraded if there is an upgrade of either its VR, for example due to a more diversified business model and less reliance on key strategic partnerships for both deposits and loan products, or if there is at least a two-notch upgrade of BOIG's VR. The reason for the latter is that the SR of '2' reflects Fitch's view that BOIG has a strong propensity to support BOI UK but its ability to provide support is constrained by BOI UK's large size relative to BOIG's own equity. Therefore the probability of support, if solely based on institutional support, is reflected in a 'BBB-' Long-Term IDR. We consequently expect that if BOIG's Long-Term IDR is upgraded to 'BBB+', BOI UK's IDR would remain at 'BBB', in line with its VR.

The rating actions are as follows:

Bank of Ireland Group plc
Long-Term IDR affirmed at 'BBB'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

Bank of Ireland
Long-Term IDR affirmed at 'BBB'; Outlook revised to Positive from Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Short-term debt, including certificates of deposit: affirmed at 'F2'
GBP197.3 million subordinated notes (XS0487711656): affirmed at 'BBB-'

Bank of Ireland (UK) Plc
Long-Term IDR affirmed at 'BBB'; Outlook Stable
Short-Term IDR affirmed at 'F3'
Viability Rating affirmed at 'bbb'

Support Rating affirmed at '2'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'

Contact:

Primary Analyst

Marc Ellsmore

Director

+44 20 3530 1438

Fitch Ratings Limited

30 North Colonnade

London E14 5GN

Secondary Analyst

Maria Shishkina

Associate Director

+44 20 3530 1379

Committee Chairperson

Bjorn Norman

Senior Director

+44 20 3530 1330

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email:
peter.fitzpatrick@thefitchgroup.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

<https://www.fitchratings.com/site/re/10044408>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus

nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.