FITCH UPGRADES BANK OF IRELAND GROUP PLC, BANK OF IRELAND AND BANK OF IRELAND (UK) TO 'BBB'

Fitch Ratings-London-23 November 2017: Fitch Ratings has upgraded Bank of Ireland Group plc's (BOIG) and Bank of Ireland's (BOI) Long- and Short-Term Issuer Default Rating (IDRs) and Viability Ratings (VRs) to 'BBB'/'F2'/'bbb' from 'BBB-'/'F3'/'bbb-'.

The agency also upgraded Bank of Ireland (UK) (BOI UK) plc's Long-Term IDR and VR to 'BBB'/'bbb' from 'BBB-'/'bbb-'. BOI UK's Short-Term IDR is affirmed at 'F3'.

The Outlooks for all Long-Term IDRs are Stable.

In addition, Fitch has assigned a 'BBB(dcr)' Derivative Counterparty Ratings (DCR) to BOI and BOI UK as part of its roll-out of significant derivative counterparties in western Europe and the US. DCRs are issuer ratings and express Fitch's view of banks' relative vulnerability to default under derivative contracts with third-party, non-government counterparties.

The IDRs of BOIG and BOI UK reflect their standalone strength as reflected in their respective VRs, which Fitch has today upgraded. In BOIG and BOI, the upgrade reflects improving asset quality, a longer record of stable profitability and strengthened capitalisation. BOI UK's upgrade reflects further reductions in the bank's legacy commercial book and sound capitalisation.

A full list of today's rating actions, which also include rating actions on BOIG's rated subsidiaries, is available at the end of this rating action commentary.

KEY RATING DRIVERS
IDRS, DCRS, VR AND SENIOR DEBT
The ratings of BOIG reflect its role as the holding company of the Bank of Ireland group 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.

BOI's VR and IDRs are primarily based on the bank's strong domestic franchise, strengthened capitalisation, sound funding profile, diversified revenue streams, and improving, albeit still weak, asset quality. The equalisation of BOIG's VR and IDRs 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.

Asset quality has a high influence on BOI's ratings. Asset quality metrics remain weak although they continue to improve on the back of a continued domestic economic recovery, non-recourse loan sales and general progress in reducing legacy impaired assets. BOI's asset quality is better than domestic peers', reflecting the bank's both lower stock of impaired loans and better-performing UK residential mortgages. The bank's impaired loans ratio fell to 6.7% of gross loans at end-1H17 (from 7.9% at end-2016) and while we expect this positive trend to continue, over the medium-term the pace of improvement is likely to slow as the bank works through smaller exposures (namely residential mortgages). Asset quality benefits from a large portfolio of performing residential mortgages in the UK. Deterioration in the UK real-estate market, which could result from the UK vote to leave the EU, is a risk for the group as the UK accounts for around a third of its loan portfolio.

Fitch views BOI's strong domestic franchise and diversified business model across retail and corporate banking and into the UK market as a rating strength for the group. BOI's franchise benefits from the highly concentrated Irish banking sector, and the bank's strong market position across several businesses provides BOI with considerable deposit and loan-pricing power relative to peers.

Profitability has improved to more stable levels as a result of lower funding costs, low loan impairment charges and improving loan mixes. However, revenue and profitability remain challenged by muted net loan growth and a still large exposure to low-yielding tracker mortgages. We expect profitability to remain under pressure from increasing competition, lower releases of loan loss provisions and increased costs related to investment in technology and digitalisation.

Capitalisation has strengthened considerably in recent years, driven by deleveraging and improved organic capital generation. BOI reported a 14.7% transitional common equity Tier 1 ratio (12.8% on a fully-loaded basis) at end-3Q17, comfortably above its Pillar 2 requirements. Fitch expects capital improvements to slow in 2018, due to IT-related investment costs and the negative impact from IFRS 9 first-time adoption on capital. Although the proportion of unreserved impaired loans to Fitch Core Capital (FCC) fell to 36.5% at end-1H17 (end-2016: 43%) it continues to show BOI's vulnerability to potentially falling collateral prices.

Funding is sound and benefits from a stable and ample retail deposit base and diversified wholesale market access. BOI is strongly positioned to meet minimum requirement for own funds and eligible liabilities (MREL), given its improved capitalisation and established access to the wholesale funding market. We expect MREL requirements to be met through a mixture of regulatory capital and senior holding company issuance.

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 the group's strong on-balance sheet liquidity and extensive contingency liquidity facilities through various central bank facilities.

We have assigned a DCR to BOI due to its significant derivatives activity and it being a counterparty in Fitch-rated transactions. The DCR is 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.

SUBSIDIARY AND AFFILIATED COMPANIES
BOI UK's IDRs reflect the bank's standalone credit profile, as expressed in the subsidiary's VR. The upgrade reflects further asset quality improvements, supported by reductions in the bank's legacy commercial book and a performing mortgage book. The ratings also incorporate sound funding and capitalisation alongside a modest franchise and fairly undiversified business model, which is concentrated on the UK mortgage and savings market. It also factors in the high level of integration with the parent's systems, processes and management. Prospects for BOI UK's standalone credit profile are stable, as reflected in the subsidiary's Stable Outlook.

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 BOI'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.

We have assigned a DCR to BOI UK due to it being a counterparty in Fitch-rated transactions. The 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.

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.

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 RATINGS

Rating upside on BOI's and BOIG's ratings is limited in the medium term given the still high proportion of legacy problem assets (including forborne, past due but not impaired and low-yielding loans). Working through the remaining impaired loans, a large proportion of which are Irish residential mortgages, will take several years.

The 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.

Over time, the Long-Term IDR of BOI could be notched up once from its VR, when sufficient senior debt is down-streamed to it from its parent company, BOIG, in a manner which is subordinated to other senior creditors of BOI. The uplift would be influenced by Fitch's assessment of whether BOI's rating would have achieved the higher level had the relevant holding company and operating company junior debt buffers been in the form of FCC, rather than debt. An upgrade of BOI's Long-Term IDR could take place once there is sufficient quantum of this down-streamed internal debt to recapitalise the bank to a viable level without having to bail in other senior debt holders at BOI.

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

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade to the SR and upward revision to 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 the VR of BOI, or to changes in their notching in accordance with our criteria and assumptions on non-performance risk.

SUBSIDIARY AND AFFILIATED COMPANIES

BOI UK's VR and IDRs are primarily sensitive to a 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 is particularly severe.

BOI UK's IDRs would only be upgraded if there is an upgrade in either the subsidiary's 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 BOI's Long-Term IDR. The reason for the latter is that the SR of '2' reflects Fitch's view that BOI has a strong propensity to support BOI UK but its ability to provide support is constrained by BOI UK's large size relative to BOI's own equity and therefore the probability of support, if solely based on institutional support, is reflected in a 'BBB-' Long-Term IDR. We therefore expect that if BOI's Long-Term IDR is upgraded to 'BBB+', BOI UK's IDR would remain at 'BBB', in line with the VR.

The rating actions are as follows:

Bank of Ireland Group plc
Long-Term IDR upgraded to 'BBB' from 'BBB-'; Outlook Stable
Short-Term IDR: upgraded to 'F2' from 'F3'
Viability Rating: upgraded to 'bbb' from 'bbb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

Bank of Ireland
Long-Term IDR upgraded to 'BBB' from 'BBB-'; Outlook Stable
Short-Term IDR: upgraded to 'F2' from 'F3'
Viability Rating: upgraded to 'bbb' from 'bbb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: assigned at 'BBB(dcr)'
Short-term debt, including certificates of deposit: upgraded to 'F2' from 'F3'
GBP197.3 million subordinated notes (XS0487711656): upgraded to 'BBB-' from 'BB+'

Bank of Ireland (UK) Plc
Long-Term IDR upgraded to 'BBB' from 'BBB-'; Outlook Stable
Short-Term IDR affirmed at 'F3'
Viability Rating upgraded to 'bbb' from 'bbb-'
Support Rating upgraded to '2' from '3'
Derivative Counterparty Rating: assigned at 'BBB(dcr)'

Contact:

Primary Analyst
Marc Ellsmore
Associate Director
+44 20 3530 1438
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Aabid Hanif
Associate Director
+44 20 3530 1786
Committee Chairperson

Committee Chair

Francesca Vasciminno
Senior Director
+39 02 87 90 87 225

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

Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051