FITCH AFFIRMS BANK OF IRELAND GROUP PLC AT 'BBB'; OUTLOOK STABLE

Fitch Ratings-Milan/London-31 October 2019: Fitch Ratings has affirmed Bank of Ireland Group Public Limited Company's (BOIG) and Bank of Ireland's (BOI) Long-Term Issuer Default Ratings (IDRs) at 'BBB' and Viability Ratings (VRs) at 'bbb'. The Outlooks on BOIG and BOI are Stable and Positive, respectively.

Fitch has also maintained the 'BBB' Long-Term IDR of Bank of Ireland (UK) plc (BOI UK) on Rating Watch Negative (RWN) whilst affirming its VR at 'bbb'. Fitch placed the Long-Term IDR of BOI UK on RWN on 1 March 2019 (see "Fitch Places Long-Term IDRs of 19 UK Banking Groups on RWN") to reflect the heightened uncertainty over the ultimate outcome of the UK's exit from the EU and the significant risk that a no-deal Brexit could result in negative action on BOI UK, most likely with a Negative Outlook being assigned. In the event a Brexit agreement is concluded, all else being equal, we would likely resolve the RWN and assign a Stable Outlook. Fitch is likely to maintain the RWN until the outcome of the Brexit negotiations is known. Resolving the RWN could extend beyond six months.

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

KEY RATING DRIVERS
IDRS, DERIVATIVE COUNTERPARTY RATING (DCR) AND SENIOR DEBT
The Positive Outlook on BOI reflects our expectation that the bank's senior creditors will receive additional and sustainable protection from default in case of failure from a buffer of qualifying junior debt (QJD), including AT1 and Tier 2, and BOIG's senior holding company debt down-streamed to its subsidiary in a subordinated manner. This is expected when the terms of the senior debt received by BOI from its parent holding company are amended so that the down-streamed debt becomes junior to BOI's external senior obligations, at the latest by end-2022.

Fitch would expect a resolution action being taken on BOI when it breaches minimum capital requirements. Fitch assumes the intervention point would be at a common equity Tier 1 (CET1) ratio of no lower than 6.75% of risk-weighted assets (RWAs). Fitch estimates that post-resolution capital needs mean that a combined buffer of QJD and internal senior non-preferred (SNP) debt of about 8% of RWAs would most likely be sufficient to restore BOI's viability without imposing losses on senior creditors of the bank.

At end-1H19, BOI's QJD and senior debt down-streamed from the holding company (adjusted for 3Q19 issuance) was EUR4.2 billion, estimated by Fitch to be around 8.6% of RWAs. In Fitch's view, if the down-streamed senior debt were in the form of SNP, this should be sufficient to recapitalise the bank in a resolution to meet its expected post resolution total capital requirement without hitting BOI's senior debt.

BOIG's Long-Term IDR and senior debt ratings are in line with the group's VR. The Stable Outlook on BOIG reflects our expectation of Stable prospects for the group.

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.

The 'F2' Short-Term IDRs of BOIG and BOI are the higher of two possible Short-Term ratings mapping to a Long-Term IDR of 'BBB'. This is based on our assessment of the group's funding and liquidity, which is in line with the level required at the 'F2' rating level under Fitch's Short-Term Ratings Criteria.

VRs

Fitch assesses the group on a consolidated basis.

BOIG acts as the group holding company and its VR is aligned with that of its main operating subsidiary, BOI. The equalisation of BOIG's VR 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.

BOI's, and therefore BOIG's, VRs are driven by average asset quality, a strong domestic retail and corporate banking franchise in the small Irish economy, a fairly diversified business model, adequate profitability and capitalisation, and a stable funding profile. The ratings also consider the group's declining but still relevant exposure to low-yielding and non-performing Irish mortgage loans.

Fitch views BOIG's strong Irish franchise and diversified business model as rating strengths. Our franchise assessment is underpinned by strong market positions across several businesses, providing BOIG 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 the group's multi-channel strategy. However, Ireland is a small and open economy. The group's UK subsidiary provides a consistent source of revenue and loan diversification.

Asset quality continues to improve, driven by a combination of organic and non-organic measures, as well as by limited inflows of new problem loans. Asset-quality indicators are better than domestic peers' due to a larger proportion of performing UK mortgage loans and a better-quality Irish mortgage book. BOIG's impaired loans ratio based on Stage 3 loans fell to 4.7% at end-1H19 from 5.7% at end-2018, while their coverage by total loan loss allowances improved to 42%. The bank met its non-performing exposures (as defined by the EBA) target of 5% in 3Q19. Management is targeting further non-performing exposure reductions including through securitisations and sales to institutional investors, depending on market conditions.

Underlying profitability is adequate, supported by an improving loan mix and diversified revenue streams, and despite the bank's still relevant non-performing and low-yielding legacy tracker mortgage loans. In the shorter term, Fitch expects profitability to be challenged by ongoing transformation investments, normalisation of risk charges and growth challenges, particularly from Brexit. In the longer term, provided the effect of Brexit is non-disruptive, we see better prospects for profitability subject to a pick-up in net loan growth, further improvements in the loan mix and better cost efficiency.

Capitalisation has improved in recent years, driven by deleveraging, sound organic capital generation and lower pension volatility. Fitch Core Capital (FCC) ratio was 14% at end-1H19. We expect the bank to maintain adequate capital buffers, which might be negatively affected by targeted strong loan growth and profitability headwinds. Unreserved impaired loans have been falling, reducing BOIG's vulnerability to falling collateral prices, although they remain elevated at 33% of FCC at end-1H19.

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. The group has proven and diversified access to secured and unsecured wholesale markets.

Liquidity is sound and largely in the form of cash and 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 134% at end-1H19, 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.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The ratings on BOI's and BOIG's subordinated Tier 2 debt are notched down once from the banks' respective VRs, 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.

SUBSIDIARY AND AFFILIATED COMPANY
BOI UK's IDRs and DCR reflect the bank's standalone credit profile, as expressed by the VR. The VR reflects a modest franchise in the UK, acceptable asset quality and profitability, somewhat constrained by a narrow business model, and sound reported capital ratios.

The ratings consider the bank's modest franchise and fairly undiversified business model, which is concentrated on the UK mortgage and savings market. The business model is also reliant on third party partnerships, resulting in the bank's weaker operational efficiency than peers'. The largest is a partnership with the Post Office, which accounts for the majority of the bank's funding.

Asset quality is acceptable, supported by a performing mortgage book and reduced exposure to higher-risk legacy commercial loans. Residential mortgage loans make up over three-quarters of

BOI UK's loan book and are performing well, supported by low interest rates and low unemployment. The bank has appetite for an above-average exposure to sectors that we view as more vulnerable in an economic downturn, such as buy-to-let or specialist segments of the UK residential market. We expect underwriting standards within these segments to remain sound, with the bank continuing to focus on prime borrowers.

The bank is seeking to improve profitability by simplifying its business model and growing selectively, including in personal lending, which also drives higher loan impairment charges. 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. It is, however, on a downward trajectory given growing competition in mass mortgage market and personal lending.

Funding is predominately sourced through retail deposits via the Post Office, with limited wholesale funding (predominantly from the parent). On-balance sheet liquidity is sound and is supported by contingent liquidity from the Bank of England, if required.

We expect regulatory capital ratios to be maintained with adequate buffers over minimum requirements although the bank has been repatriating excess capital to its parent. Capitalisation benefits from reductions in the bank's legacy commercial property loans and acceptable profitability.

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, equivalent to a 'BBB-' Long-Term IDR. Although we view BOIG's propensity to support its UK subsidiary as extremely high, driven by the large reputational risk it would face from a default of 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.

RATING SENSITIVITIES

IDRS, DCR, AND SENIOR DEBT

The Long-Term IDRs and senior debt ratings of BOI and BOIG are sensitive to changes in the VRs. Fitch expects to upgrade BOI's IDR to one notch above the bank's 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 to protect third-party senior preferred obligations from default in case of failure.

BOI's 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.

The Short-Term IDRs of BOIG and BOI are sensitive to changes in the Long-Term IDRs and to deterioration of funding and liquidity.

VRs

BOIG's and BOI's VRs could be upgraded if the group successfully executes its strategy to improve cost efficiency and profitability and makes further progress in reducing the still high proportion of problem loans to levels more commensurate with higher-rated peers' while reducing capital encumbrance.

BOIG's and BOI's VRs 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 a significant erosion of profitability.

BOIG's ratings would be downgraded if there is 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 the subordinated instruments are primarily sensitive to a change in BOI's and hence BOIG's VR, or to changes in their notching in accordance with our criteria and assumptions on non-performance risk.

SUBSIDIARY AND AFFILIATED COMPANIES
BOI UK's ratings are primarily sensitive to how the UK will leave the EU and how this will affect the UK's economic outlook, particularly given its targeted niche economic segments and borrowers could be more vulnerable to the fallout of a disruptive Brexit. In the event of a disruptive Brexit, we see a heightened probability that we would revise the Outlook to Negative, as the impact on earnings, asset quality, liquidity and funding is likely to be negative.

BOI UK's VR and IDRs are also sensitive to a material increase in exposure to higher-risk segments of the mortgage market and/or commercial real estate through the bank's 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.

Based on institutional support, BOI UK's IDR could only be upgraded if there is at least a two-notch upgrade of BOIG's VR. If BOIG's Long-Term IDR is upgraded to 'BBB+', BOI UK's IDR would remain at 'BBB', in line with the VR.

ESG CONSIDERATIONS
Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the banks under review, either due to their nature or to the way in which they are being managed by the banks.

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'
EUR300 million subordinated notes (XS2065555562): affirmed at 'BBB-'

Bank of Ireland
Long-Term IDR affirmed at 'BBB'; Outlook Positive
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 of 'BBB' maintained on RWN
Short-Term IDR affirmed at 'F3'
Viability Rating affirmed at 'bbb'
Support Rating affirmed at '2'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'

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Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

SOLICITATION STATUS

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