FitchRatings

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Fitch Revises Bank of Ireland Group's Outlook to Stable; Affirms Ratings

Fitch Ratings - Milan - 04 Oct 2021: Fitch Ratings has revised Bank of Ireland Group plc's (BOIG) Outlook to Stable from Negative and affirmed the bank's 'BBB' Long-Term Issuer Default Rating (IDR) and 'bbb' Viability Rating (VR).

The agency has also affirmed the ratings of BOIG's operating subsidiaries, Bank of Ireland (BOI) and Bank of Ireland (UK) plc (BOI UK), and revised the Outlooks on their Long-Term IDRs to Stable from Negative. A full list of rating actions is below.

The Outlook change reflects our view that the pandemic-related risks have largely receded and that the Irish economy will continue to perform strongly after a robust rebound in the year to date, which should continue to support the bank's performance.

Fitch expects robust economic activity to continue in Ireland, with 14% GDP growth forecast for 2021 after an exceptionally strong first quarter (10.7% yoy), before moderating to a still very strong level in 2022 and 2023. Fitch forecasts modified domestic demand, which excludes the GDP-inflating effects of multinational companies and better reflects the country's actual level of economic activity, to continue to recover as pandemic-related risks recede and confidence continues to improve in 2022. This should be supported by the unwinding of domestic savings accumulated during the pandemic and the recovery of the worst-hit sectors, due to large fiscal support available since 2Q20.

Key Rating Drivers

VRs

Fitch assesses BOIG, which is the group's holding company, on a consolidated basis. Its VR is aligned with that of its main operating subsidiary, BOI, to reflect the absence of material double leverage at the holding company and the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements.

BOI's and BOIG's VRs are driven by the group's diversified business model; a strong retail and corporate-banking franchise primarily focused on the small Irish market; sound regulatory capitalisation with comfortable buffers above minimum regulatory requirements; and a stable funding and liquidity profile. The VRs also consider the group's weaker asset quality than international peers', driven predominantly by impaired loans underwritten before the global financial crisis.

BOIG has been reducing its stock of impaired loans over recent years through workout and portfolio sales. Its asset-quality metrics before the pandemic were better than domestic peers', in part due to a larger proportion of performing UK mortgages and better-performing Irish mortgage book. BOIG's Stage 3 loans ratio decreased to 5.4% at end-1H21 from 5.6% at end-2020, while the Stage 2 loans ratio increased to 22.5% at end-1H21 loans from 20.1% at end-2020, mainly due to pandemic-driven management adjustments.

At end-1H21 99.5% of payment breaks granted at the beginning of the pandemic have expired, and the majority of payment breaks have now reverted to normal payment patterns. The remaining 0.5% payment breaks at end-1H21 primarily related to UK loans, all of which have now expired. Of the expired payment breaks across BOIG, about 5% are subject to further forbearance measures. Management has continued to be successful in managing legacy non-performing exposures (NPEs) with a EUR300 million sale in 1H21, where the bank has in place a long running and comprehensive framework for dealing with NPEs.

We have revised our outlook on BOIG's earnings and probability to stable from negative, to reflect our view that the earnings impact from the pandemic has moderated. Loan impairment charges are no longer denting profits and the bank is on track with its cost-reduction strategy. BOIG reported a strong net income of EUR341 million in 1H21, against a EUR725 million loss in 1H20 that was driven by large and mostly pandemic-driven impairment charges of EUR937 million. A negligible impairment charge of EUR1 million booked in 1H21 reflects the bank's much improved economic forecasts and smaller actual loan losses than expected.

BOIG's profitability is supported by a diversified business model and a leading market position in Ireland, which should benefit from the acquisitions (announced in 2021) of Davy's stockbrokers and KBC Ireland's performing loans and deposits, pending regulatory approval. The acquisition of Davy's will also support BOIG's diversification toward non-interest revenue, which is already a strength relative to domestic peers', due to BOIG's wealth-management and insurance activities.

The group's regulatory capital and leverage ratios remain sound. Its transitional common equity Tier 1 (CET1) ratio of 15.3% at end-1H21 (14.1% fully-loaded) was 550bp above the minimum regulatory requirement (excluding P2G). BOIG's leverage ratio of 6.5% comfortably exceeds the regulatory minimum of 3%. At 28% of CET1 capital at end-1H21, capital encumbrance by unreserved impaired loans is fairly high compared with peers'. The Davy's and KBC acquisitions will be financed by internal capital resources.

Funding is a key rating strength, as the group benefits 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. In addition, the group has proven and diversified access to secured and unsecured wholesale markets.

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 177% at end-1H21, comfortably above minimum regulatory requirements.

As the group reduces the balance sheet of its UK subsidiary in line with its plan and expands its Irish loan book through the announced acquisitions, our assessment of the Irish operating environment might become more relevant for the overall VR.

IDRS, DERIVATIVE COUNTERPARTY RATINGS (DCR) AND SENIOR DEBT

BOIG's Long-Term IDR and long-term senior debt rating are in line with the group's VR.

BOI's Long-Term IDR, DCR and long-term senior debt rating are one notch above the bank's VR to reflect the protection of BOI's senior third-party creditors by resolution funds ultimately raised by BOIG, down-streamed to BOI and designed to protect the operating company's external senior creditors in a group failure. The buffers of junior and down-streamed holding-company senior debt are built to comply with minimum requirement for own funds and eligible liabilities (MREL).

BOIG's Short-Term IDR and short-term senior debt ratings are the higher of two options corresponding to the group's Long-Term IDR and long-term senior debt ratings of 'BBB'. BOI's Short-Term IDR and short-term senior debt ratings are the lower of two options corresponding to the bank's Long-Term IDR and long-term senior debt ratings of 'BBB+'. This is based on our assessment of the group's funding and liquidity, which, at 'bbb+', warrants 'F2' short-term ratings.

BOI's DCR is aligned with the bank's Long-Term IDR because under Irish legislation, derivative counterparties have no preferential status over other senior obligations in a resolution.

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 and the Single Resolution Mechanism 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 rating of BOIG's and BOI's subordinated Tier 2 debt is notched down twice from the respective VRs. This reflects the notes' poor recovery prospects arising from their subordinated status in a resolution. We do not notch for non-performance risk because the terms of the notes do not provide for loss absorption on a going-concern basis.

BOIG's additional Tier 1 notes are rated four notches below the group's VR. This reflects poor recovery prospects arising from their subordinated status (two notches) as well as incremental non-performance risk relative to the VR (two notches), given fully discretionary coupon payments and mandatory coupon restriction features.

SUBSIDIARY - BOI UK

The IDRs of BOI's fully-owned UK subsidiary, BOI UK, are equalised with BOI's. Our support assessment of BOI UK's and SR of '2' reflects our view that the probability of support from BOI is high. This is underpinned by a record of unquestioned support from the parent, strong integration into the group, high fungibility of capital and funding between BOI UK and the group, and the high reputational risk the group would face in case of BOI UK's default. The IDRs also reflect the protection of its third-party senior liabilities provided by the group's buffers of junior and senior debt.

BOI UK's VR reflects the subsidiary's acceptable asset quality and profitability, and sound capital ratios. The VR is somewhat constrained by the bank's modest franchise in the UK and fairly undiversified business model, which is concentrated on UK mortgage lending. Following a strategic review, the UK operations are expected to shrink and focus more on bespoke mortgage lending, motor finance, consumer lending, and travel money. Its business model will remain reliant on third-party partnerships, the largest of which is with the Post Office, which accounts for the majority of the bank's customer deposit funding.

Asset quality is acceptable by UK standards, with a stage 3 loans ratio of 2.5% at end-2020. We have revised the outlook on asset quality to stable from negative as we expect any deterioration to be manageable. Residential mortgage loans make up over three-quarters of BOI UK's loans and include an above-average exposure to sectors that we view as more vulnerable in an economic downturn, such as buy-to-let. At end-1H21, 1% of total loans was still subject to payment breaks, and another 2% to forbearance measures. We expect underwriting standards to remain sound and within the bank's current risk appetite, with BOI UK continuing to focus on prime borrowers.

BOI UK is seeking to improve its profitability by focusing on higher-margin lending and downsizing businesses with lower returns, such as vanilla mortgage loans. We have revised the outlook on earnings and profitability to stable from negative. This reflects our expectation that loan impairment charges will decrease and revenue will strengthen toward pre-pandemic levels (particularly in the most affected motor finance and travel money segments), as immediate risk from the pandemic has significantly reduced over the last quarters. Further cost optimisation including a reduction in branches, higher margins and a smaller balance sheet should also support profitability.

Customer deposit funding is predominately sourced through retail deposits via the Post Office, although customer balances have decreased 8% in 1H21, as the bank is reducing its more expensive funding. Wholesale funding is limited and sourced predominantly from the parent. On-balance sheet liquidity is sound and is supported by access to contingent liquidity from the Bank of England.

Capitalisation is sound, supported by continued reductions in the bank's legacy commercial property loans and acceptable profitability. BOI UK has been upstreaming excess capital to its parent, but we expect it to maintain adequate buffers over minimum regulatory requirements.

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

Factors that could, individually or collectively, lead to positive rating action/upgrade:

IDRS, DCRs AND SENIOR DEBT

The IDRs, senior debt ratings and DCR of BOI and BOIG would be upgraded if their respective VRs are upgraded and if the resolution buffer continues to provide BOI's senior creditors and derivative counterparties with additional protection.

VRs

The VRs could be upgraded if the group successfully executes its strategy to improve cost efficiency and profitability, resulting in a clear path toward generating an operating profit/risk-weighted assets (RWAs) of above 2%, reducing impaired loans to about 3% of gross loans, and significantly reducing capital encumbrance.

SR and SRF

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.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

IDRs, DCRs AND SENIOR DEBT

BOI'a and BOIG's IDRs, senior debt ratings and DCR could be downgraded if the VRs are downgraded, or if we no longer estimate that the resolution debt buffer provides BOI's senior creditors and derivative counterparties with additional protection.

BOIG's Short-Term IDR and short-term senior debt rating are also sensitive to a negative reassessment of the group's funding and liquidity.

VRs

The ratings would likely be downgraded if, as opposed to our baseline scenario, a deterioration of economic performance and the operating environment for banks in Ireland increases the group's impaired loan ratio towards 10%, if the bank is unable to reduce its stock of impaired loan fairly quickly or if encumbrance by impaired loans increases significantly without prospects of recovering within a reasonable timeframe. The VRs would also be downgraded if the group's CET1 ratio falls below 13%, following losses or RWA increases without prospects for sufficient internal capital generation.

BOIG's VR would also be downgraded if the holding company's double leverage durably increases to above 120%, which we do not expect.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings of all subordinated instruments are primarily sensitive to a change in the VRs, or to changes in their notching should Fitch change its assessment of loss severity or relative non-performance risk.

SUBSIDIARY - BOI UK

BOI UK's IDRs are sensitive to the same factors that might drive a change in BOI's IDRs. We could also downgrade BOI UK's IDRs and SR if the subsidiary's strategic importance diminishes, resulting in weaker integration within the group and support propensity, in our view. This could, for example, be signalled by group resources no longer being made available to fulfil the subsidiary's internal MREL and thus reducing the protection of third-party senior creditors.

BOI UK's VR would likely be downgraded if the bank's financial profile deteriorates due to a material weakening of asset quality and earnings, for example, if the operating environment worsens or increased competition in the mortgage market or in its other chosen business segments prevents the bank from executing its strategy of higher returns.

BOI UK's VR may also be downgraded if the bank's strategy to target under-served and niche market segments results in increased risk appetite and credit risk.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

The ratings of BOI UK are directly linked to BOI's.

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 entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Bank of Ireland	LT IDR	BBB	Affirmed		BBB

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Group Public Limited Company					
	ST IDR	F2	Affirmed		F2
	Viability	bbb	Affirmed		bbb
	Support	5	Affirmed		5
	Support Floor	NF	Affirmed		NF
• subordinated	LT	BB+	Affirmed		BB+
• senior unsecured	LT	BBB	Affirmed		BBB
• subordinated	LT	BB-	Affirmed		BB-
• senior unsecured	LT	BBB	Affirmed		
Bank of Ireland	LT IDR	BBB+	Affirmed		BBB+
	ST IDR	F2	Affirmed		F2
	Viability	bbb	Affirmed		bbb
	Support	5	Affirmed		5

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Support Floor	NF	Affirmed		NF
	DCR	BBB+(dcr)	Affirmed		BBB+(dcr)
• subordinated	LT	BB+	Affirmed		BB+
• senior unsecured	LT	BBB+	Affirmed		BBB+
• senior unsecured	ST	F2	Affirmed		F2
Bank of Ireland (UK) Plc	LT IDR	BBB+	Affirmed		BBB+
	ST IDR	F2	Affirmed		F2
	Viability	bbb	Affirmed		bbb
	Support	2	Affirmed		2
	DCR	BBB+(dcr)	Affirmed		BBB+(dcr)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Bank of Ireland	EU Issued, UK Endorsed
Bank of Ireland (UK) Plc	UK Issued, EU Endorsed
Bank of Ireland Group Public Limited Company	EU Issued, UK Endorsed

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