FINANCIAL INSTITUTIONS

MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 December 2018

Update

Rate this Research

RATINGS

Bank of Ireland

Domicile	Dublin, Ireland
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A3
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Bank of Ireland

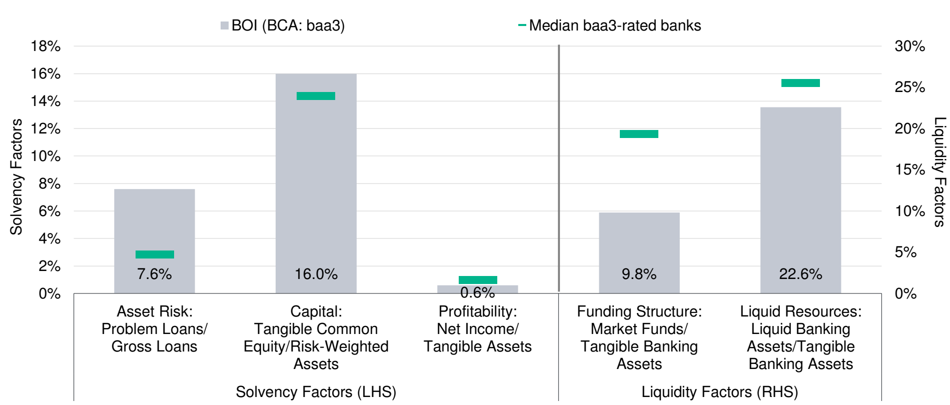
Update to credit analysis

Summary

We rate Bank of Ireland's (BOI's) long-term bank deposits and long-term senior unsecured debt at A2 and A3, respectively. The ratings are driven by the bank's baseline credit assessment (BCA) of baa3, the results of our Advanced Loss Given Failure Analysis (LGF) leading to a preliminary rating assessment (PRA) three notches above the BCA for deposits and two notches above the BCA for senior unsecured debt and an expectation of a moderate level of government support, which translates into one notch of further uplift for both the deposit and senior unsecured ratings. BOI's counterparty risk assessment (CRA) is A2(cr)/ Prime-1(cr). The bank's short-term deposit and debt ratings are Prime-1.

BOI's BCA of baa3 reflects (1) improving asset quality, with the problem loan ratio standing at 6.7% at end-June 2018 and which the bank plans to reduce to below 5% by end-2019; (2) sound capital ratios, with the group's regulatory common equity tier 1 (CET1) ratio of 15.1% at end-September 2018 comfortably above the SREP requirement of 8.625%; (3) stable profitability and net interest margin, sustained in 1H18 by write-backs on impaired loans; and (4) a strong funding profile. The BCA remains constrained by the remaining sizeable stock of non-performing loans in addition to a significant stock of forborne loans.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Banking Financial Metrics

Credit strengths

» Leading domestic franchise in Ireland and established position in the UK through partnerships with the Post Office and AA plc;

» Sound capitalisation supported by sustained earnings generation and conservative capital management;

» Ample customer deposits base and sufficient liquidity buffers.

Credit challenges

» Sizeable stock of problem loans, albeit declining aided by a favorable operating environment in Ireland;

» Macroeconomic uncertainties in the UK and Ireland related to the UK's exit from the EU;

» Pressures on the net interest margin given the increasing pricing competition in the Irish mortgage market and the low interest rate environment in both the UK and Ireland.

Outlook

The outlook on BOI's long-term senior unsecured debt and issuer ratings is positive, reflecting our expectation that BOI's BCA could be upgraded if the bank continues to reduce its stock of problem loans, improves its profitability, and maintains adequate capital levels.

The outlook on BOI's long-term deposit rating is stable as the rating currently includes one notch of government support and is in line with the ratings of the Government of Ireland (A2 stable). Should the BCA be upgraded, the deposit rating would likely be affirmed because this potential government support would no longer benefit these creditors.

Factors that could lead to an upgrade

» BOI's long-term senior unsecured and issuer ratings could be upgraded as a result of an upgrade in its standalone BCA or following a significant increase in the bank's bail-in-able debt.

» The bank's BCA could be upgraded following (1) further significant reductions in non-performing loans and/or improving provisioning coverage; (2) improving capitalisation and risk absorption capacity, while maintaining (3) stable profitability, funding and liquidity metrics.

Factors that could lead to a downgrade

» BOI's ratings could be downgraded as a result of (1) a downgrade of its standalone BCA; or (2) the redemption of maturing subordinated instruments without their replacement.

» BOI's BCA could be downgraded due to (1) a significant deterioration in the bank's asset quality; (2) a significant and sustained drop in the bank's capitalisation; (3) a deterioration in its core profitability metrics; or (4) a significant reduction in liquid assets.

Key indicators

Exhibit 2

Bank of Ireland (Consolidated Financials) [1]

	6-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (EUR million)	119,889	120,111	119,032	127,089	125,540	-1.3[4]
Total Assets (USD million)	139,977	144,229	125,549	138,056	151,910	-2.3[4]
Tangible Common Equity (EUR million)	7,599	7,202	6,935	7,451	6,237	5.8[4]
Tangible Common Equity (USD million)	8,873	8,648	7,315	8,094	7,547	4.7[4]
Problem Loans / Gross Loans (%)	6.7	5.2	7.6	11.0	15.0	9.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.0	15.7	13.5	13.2	11.1	13.9[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	54.2	42.3	57.6	74.9	98.1	65.4[5]

Net Interest Margin (%)	1.8	1.8	1.8	1.8	1.7	1.8[5]
PPI / Average RWA (%)	1.5	1.7	1.9	2.4	2.2	1.9[6]
Net Income / Tangible Assets (%)	0.6	0.5	0.9	0.6	1.1	0.8[5]
Cost / Income Ratio (%)	74.9	73.5	67.2	58.3	57.2	66.2[5]
Market Funds / Tangible Banking Assets (%)	8.9	9.8	10.5	10.0	15.4	10.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	21.2	22.6	19.9	19.6	20.1	20.7[5]
Gross Loans / Due to Customers (%)	102.3	103.5	109.6	113.0	119.6	109.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.

Source: Moody's Financial Metrics

Profile

Bank of Ireland (BOI) is an Irish retail and commercial bank. Its products and services include deposit-taking, current accounts, personal loans, business and corporate lending, leasing, international asset finance, financial advice, mortgages, foreign exchange, life assurance, pensions and credit cards. As of 30 June 2018, BOI accounted for almost one-third of the domestic market assets held by Irish credit institutions, based on its total consolidated assets of €121.8 billion.

The Bank of Ireland Group (the group) operates mainly in Ireland, but also has operations in the UK and internationally. In Ireland it operates through more than 250 branches and in the UK it also operates in partnership with the UK Post Office. The bank also has branches in France, Germany and the US.

BOI was established in 1783, and in 1922 it became the official bank of the Irish government. The group's ordinary shares are listed on the Irish Stock Exchange (ticker: BIR) and the London Stock Exchange (ticker: BIRG). As of 31 December 2017, BOI's largest shareholder was the Irish government, through the Ireland Strategic Investment Fund, which owned 13.95% of the bank's total share capital

Detailed credit considerations

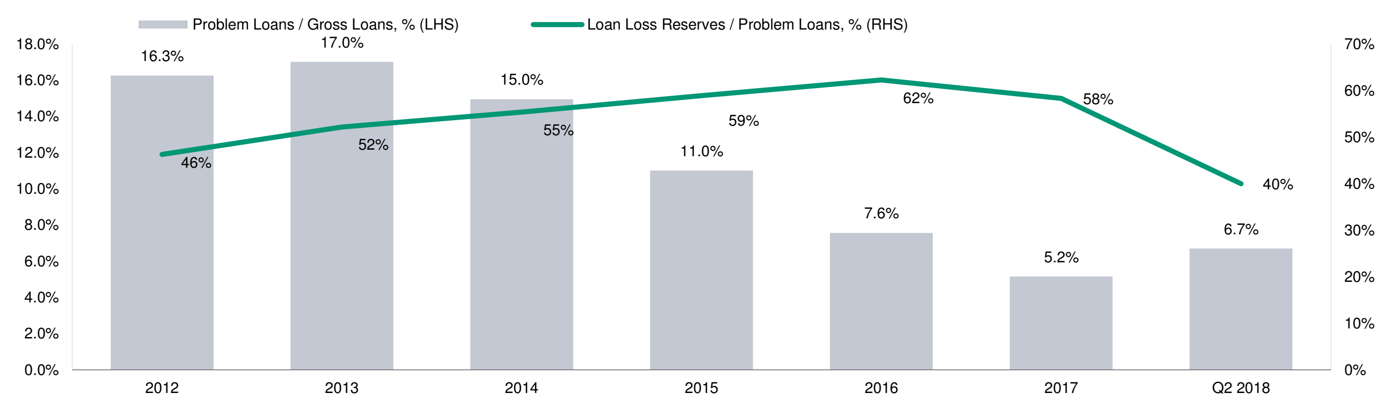
The financial data in the following sections are sourced from BOI's consolidated financial statements unless otherwise stated.

Improving asset quality but the stock of impaired and forborne loans remain sizeable

BOI is gradually reducing its level of problem loans, which decreased to €5.2 billion at June 2018 from €6.2 billion at December 2016, leading to a reduction in the bank's problem loan ratio to 6.7% from 7.6%. The reduction was supported by the favorable operating environment in Ireland leading to improvements in the labour market and the bank's significant effort to provide sustainable restructuring solutions to troubled borrowers. Upon implementation of IFRS9 on 1 January 2018 the level of problem loans increased due to the reclassification of material exposures to level 3 assets, but on a like-for-like basis the level of problem loans continued to improve in H1 2018 and we expect further improvements in 2H 2018 and 2019 as BOI plans to bring its NPL ratio below 5% by end-2019.

Exhibit 3

Problem loans continue to decrease and are adequately provisioned



Source: Moody's Banking Financial Metrics

Following improvements in property prices in Ireland, the bank is better positioned to negotiate restructuring of existing problem loans, assuming that positive momentum in the housing market is maintained. As a result, the proportion of the bank's portfolio in negative equity continues to decline, with the proportion of residential mortgages in Ireland with a loan-to-value above 100% falling to 4% at June 2018 (down from 7% at December 2017 and 16% at December 2016).

The reduced inflow of new non-performing loans should continue to support the strengthening of BOI's asset quality metrics. The bank has historically reported lower levels of problem loans compared to those of its Irish peers, reflecting its geographic diversification due to its lending activities in the UK as well as its conservative underwriting standards.

However, we believe that the bank still faces asset quality challenges in its domestic loan book: 30% of BOI's Irish buy-to-let loans (BTL loan book of €3.7 billion) were classified as non-performing at end-June 2018 (33% at December 2017). At the same date 14% of the Irish non-property SME portfolio was non-performing (SME loan book of €7.8 billion), while the non-property corporate book recorded a non-performing exposure ratio of 2.7%. The property and construction portfolio continues to be the worst performer with 15.3% non-performing exposures at June 2018, although the exposure to this segment has been reduced to €8.46 billion at end-June 2018 from €8.75 billion at end-2017.

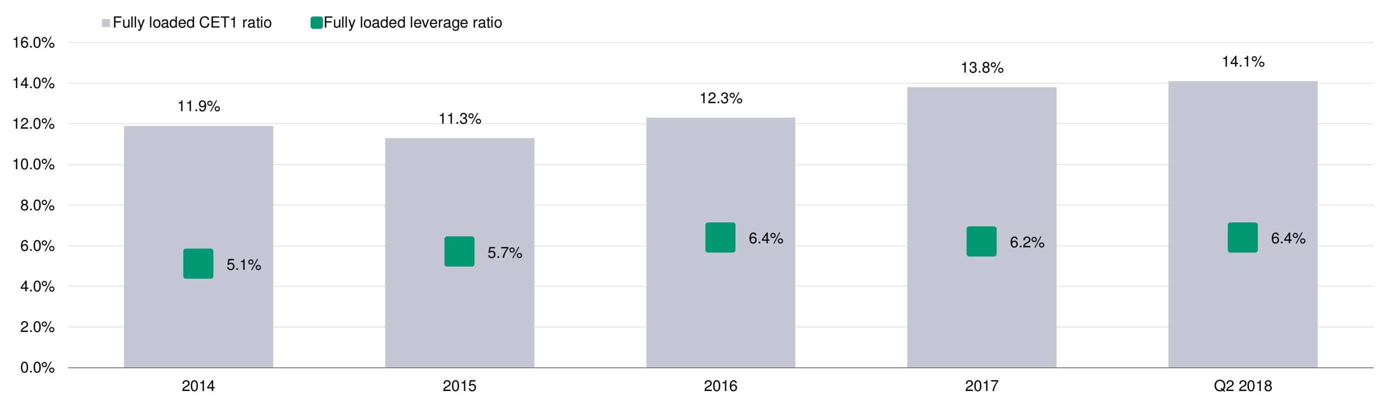
BOI has a large portion of vulnerable restructured loans, which, in our view, have an increased probability of falling back into non-performance in the event of macro-economic headwinds. We note, however, that Forborne Collateral Realisation loans (FCRs) are included in the non-performing exposures (NPEs). The overall level of impaired and forborne loans and loans in negative equity is still relatively high, exposing the bank to material downside risk in case of adverse macroeconomic developments. We therefore consider the bank's asset quality remains a relative weakness for the bank, reflected in an assigned score of ba3.

Capitalisation expected to remain solid supported by sustained earnings generation

BOI reported a fully loaded common equity tier 1 (CET 1) ratio of 14.1% at June 2018, increasing from 13.8% at December 2017, driven by steady capital generation and a reduction in risk-weighted assets (RWAs). The bank's fully loaded leverage ratio was at 6.4% at June 2018, which we consider as solid. The group's regulatory CET1 of 15.1% at end-September 2018 comfortably exceeds its SREP requirement of 8.625%.

Exhibit 4

Regulatory capital ratios remain strong



Source: BOI financial reports

BOI recommenced modest dividend payments in 2018, in respect of the financial year 2017. We believe the bank's demonstrated ability to generate capital organically and conservative capital management will largely mitigate any potential future volatility due to movements in the pension deficit, sterling exchange rate changes (although the impact is limited due to hedging in place) and potential increase in impairment charges. We therefore expect BOI to continue to maintain adequate capital levels in excess of regulatory requirements and view its capitalisation as a relative strength for the BCA.

We calculate a tangible common equity to risk weighted assets ratio of 16% at end-June 2018, corresponding to a macro-adjusted score of aa3. The assigned score of baa1 reflects our expectation of the maintenance of solid capital level but also takes into account the downside risks arising from a still relatively high proportion of unprovisioned problem loans and NPEs in negative equity as a percentage of the bank's capital.

Profitability is supported by decreasing funding costs and impairment charges, but pressures persist from low asset margins

BOI's profitability is supported by growing lending volumes, decreasing impairment charges and improving efficiency, but pressures comes from heightened competition and high investments in digital transformation.

BOI reported statutory profit before tax of €454 million in 1H18, after reporting €852 million profit before tax in 2017. The 1H18 result is positively impacted by €81 million of net impairment gains, compared to €59 million loan losses in 1H17, which reflects successful resolution strategies and the positive economic environment in Ireland. Although there may be a further decline in impairments in the short term, we expect that provision releases will gradually diminish and the bank's impairment charges will stabilise at a somewhat higher level than the current one.

The Moody's-calculated net interest margin (NIM) stood at 1.82% in 1H 2018, overall stable from one year earlier. The NIM benefits from new lending which replaces legacy low yielding tracker mortgages and nonperforming assets, but rising competition in the mortgage market, in both Ireland and the UK, could put pressure on the margins. We also expect the high volume of planned MREL issuances to lead to relatively high overall cost of funding.

BoI reported a cost-to-income ratio of 66% in 1H18, which according to the current strategic plan, the bank plans to reduce to 50% by 2021 mostly through personnel cost reductions in line with the announced digital transformation plan.

BOI's profitability was negatively affected during 2017 by the announced additional provisions related to the Tracker Mortgage Examination Review. Although the additional provisioning seeks to settle this conduct issue for BOI, in our view a risk of further provisions over the outlook period remains.

We assign a Profitability score of baa3 to BOI, in line with the macro-adjusted score. The assigned score also reflects the challenges the bank's profitability is facing from the prolonged period of low interest rates and the macroeconomic uncertainties related to the UK's exit from the EU.

Relatively low use of wholesale funding and sufficient liquidity

We see BOI's funding structure as a relative strength and we assign an a3 score to this factor. The bank's market funding mix is diverse, we calculate a market funds to tangible banking assets ratio of 9.79% at end-2017. The use of wholesale funding decreased to €11.4 billion at June 2018 from €12.7 billion at end-2017, but we expect an increase in market funding in the near future as we expect the bank to continue to issue debt at the holding company level to meet its Minimum Requirements for Eligible Liabilities (MREL) of 12.9% of total liabilities and own funds, or 26.4% of the bank's RWAs.

The gross loans to customer deposits (LTD) ratio is overall stable at 102% in June 2018, slightly down from 103% in 2017.

BOI has sufficient stock and good quality of liquid assets in both Ireland and the UK. At June 2018, the bank had a liquid banking assets to tangible banking assets ratio of 21.2%. BOI also comfortably meets regulatory liquidity requirements, reporting a Net Stable Funding Ratio of 127% and a Liquidity Coverage Ratio of 139% at June 2018. We assign a Liquid Resources score of baa3.

Support and structural considerations

Loss Given failure

BOI is subject to the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assigns a 25% probability to deposits being preferred to senior unsecured debt. We also assume that the junior proportion of BOI's deposits is in line with our estimated EU-wide average of 26%. These are in line with our standard assumptions.

Our Advanced LGF analysis indicates that BOI's deposits are likely to face extremely low loss-given-failure, due to the loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves. This results in a PRA of A3, three notches above the BCA.

BOI's senior unsecured debt is likely to face very low loss-given-failure due to the loss absorption provided by its own volume and the amount of debt subordinated to it. This results in a PRA of baa1, two notches above the BCA. This is lower than the PRA for deposits because of the probability that we incorporate in our LGF analysis that resolution authorities may take actions to preserve deposits in a bail-in, at the expense of senior unsecured debt.

BOI's subordinated instruments are likely to face a high level of loss-given-failure according to our LGF analysis given the relatively small volume of debt and limited protection from more subordinated instruments and residual equity. The rating of BOI's subordinated debt and junior subordinated debt is Ba1 and Ba2(hyb), respectively.

Government support

We believe that there is a moderate probability of government support for BOI should the bank fail, which leads to one notch of uplift from the Preliminary Rating Assessments for both deposits and senior unsecured ratings.

For other junior securities, we continue to believe that the probability of government support is low, and, as such, the ratings for these instruments do not include any related uplift.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

BOI's CR Assessment is positioned at A2(cr)/Prime-1(cr).

The CR Assessment, prior to government support, is positioned three notches above the BOI's BCA of baa3, based on the cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

The CR Assessment also benefits from one notch of government support, in line with our support assumptions on deposits and senior unsecured debt. This reflects our view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions.

Counterparty Risk (CR) Rating

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

BOI's CR Rating is positioned at A2/Prime-1.

About Moody's bank scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 5

Bank of Ireland

Macro Factors		
Weighted Macro Profile	**Strong**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.6%	ba1	↑↑	ba3	Expected trend	Sector concentration
Capital						
TCE / RWA	16.0%	aa3	←→	baa1	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	0.6%	baa3	←→	baa3		
Combined Solvency Score		baa1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	9.8%	a2	↓	a3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	22.6%	baa2	←→	baa3	Expected trend	
Combined Liquidity Score		a3		baa1		
Financial Profile				baa2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				A2		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

Balance Sheet	**in-scope (EUR million)**	**% in-scope**	**at-failure (EUR million)**	**% at-failure**
Other liabilities	13,709	18.2%	19,350	25.8%
Deposits	55,313	73.6%	49,671	66.1%
Preferred deposits	40,932	54.5%	38,885	51.8%
Junior Deposits	14,381	19.1%	10,786	14.4%
Senior unsecured bank debt	1,000	1.3%	1,000	1.3%
Dated subordinated bank debt	2,016	2.7%	2,016	2.7%
Junior subordinated bank debt	85	0.1%	85	0.1%
Preference shares (bank)	740	1.0%	740	1.0%
Equity	2,254	3.0%	2,254	3.0%
Total Tangible Banking Assets	75,116	100%	75,116	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	22.5%	22.5%	22.5%	22.5%	3	3	3	3	0	a3
Counterparty Risk Assessment	22.5%	22.5%	22.5%	22.5%	3	3	3	3	0	a3 (cr)
Deposits	22.5%	6.8%	22.5%	8.1%	2	3	2	3	0	a3
Senior unsecured bank debt	22.5%	6.8%	8.1%	6.8%	2	0	1	2	0	baa1
Dated subordinated bank debt	6.8%	4.1%	6.8%	4.1%	-1	-1	-1	-1	0	ba1
Junior subordinated bank debt	4.1%	4.0%	4.1%	4.0%	-1	-1	-1	-1	-1	ba2 (hyb)
Cumulative bank preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-2	ba3 (hyb)
Non-cumulative bank preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-2	ba3 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a3	1	A2	A2
Counterparty Risk Assessment	3	0	a3 (cr)	1	A2 (cr)	--
Deposits	3	0	a3	1	A2	A2
Senior unsecured bank debt	2	0	baa1	1	A3	A3
Dated subordinated bank debt	-1	0	ba1	0	Ba1	Ba1
Junior subordinated bank debt	-1	-1	ba2 (hyb)	0	--	Ba2 (hyb)
Cumulative bank preference shares	-1	-2	ba3 (hyb)	0	Ba3 (hyb)	--
Non-cumulative bank preference shares	-1	-2	ba3 (hyb)	0	Ba3 (hyb)	Ba3 (hyb)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
BANK OF IRELAND	
Outlook	Stable(m)
Counterparty Risk Rating	A2/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating	A3
Senior Unsecured	A3
Subordinate	Ba1
Jr Subordinate	Ba2 (hyb)
Pref. Stock -Dom Curr	Ba3 (hyb)
Pref. Stock Non-cumulative	Ba3 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1
PARENT: BANK OF IRELAND GROUP PLC	
Outlook	Positive
Issuer Rating	Baa3
Senior Unsecured	Baa3
Subordinate	Ba1
BANK OF IRELAND (UK) PLC	
Outlook	Positive
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Source: Moody's Investors Service

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