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Research Update:

Ratings On Bank of Ireland Group Affirmed Following Risk-Adjusted Capital Criteria Revision; UCO Removed; Outlook Stable

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Overview

- On July 20, 2017, we published an update to our risk-adjusted capital framework methodology. Under the new methodology, our calculation of Bank of Ireland Group's (BOI) risk-adjusted capital ratio (RAC) is about 40 basis points higher than before, mostly because of our updated treatment of its investment in its insurance subsidiary.
- We believe that BOI is making steady progress to improve its capitalization and reduce its nonperforming exposures, in line with our rating expectations.
- We are therefore affirming our 'BBB-/A-3' long- and short-term ratings on Bank of Ireland Group PLC, the nonoperating holding company (NOHC), and our 'BBB/A-2' long- and short-term ratings on Bank of Ireland, the main operating bank.
- Our issuer ratings on all rated entities and the associated issue ratings are no longer designated as under criteria observation, now that we have completed our criteria review for BOI.
- The stable outlook reflects our view that the group's capitalization and earnings capacity and asset quality trajectory will remain commensurate with our expectations at this rating level over the next 18-24 months.

Rating Action

On Aug. 1, 2017, S&P Global Ratings affirmed its 'BBB-/A-3' long- and short-term counterparty credit ratings on Ireland-based nonoperating holding company Bank of Ireland Group PLC (the NOHC). At the same time, we affirmed our 'BBB/A-2' long- and short-term counterparty credit ratings on Bank of Ireland, the group's main operating entity. The outlook on both ratings is stable.

Furthermore, having now completed our criteria review for BOI, we have removed the under criteria observation (UCO) designation from our ratings on BOI group rated entities. We added this designation to the ratings on July 20, 2017, after updating our risk-adjusted capital (RAC) framework criteria (see "Financial Institution Ratings Placed Under Criteria Observation After Risk-Adjusted Capital Framework Criteria Published," published on RatingsDirect).

Rationale

The affirmation follows our review of the impact on the group of our revised risk-adjusted capital (RAC) framework, which we published on July 20, 2017.

Our updated view of BOI's capitalization, and the progress that BOI is making to reduce its nonperforming loans (NPLs) as indicated by its recently published 2017 interim results, does not lead us to believe that BOI's overall creditworthiness has materially improved. In particular, BOI's asset quality metrics remain weaker than higher rated peers.

We calculate that BOI's RAC ratio stood at 10.1% on a pro forma basis at end-2016 under our updated RAC framework (incorporating the revision of Ireland's economic risk score to '5' from '6' in January 2017), which is around 40 basis points higher than before. The increase mainly reflected our updated treatment of its investment in its insurance subsidiary.

We now project that BOI's RAC ratio will be in the 10.0%-10.5% range through end-2019; previously, we projected that it would be 9.0%-9.5% by end-2018. We assume that BOI will demonstrate reasonably predictable preprovision earnings despite its ongoing investment in its core banking platforms, and that loan impairment charges will remain fairly benign. We also expect that BOI's dividend payout ratio will trend toward the bank's 50% target level by 2019 and that by then the balance sheet will be back in growth mode. BOI reported a regulatory common equity tier 1 ratio of 12.5% on June 30, 2017. Within this, it announced a deduction of 15 basis points in relation to its statement that it expects to recommence dividend payments in respect of financial year 2017, with the initial payment being made in the first half of 2018.

We consider that BOI's asset quality is better than its Irish peers but is weaker than higher rated peers. Relative to Irish peers, BOI benefits from a higher U.K. loan book weighting and a lower proportion of impaired loans within its total NPLs, by our measures. Our calculation of NPLs--which includes impaired loans, loans 90 days past due, and performing renegotiated loans--stood at 13.8% at June 30, 2017. Excluding performing renegotiated loans, BOI's NPL ratio was stillelevated at 7.4%. We also calculate that BOI's Texas ratio (including performing forborne loans), which measures NPLs to tangible common equity and loan loss reserves, was 102% at this date, which remains high on an absolute and relative basis, notwithstanding the ongoing reduction in NPLs and increase in tangible common equity.

BOI reported that its nonperforming exposures (a reported €8.1 billion, or 10.1% of gross loans) had reduced by €1.3 billion in the first half of 2017. Notably, impaired loans reduced by €0.8 billion to €5.4 billion. We assume that BOI will continue to steadily reduce its nonperforming exposures, helped by the current economic tailwinds that are supporting the Irish economy and property markets.

Therefore, we continue to view BOI's capitalization, compared to the risks it

faces, as a credit-neutral ratings factor. We have reflected these developments by revising upward our capital and earning assessment to strong from adequate, and counterbalanced this by lowering our risk position assessment to moderate from adequate. The unsupported group credit profile remains unchanged at 'bbb'.

BOI recently completed a corporate reorganization that resulted in the creation of Bank of Ireland Group PLC as the listed holding company of the group. We expect the NOHC to downstream issued debt and equity capital to its operating subsidiary and that, over time, it will become a key vehicle for the group's issuance of long-term instruments designed to absorb losses, whether on a going-concern or nonviability basis. The ratings on both the NOHC and Bank of Ireland do not benefit from any external support under our additional loss-absorbing capacity (ALAC) criteria.

In time, it is possible that we could revise this stance--for example, if it becomes clear that the group will build a sizable buffer of loss-absorbing capacity designed to enable a recapitalization, rather than a liquidation, if it becomes nonviable. Under our revised RAC criteria--specifically, in this case, our revised insurance approach--the threshold for raising the rating by one notch as a result of ALAC has increased to 5.0% from 4.75%. Currently, we calculate BOI's ALAC ratio at about 2.2%.

Outlook

Bank of Ireland Group PLC

The stable outlook on Bank of Ireland Group PLC reflects our expectation that the group will continue to steadily reduce its non-performing loan ratio over our two-year outlook timeframe, and that its relatively large U.K. business will not be a source of weakness for the group.

An upgrade may occur if BOI significantly improves its asset quality metrics to be broadly in line with higher rated peers, while continuing to demonstrate predictable earnings from both its Irish and U.K. franchises.

We consider a downgrade to be relatively unlikely at this time, but we could consider lowering the ratings if the group's business and earnings predictability falters.

Bank of Ireland

The stable outlook mirrors that on the group. We could raise or lower the ratings if we revised the group credit profile upward or downward, as explained above.

We could also raise the ratings on Bank of Ireland if we perceived a clear path to the group building a sufficiently large ALAC buffer, subject to evidence of sustained issuance. This would only benefit the ratings on Bank of

Ireland because we do not include notches for ALAC support in the ratings on NOHCs.

Ratings Score Snapshot

Bank of Ireland Group PLC: BBB-/Stable/A-3

Bank of Ireland: BBB/Stable/A-2

Unsupported GCP:	bbb
Anchor	bbb-
Business Position	Strong (+1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)

Support* 0

ALAC Support 0

GRE Support 0

Group Support 0

Sovereign Support 0

Additional Factors 0

*We do not include any external support in our ratings on the NOHC or the operating subsidiary.

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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.

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