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Bank of Ireland

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Bank of Ireland

SACP	bbb-	+	Support	+1	+	Additional Factors	-1

Anchor	bbb-	
Business Position	Strong	+1
Capital and Earnings	Moderate	-1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

GRE Support	0
Group Support	0
Sovereign Support	+1

Issuer Credit Rating
BBB-/Positive/A-3

Major Rating Factors

Strengths:	Weaknesses:
• Stable franchise in Ireland, with a high market share across business lines, and better international business diversity than Irish peers. • Better relative asset quality performance than Irish peers, which we expect to remain the case. • Stable deposit base characterized by very low concentration risks and a relatively low proportion of corporate deposits.	• Muted growth in loan balances, which hinders future pre-provision earnings prospects. • Still-high stock of non-performing assets despite declining trend.

Outlook: Positive

The positive outlook indicates that we may raise the ratings on Bank of Ireland (BOI) over the next one-to-two years if we expect that capitalization, as indicated by Standard & Poor's-adjusted return on capital (RAC) ratio, will comfortably and sustainably exceed 7%. This could, for example, result from an improvement in our view of the macroeconomic risks that BOI faces, which in turn would lower the risk weights that we apply to its exposures.

We may also upgrade BOI if we include a notch of support for additional loss-absorbing capacity. We would do this if we deem the resolution regime in Ireland to be effective, and if we expect BOI's subordinated buffers to meet the required threshold over a two-year horizon, or potentially longer. Although less likely, we could also raise the rating if we consider that potential extraordinary government support for BOI's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability.

We could revise the outlook to stable if we perceive that BOI's dividend policy, its longer-term growth in Standard & Poor's-adjusted risk-weighted assets (RWAs), and its risk appetite, do not warrant an upward revision of the bank's group credit profile (GCP).

Rationale

We base our ratings on BOI on the bank's "strong" business position, as defined by our criteria, due to its relative business stability in Ireland and its reasonably diversified revenue profile. We view capital and earnings as "moderate," as we expect the bank's RAC ratio to be in the the 7.0%-7.5% range by end-2016. Our assessment of the bank's risk position is "adequate," because we think that its risks are reasonably captured by the standard assumptions in our capital assessment. We view funding as "average" and liquidity as "adequate," noting that BOI has led the way among Irish banks in terms of re-establishing wholesale funding access, including senior unsecured issuance.

We assess BOI's GCP (its intrinsic creditworthiness) as 'bbb-'.

Anchor: 'bbb-'

The 'bbb-' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the weighted-average economic risk in the countries in which BOI operates, based on the geographic distribution of its customer loan exposures, which is about: Ireland (50%) and U.K. (45%), and rest of the world (5%). The weighted-average economic risk score for these territories is '5' on a scale of 1-10 (where '1' is the lowest risk and '10' is the highest). This contrasts to an economic risk score of '6' for a bank operating only in Ireland. We note the ongoing downsizing of BOI's business and corporate banking franchises in Great Britain that resulted from the finalization of its EU restructuring plan in 2013. We also note that a meaningful part of its U.K. exposure relates to Northern Ireland where we consider that economic risks are typically higher than the U.K. average.

We continue to view economic risks in Ireland as high, albeit improving. We are now seeing clearer evidence that the Irish economy is recovering from its deep contraction and that property prices are rising. Furthermore, the private sector has substantially reduced its debt. We expect domestic system-wide credit losses to remain low on the back of provision releases and declining inflows into new arrears. However, the stock of nonperforming assets is high relative to higher-ranked banking systems, and we expect the workout of these assets to take a while. This factor continues to weigh on our view of economic risk. Ireland's banking industry risk has fallen, but remains high relative to many peers. Pre-provision profitability for Irish banks has improved on the back of expanding net interest margins, and we view the post-crisis structure of the industry as stable, with relatively few domestically-focused players. That said, Ireland's weak regulatory track record, government ownership of much of the banking sector, and relatively shallow domestic debt capital markets, continue to be constraining factors.

Table 1

Bank of Ireland Key Figures					
		--Year-ended Dec. 31--			
(Mil. €)	**2015***	**2014**	**2013**	**2012**	**2011**
Adjusted assets	118,747	117,862	121,457	138,315	145,573
Customer loans (gross)	92,371	89,541	92,755	100,165	108,102
Adjusted common equity	5,699	4,797	4,079	4,413	7,070
Operating revenues	1,795	3,079	2,700	1,936	2,106
Noninterest expenses	860	1,658	1,581	1,608	1,644
Core earnings	660.1	669.8	(751.0)	(1,385.2)	(1,341.7)

*Data as of June 30.

Business position: Leading market position in Ireland

We assess BOI's business position as "strong." The bank returned to statutory profitability in 2014, in part because, in our view, it was better placed than other Irish banks to adjust its deposit pricing and generate new lending. We also believe that its U.K. business includes a useful source of customer deposits and allows for long-term growth potential. BOI's U.K. footprint adds an important element of geographic diversity relative to Irish peers, in our view.

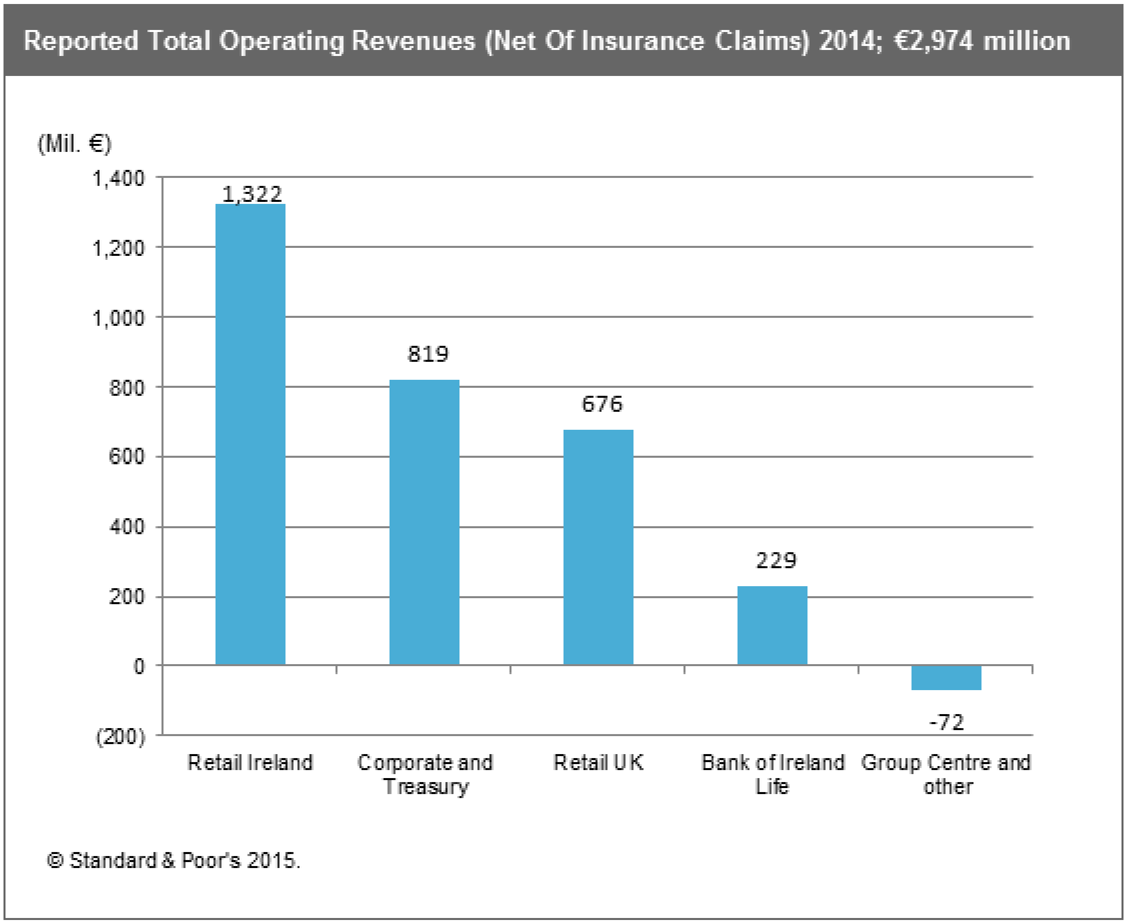
BOI's main rated peers active in the Irish banking industry include Allied Irish Banks PLC (AIB) and Permanent TSB PLC (PTSB), together referred to as "domestic peers". The broader "Irish peer" group includes foreign-owned banks KBC Bank Ireland PLC and Ulster Bank Ltd..

BOI has resilient franchises and high market shares across all retail and commercial banking lines in Ireland. We also note that the Irish government owns about 14% of BOI's ordinary shares, compared with over 99% at AIB and 75% at PTSB.

We consider that BOI's domestic franchise has been enhanced by the significant shake-up of the Irish banking system over the past few years, which has resulted in fewer market participants, including the withdrawal of some overseas lenders. In particular, the number of alternative personal current account and small business lending providers has diminished, enabling BOI to at least maintain its strong market shares.

BOI's business activity is well diversified by business line, and we expect this to remain the case (see chart 1).

Chart 1



In our opinion, what differentiates BOI from its Irish peers is its meaningful U.K. franchise. While we consider this franchise to be weaker than most rated U.K. banks, it includes a long-term joint venture with the U.K. Post Office, which gives BOI the potential for long-term growth. In July, 2015, BOI announced another long-term (minimum 10-year) partnership with U.K. breakdown cover organisation AA PLC. The partnership's proposition is to meet the financial product needs of AA's nearly four million members, for example, through AA-branded credit cards.

We recognize that BOI's management, which was more stable than most Irish peers throughout the Irish banking crisis, has delivered on its aim to return the bank to profitability. That said, reported net loans on June 30, 2015, were €85.2 billion, which is below management's strategic target of €90 billion, on which its current cost base is predicated. Moreover, in the near term, we expect credit demand in Ireland across retail and business segments to remain muted, despite the economic recovery.

Capital and earnings: Retained earnings and issuance spur rapid improvements in core capitalization

We view BOI's capital and earnings as "moderate." A combination of improved retained earnings and a continued reduction in RWAs has led to a significant improvement in capitalization over the course of 2014 and the first half of 2015. Capitalization, as measured by our RAC ratio, stood at 4.9% at end-December 2014, a material increase from around 3.9% (on a constant risk weight basis) at end-2013. BOI's reported Basel III fully loaded common equity tier 1

(CET1) ratio (excluding 2009 government preference shares) increased to 9.3% from 6.3% over the same period. It further increased to 11.1% on June 30, 2015.

One of the main reasons for the large gap between the regulatory CET1 ratio and our capital analysis is that within our calculation of RWAs, we apply more conservative risk weightings to reflect our view of Ireland's economic risk. We also apply a 1,250% risk weight to BOI's equity participation in its insurance subsidiary.

BOI successfully issued €750 million additional tier 1 (AT1) securities in June, 2015. In accordance with our criteria, these securities are eligible for "intermediate" equity content in total adjusted capital, the numerator of the RAC ratio. As a result of both the AT1 issuance and our view that the Irish macroeconomic recovery will continue to support steady internal capital generation, we now expect that the bank's RAC ratio will increase to around 6.5% by end-2015 and to 7.0%-7.5% by end-2016.

Our RAC forecast assumes:

- Ongoing contraction of BOI's loan book in 2015 as redemptions and asset sales outpace new lending and asset purchases(albeit at a slower rate). We also assume modest net loan growth in 2016. Standard & Poor's RWAs broadly follow the same trend.
- Higher revenues owing to substantial increases in the net interest margin (NIM) over the past two years, primarily due to the lower cost of deposits and declining eligible liabilities guarantee fees. Nevertheless, we expect only modest increases in the NIM over the forecast horizon, as deposit re-pricing has substantially run its course, and in our view some asset margin pressure is beginning to arise.
- A continued improvement in underlying asset quality, although we may not see the same extent of provision releases as in 2014.

The 2014 full-year results highlighted to us that BOI should remain profitable. BOI reported a statutory profit before tax (PBT) for the period of €920 million, which was its first period of solid earnings since the 2008 financial crisis. In particular, BOI reported that its NIM (before eligible liabilities guarantee fees, which now have a minor negative effect on revenues) improved to 2.11% in 2014, from 1.84% in 2013. This mainly reflected a combination of wider asset spreads, lower retail deposit costs, and reduced other funding costs. Growth in noninterest income was more modest. We expect future revenue growth to be primarily dependent on business growth, particularly from BOI's U.K. subsidiary, because we believe that most of the drivers behind the recovery in NIMs have now played out. BOI's recovery in pre-provision profitability as a proportion of assets has outpaced that of its Irish peers (see chart 2).

The other main driver behind BOI's earnings recovery has been a sharp fall in loan impairment charges. In 2014, reported charges were €472 million, down from €1.7 billion in 2013. In part, this reflected the benefit of a €70 million write-back for Ireland's National Asset Management Agency's (NAMA) subordinated bonds. Nevertheless, BOI reported lower impairment charges across all of its loan portfolios, and the Irish mortgage portfolio benefited from a €140 million provision release. This was because the property price recovery enabled BOI to adjust its peak-to-trough assumption in Irish house prices in its collective provisioning models.

Results for the half year to June 30, 2015, indicated a continuation of favorable operating trends. Statutory PBT was €725 million, compared to €399 million in the same period in 2014. The reported NIM improved modestly to 2.21%, and the loan impairment charge came in at €168 million, versus €444 million in the first half of 2014.

Chart 2

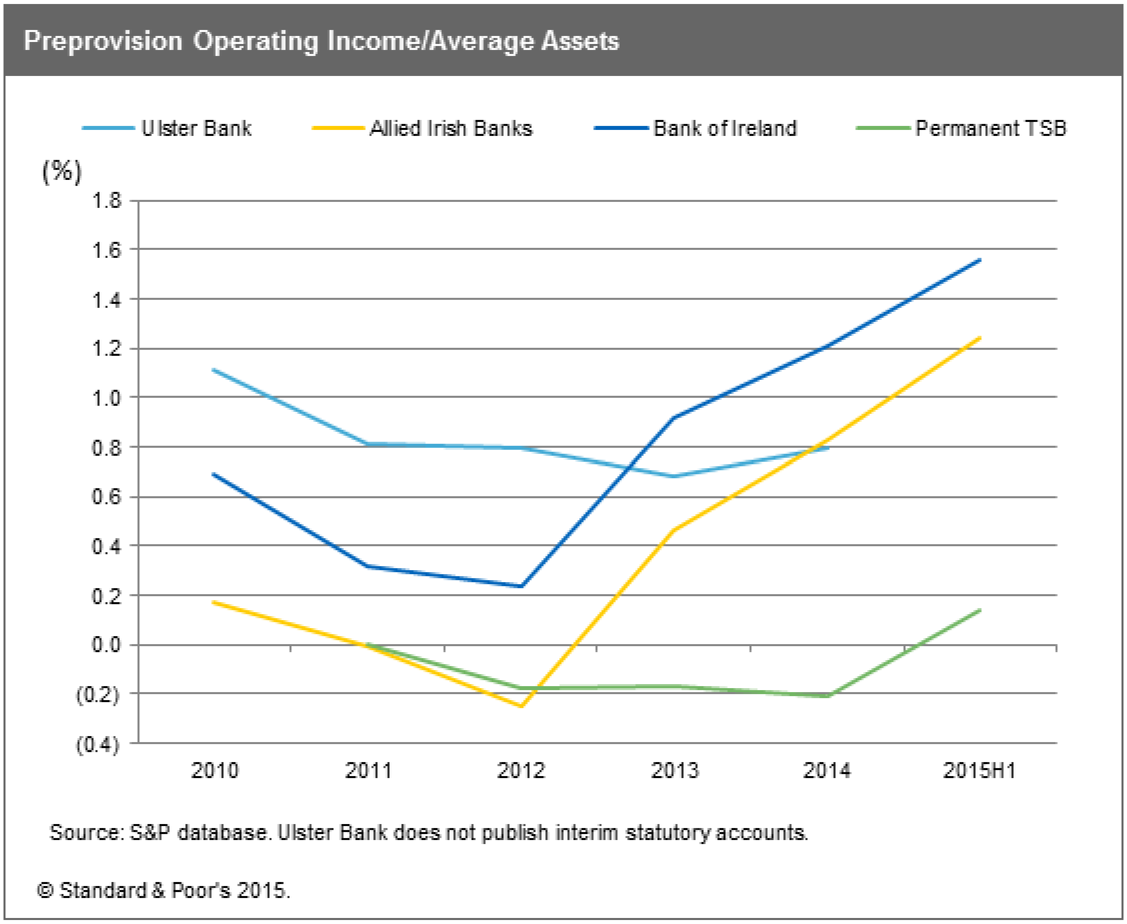


Table 2

Bank of Ireland Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2015***	**2014**	**2013**	**2012**	**2011**
Tier 1 capital ratio	17.4	14.9	12.3	14.5	14.4
S&P RAC ratio before diversification	N.M.	4.9	3.6	3.7	N.M.
S&P RAC ratio after diversification	N.M.	5.0	3.7	3.8	N.M.
Adjusted common equity/total adjusted capital	87.8	98.9	98.7	98.7	99.2
Net interest income/operating revenues	67.6	75.4	74.2	70.1	72.8
Fee income/operating revenues	9.3	11.2	11.1	15.5	19.9
Market-sensitive income/operating revenues	4.8	(1.0)	6.1	1.2	(1.7)
Noninterest expenses/operating revenues	47.9	53.8	58.6	83.1	78.1
Preprovision operating income/average assets	1.4	1.1	0.8	0.2	0.3
Core earnings/average managed assets	1.0	0.5	(0.5)	(0.9)	(0.8)

*Data as of June 30. N.M.--Not meaningful. RAC--Risk-adjusted capital.

Table 3

Bank of Ireland RACF [Risk-Adjusted Capital Framework] Data

(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	19,083	25	0	1,468	8
Institutions	6,067	1,188	20	1,530	25
Corporate	32,934	25,100	76	41,058	125
Retail	56,207	14,850	26	34,013	61
Of which mortgage	50,206	11,425	23	26,912	54
Securitization§	401	275	69	1,467	366
Other assets	1,842	2,188	119	3,102	168
Total credit risk	116,534	43,625	37	82,638	71
Market risk					
Equity in the banking book†	233	0	0	2,913	1,250
Trading book market risk	--	513	--	769	--
Total market risk	--	513	--	3,681	--
Insurance risk					
Total insurance risk	--	--	--	7,038	--
Operational risk					
Total operational risk	--	4,038	--	5,196	--
		Basel III RWA		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		51,600		98,553	100
Total Diversification/Concentration Adjustments		--		(1,647)	(2)
RWA after diversification		51,600		96,906	98
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		6,136	11.9	4,849	4.9
Capital ratio after adjustments‡		6,136	11.9	4,849	5.0

*Exposure at default. §Securitization Exposure includes the securitzation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2014, Standard & Poor's.

Risk position: Reducing credit risk

Our assessment of BOI's risk position is "adequate," viewed in the context of peers with a similar economic risk and product mix, including Portuguese, Spanish as well as Irish banks. We take into account BOI's more favorable overall loss experience than some of its Irish peers, because it generally avoided the worst excesses of commercial property and other lending. Net nonperforming assets (net of provisions) by our calculations remain high at over 8%, but compare favorably with those of peers (see chart 3).

Like its Irish peers, BOI has materially reduced its balance sheet in recent years, and like AIB, it has benefited from being able to transfer a meaningful portion--€10 billion--of some of the worst parts of its loan book to NAMA in 2009-2011. Reported gross customer loans have fallen by about one-third since 2010, to €89.5 billion on Dec. 31, 2014. This increased to €92.4 billion on June 30, 2015, mainly because of the depreciation of the euro against pound sterling. Within the total loan portfolio, the proportion of property and construction loans is 16%.

Over the five years to 2014, we calculate that BOI's average ratio of new loan loss provisions to average loans was about 1.8%, which compares to over 3.3% across the Irish peer group.

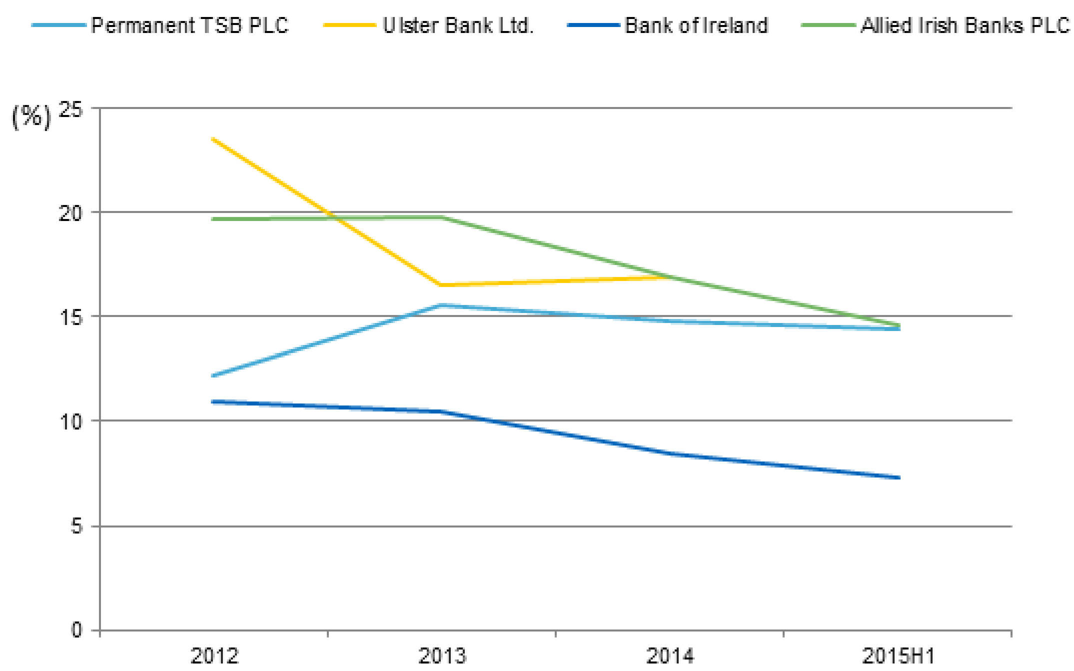
BOI states that its stock of nonperforming loans is steadily declining. Nonperforming loans by our measures (defined as impaired loans plus loans over 90 days due, but not impaired) were €13.3 billion on June 30, 2015, down from a peak of €18.3 billion on June 30, 2013. We assume that this declining trend will continue, albeit slowly.

Residential mortgages account for a fairly high 61% of BOI's net loan book, with a slight bias toward U.K. mortgages (see chart 4). While the profile of BOI's domestic mortgage book is broadly in line with the industry--for example, BOI reports that 29% of this book was in negative equity on June 30, 2015--its arrears and forbearance rates are better than the industry average. Its vintage profile is a little better too. BOI reported that 11.1% of its Irish mortgage book was nonperforming on June 30, 2015. While a very weak performance, this is better than BOI's Irish peers. Reported provision coverage of such loans was 48% on June 30, 2015.

In contrast, BOI appears to be maintaining the asset quality of its large U.K. mortgage book. The bank states that on June 30, 2015, 1.8% of its U.K. mortgages were nonperforming, which is broadly in line with the U.K. industry average. Provision coverage is also in line with what we typically observe for this asset class, at 24%.

Chart 3

Net NPL Ratio Trend For Three Years (%)



Source: S&P database. Ulster Bank does not publish interim statutory accounts.

Chart 4

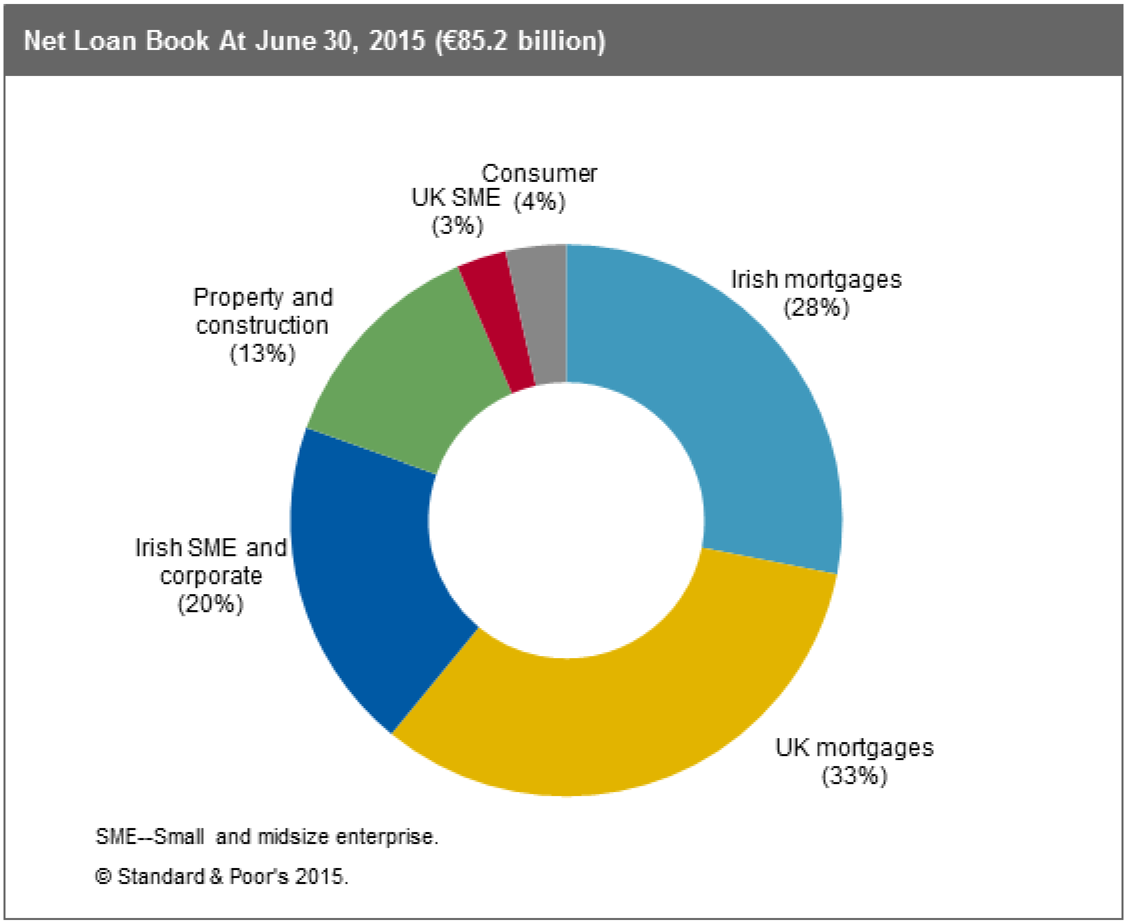


Table 4

Bank of Ireland Risk Position					
	--Year-ended Dec. 31--				
(%)	**2015***	**2014**	**2013**	**2012**	**2011**
Growth in customer loans	6.3	(3.5)	(7.4)	(7.3)	(10.1)
Total diversification adjustment / S&P RWA before diversification	N.M.	N.M.	(3.0)	(3.6)	N.M.
Total managed assets/adjusted common equity (x)	23.1	27.1	32.4	33.6	21.9
New loan loss provisions/average customer loans	0.37	0.52	1.73	1.70	1.73
Net charge-offs/average customer loans	1.5	1.8	1.1	0.7	0.5
Gross nonperforming assets/customer loans + other real estate owned	14.4	16.0	18.5	17.7	14.3
Loan loss reserves/gross nonperforming assets	53.4	51.8	48.1	42.6	41.2

*Data as of June 30. N.M.--Not meaningful. RWA--Risk-weighted asset.

Funding and liquidity: Trends remain favorable

We regard BOI's funding as "average" and its liquidity as "adequate." We believe that BOI has made good progress in recent years to better align its funding and liquidity profiles and that it has led the way among Irish banks in terms of re-establishing wholesale funding access, including senior unsecured issuance and deposit repricing. We therefore expect greater stability in funding and liquidity metrics in the future.

BOI's reported loan-to-deposit ratio was 108% on June 30, 2015. This represents a significant improvement from 175% reported on Dec. 31, 2010. Customer deposits are stable and we therefore expect little change in BOI's loan deposit ratio over the next two years. Customer deposits are largely sourced from retail customers, and are granular in nature. We also note that near-term senior unsecured debt maturities are small. U.K. Post Office balances, which are newer, are about 21% of the total customer deposit base. Overall, BOI's funding profile compares well with the domestic industry average, but in our view is not materially superior. Our assessment of BOI's stable funding metric of 100% on Dec. 31, 2014, supports this view.

Borrowings from monetary authorities continue to fall. All of these borrowings are under the targeted long-term refinancing operation (TLTRO), which we treat as short term in our calculations. BOI reported that such funding was €1.5 billion as of June 30, 2015, down from €4 billion on Dec. 31, 2014. Otherwise, short-term wholesale funding requirements appear modest and reported liquid assets are stable. Our metric of broad liquid assets to short-term wholesale funding was 1.9x as of Dec. 31, 2014, although this measure is slightly overstated due to asset encumbrance. We expect this metric to remain comfortably over 1x.

Table 5

Bank of Ireland Funding And Liquidity

	--Year-ended Dec. 31--			
(%)	**2014**	**2013**	**2012**	**2011**
Core deposits/funding base	76.4	71.2	63.8	57.5
Customer loans (net)/customer deposits	110.6	115.2	124.9	144.3
Long term funding ratio	89.4	85.3	79.0	76.8
Stable funding ratio	99.7	97.4	93.1	88.6
Short-term wholesale funding/funding base	11.4	15.6	22.2	24.7
Broad liquid assets/short-term wholesale funding (x)	1.9	1.4	1.1	0.9
Net broad liquid assets/short-term customer deposits	15.2	10.1	4.8	(4.9)
Short-term wholesale funding/total wholesale funding	48.2	54.2	61.3	58.1
Narrow liquid assets/3-month wholesale funding (x)	3.9	2.2	1.4	0.9

External support and additional factors

Although we consider BOI to have high systemic importance in Ireland and the Irish government to be "supportive" of the banking system, we observe that European authorities are taking steps to increase the resolvability of banks and require creditors rather than taxpayers to bear the burden of the costs of failure. The EU's Bank Recovery and Resolution Directive was transposed into national law in Ireland on July 15, 2015. Importantly, mandatory bail-in powers of a minimum amount of eligible liabilities will become effective on Jan. 1, 2016, as required by the directive.

Therefore, in our view, the likelihood of extraordinary government support available to the senior unsecured bondholders will probably diminish by end-2015. We therefore incorporate a negative adjustment in the rating, thereby eliminating the uplift for extraordinary sovereign support.

Related Criteria And Research

Related criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related research

- Various Rating Actions Taken On Irish Banks Due To Improving Industry Profitability, July 20, 2015
- Ireland Long-Term Rating Raised To 'A+' On Government Debt Reduction; Outlook Stable, June 5, 2015

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	**5**	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	**bbb-**	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of September 14, 2015)	
Bank of Ireland	
Counterparty Credit Rating	BBB-/Positive/A-3
Certificate Of Deposit	BBB-/A-3
Commercial Paper	
Local Currency	A-3
Junior Subordinated	B+
Preference Stock	B+
Senior Unsecured	A-3
Senior Unsecured	BBB-
Subordinated	BB

Ratings Detail (As Of September 14, 2015) (cont.)	
Counterparty Credit Ratings History	
20-Jul-2015	BBB-/Positive/A-3
09-Dec-2014	BB+/Positive/B
29-Apr-2014	BB+/Negative/B
16-Jul-2013	BB+/Stable/B
20-Jan-2012	BB+/Negative/B
08-Dec-2011	BB+/Watch Neg/B
11-Jul-2011	BB+/Negative/B
02-Feb-2011	BB+/Watch Neg/B
26-Nov-2010	BBB+/Watch Neg/A-2
14-Sep-2010	A-/Negative/A-2
Sovereign Rating	
Ireland (Republic of)	A+/Stable/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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