Moody's
INVESTORS SERVICE

Credit Opinion: Bank of Ireland

Global Credit Research - 22 Jun 2015

Dublin, Ireland

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Issuer Rating	Baa2
Senior Unsecured	Baa2
Subordinate	Ba3
Jr Subordinate	B1
Pref. Stock -Dom Curr	B2
Pref. Stock Non-cumulative	B3
Commercial Paper	P-2
Other Short Term	(P)P-2
Bank of Ireland (UK) Plc	
Outlook	Stable
Bank Deposits	Ba2/NP
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Bank of Ireland UK Holdings Plc	
BACKED Pref. Stock -Dom Curr	B3
Avondale Securities SA	
Outlook	Stable
Senior Secured -Dom Curr	Baa3

Contacts

Analyst	**Phone**
Carlos Suarez Duarte/London	44.20.7772.5454
Dany Castiglione/London	
Nicholas Hill/Paris	33.1.53.30.10.20
Maija Sankauskaite/London	44.20.7772.5454

Key Indicators

BANK OF IRELAND (Consolidated Financials)[1]

	[2]**12-14**	[2]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (EUR million)	**125,540.0**	**128,215.0**	**141,854.0**	**154,880.0**	**167,473.0**	[4]**-7.0**
Total Assets (USD million)	**151,910.1**	**176,672.8**	**187,019.1**	**201,056.7**	**224,672.3**	[4]**-9.3**
Tangible Common Equity (EUR million)	**6,243.3**	**5,546.9**	**5,897.2**	**8,750.4**	**5,064.1**	[4]**5.4**
Tangible Common Equity (USD million)	**7,554.7**	**7,643.4**	**7,774.8**	**11,359.3**	**6,793.7**	[4]**2.7**
Problem Loans / Gross Loans (%)	**15.0**	**17.0**	**16.3**	**12.8**	**9.2**	[5]**14.0**
Tangible Common Equity / Risk Weighted Assets (%)	**11.1**	**8.5**	**8.9**	**11.4**	**6.1**	[6]**9.8**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**98.0**	**114.5**	**121.2**	**89.3**	**109.4**	[5]**106.5**
Net Interest Margin (%)	**1.7**	**1.4**	**0.9**	**0.9**	**1.3**	[5]**1.2**
PPI / Average RWA (%)	**2.2**	**1.8**	**0.1**	**0.3**	**0.4**	[6]**2.0**
Net Income / Tangible Assets (%)	**1.1**	**-0.4**	**-0.8**	**-1.1**	**-2.0**	[5]**-0.6**

Cost / Income Ratio (%)	**57.2**	**58.2**	**97.8**	**86.2**	**88.3**	[5]**77.6**
Market Funds / Tangible Banking Assets (%)	**15.4**	**20.4**	**27.2**	**37.4**	**43.7**	[5]**28.8**
Liquid Banking Assets / Tangible Banking Assets (%)	**20.1**	**19.6**	**21.6**	**18.5**	**14.9**	[5]**18.9**
Gross Loans / Total Deposits (%)	**118.9**	**124.5**	**132.3**	**146.1**	**170.3**	[5]**138.4**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

We assign long-term bank deposit and long-term senior unsecured ratings of Baa2 and short-term deposit and senior debt ratings of Prime-2 to Bank of Ireland (BOI). The ratings are underpinned by (1) the bank's ba2 baseline credit assessment (BCA); (2) the results of our advanced Loss Given Failure (LGF) analysis which leads to a preliminary rating assessment (PRA) for both deposits and senior unsecure debt, two notches above the BCA and; (3) a moderate expectation of systemic support, resulting in a notch of uplift above the PRA for both deposit and senior unsecured debt ratings.

BOI's BCA of ba2 reflects (1) the downside risk arising from the still sizable stock of problem loans, albeit we expect that the favourable operating environment in the UK and Ireland will contribute to further improvements in asset quality ratios; (2) our view that the bank's improving capital and leverage metrics driven by the bank's enhanced ability to generate capital organically will offset the maturity and derecognition of some capital instruments in 2016; (3) our expectation of improving but potentially volatile profitability metrics given the uncertainty about the future size of provision write-backs and the pressure on the bank to reduce its interest rate on mortgages and; (4) the bank's improved funding and liquidity profiles.

BOI'S BCA IS SUPPORTED BY ITS STRONG- MACRO PROFILE

The `Strong-` macro profile of BOI is driven by its exposure to Ireland (Moderate +) and the UK (Very Strong-), wealthy countries with very high institutional strength and low level of susceptibility to event risk. Both economies have returned to growth and shown sustainable recoveries, supporting the financial sector performance. Consumer confidence is gradually being restored driven by positive employment trends, contributing to improvements in banks' credit fundamentals in both jurisdictions.

Negative considerations in both the UK and Ireland operating environments include elevated, although decreasing, private sector indebtedness and credit conditions that are sensitive to interest rates and housing prices.

Funding conditions have materially improved for Irish banks. However, even though the Irish banking industry structure is highly concentrated, the barriers to entry are relatively low compared to other non-European countries.

RATING DRIVERS

- Strong Irish domestic franchise and established position in the UK through its partnership with the Post Office

- Elevated stock of problem loans, albeit asset quality is improving driven by a positive operating environment in Ireland and the UK

- Adequate current capital as evidenced by results from successive regulatory assessments and stress test and enhanced ability to generate capital organically

- Demonstrated market access, reduced reliance on wholesale funding and reduced use of funding facilities from monetary authorities

- Large volume of deposits and senior debt resulting in deposit and senior debt ratings benefiting from a very low LGF, which translates into two notches of uplift from the BCA

- Moderate probability of government support resulting in one-notch uplift from PRA for both senior unsecured debt and deposits

RATING OUTLOOK

The stable outlook on all BoI's ratings reflects improvements in capital and profitability, also stemming from the favourable operating environments in the UK and Ireland. We also expects a reduction in the stock of problem loans from still high levels.

WHAT COULD CHANGE THE RATING - UP

Upward pressure on BOI's BCA could develop from a significant reduction in the stock of problem loans along with positive net lending without material changes in underwriting standards. Other elements that could exert upward pressure on the bank's BCA in the medium term are (1) further improvements in profitability and efficiency; (2) additional improvements in the bank's fully loaded capital and leverage metrics; and (3) maintenance of sound liquidity and funding metrics. A positive change in the bank's BCA would likely affect all ratings. BOI's deposit and senior unsecured ratings could also face positive pressure if the bank issued a significant amount of subordinated debt, further shielding these more senior instruments from loss in the event of the bank's failure.

WHAT COULD CHANGE THE RATING - DOWN

BOI's standalone ratings could be adversely affected by (1) a change in Ireland's positive economic environment, because such developments will likely be followed by a reversal in the bank's improving asset quality trend; (2) an unexpected deterioration in the bank's profitability metrics and; (3) a material deterioration in its liquidity profile or funding position. A downward movement in BOI's BCA would likely result in downgrades to all ratings.

DETAILED RATING CONSIDERATIONS

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

STOCK OF PROBLEM LOANS REMAINS ELEVATED, ALBEIT ASSET-QUALITY IS IMPROVING

BOI's non-performing loan (NPL) metrics have improved - the impaired loan ratio declined to 15% at year-end-2014 compared to 17% year-end 2013 with the total level of impaired loans declining by EUR2.4 billion. The reduction in the amount of impaired loans is mainly driven by improvements in the operating environment in Ireland, which have led to a decline in the overall level of loan arrears in the country. Moreover, following improvements in property prices, the bank is better positioned - in the event of borrower default - to reclaim higher-value collateral, assuming the positive economic conditions are maintained. Despite improvements, the overall level of impaired loan is still elevated at EUR13.4 billion at end-December 2014, exposing the bank to material downside risk.

We consider the results of the European Central Bank's (ECB) Asset Quality Review as positive since no additional adjustments were required to the level of provisions on their retail lending books. Although the aggregate adjustments would still suggest that some additional provisions were required in relation to its corporate portfolio, we believe that the bank have already addressed these. From March 2014 to March 2015, residential property prices in Ireland, increased by 16.8%. Although the improvements continue to be based on a limited number of transactions, supply limitations will likely help to maintain prices as demand recovers and unemployment continues to decline. 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 120% falling to 15% at the end of 2014 from 31% at the end of 2013. We expect these improvements to eventually lead to further provisioning releases.

However, we believe that the bank still faces asset quality challenges in its domestic loan book; 12.6% of mortgage loans in Ireland, including buy-to-let loans, were non-performing as of December 2014. In addition, as of the same date approximately 25.6% of Irish non-property SME was non-performing, while the non-property corporate book recorded an NPL ratio of 5.6%. BOI's buy-to-let portfolio continues to face challenges since loans in arrears by more than 90 days accounted for 27.2% of the loan book at end-December 2014 (27.9% at end-December 2013).

As already evidenced in the improving trend in the bank's performance and the reduced rate of build-up of new NPLs further improvement in the economy should support continued strengthening in BOI's asset quality and profitability metrics. The bank has traditionally reported lower levels of problem loans compared to those of peers reflecting geographic diversification derived from its lending activities in the UK as well as its traditionally conservative underwriting standards. However, the downside risk is still significant given the size of the problem loan portfolio and the volatility of asset prices in Ireland. As a result, asset risk remains as a relative weakness for the BCA with an assigned score of b2. The higher assigned score relative to the macro adjusted problem loan ratio reflects our expectation of further improvements in asset quality over the medium term.

RESULTS FROM SUCCESSIVE REGULATORY ASSESSMENTS AND STRESS TEST INDICATE THAT THE BANK IS SUFFICIENTLY CAPITALISED

BOI's Tangible Common Equity/ RWA ratio was 11.1% at end-December 2014 as per Moody's calculations. Our calculation includes high trigger contingent capital instruments and exclude all preference shares which will be `grandfathered' until the year 2017. However, since these instruments currently provide loss absorption for investors of more senior instruments, we incorporate them in our advanced Loss Given Failure analysis.

We expect the bank's capital ratio to improve driven by the bank's increasing ability to generate capital through profit retention. However, improvements in the medium-term will be partially offset in the calculation of our TCE ratio by the maturity of contingent capital instruments which accounted for 1.8% of the total RWAs at end-June 2014.

BOI's Basel III pro-forma fully loaded CET1 ratio (excluding preference shares) stood at 9.1% at end-March 2015, down from 9.3 at end-December 2014. This ratio is still relatively low compared to other European banks. Despite the decline between December and March due to the adverse impact of the increase in the bank's pension deficit, we note that in 2013, the bank was able to increase this ratio by 300 basis points. This material increase was driven by the bank's improved ability to generate earnings, a reduction in its RWAs and the payment of a one-off dividend from the life assurance subsidiary. The bank's leverage ratio on a Basel III fully loaded basis stood at 4% as of December 2014. The bank's results under the ECB stress test show strong transitional common equity tier 1 (CET1) ratios under both the European Banking Authority's `baseline' (12.43%) and the `adverse' (9.31%) scenarios. We assign a Capital score of baa3 to reflect these factors.

IMPROVEMENTS IN PROFITABILITY DRIVEN BY LOWER IMPAIRMENT CHARGES AND COST OF FUNDING

Given our expectations of lower impairment charges going forward, we expect further improvements in BoI's profitability metrics. Impairment charges on loans and advances declined to EUR542 million in 2014 compared to EUR1.7 billion in 2013. The bank has also reported an increase in its net interest margin (NIM) to 2.11% in 2014 from 1.84% in 2013 driven by lower cost of funding and new lending volumes which helped to offset the negative impact due to the ECB rate cuts in November 2013, June and September 2014.

Potential further NIM expansion will be driven by further improvements in the cost of funding. Also further reductions in the exposure to tracker mortgages on the `back book' (not available to new customers) should allow the bank to increase its net interest income. However, the Minister of Finance, Michael Noonan, has asked banks to reduce the rates being charged on mortgage loans and as a response BOI announced cuts to its fixed mortgage rates available to new and existing customers. Absent any further reduction in the cost of funding for the bank, this could have a negative effect in the group's profitability. In addition, we expect demand for credit and thus growth in business volumes to remain relatively muted despite the efforts of the ECB following the last rate cut to 0.05% in September 2014.

Given our expectations regarding significant improvements in the bank's profitability, the assigned profitability score is significantly higher than the score suggested by historic ratios at ba3.

DEMONSTRATED MARKET ACCESS AND REDUCED USE OF FUNDING FROM MONETARY AUTHORITIES

The bank continues to reduce its loan-to-deposit ratio and its use of wholesale funding, although it still maintains a negative funding gap. Use of wholesale funding reduced to EUR19 billion as of March 2015 (from EUR27 billion at end- 2013). The bank also reduced its use of funding provided by monetary authorities to EUR4.4 billion in 2014 (from EUR8.3 billion in 2013), which includes EUR2.4 billion related to the funding of National Asset Management Agency (NAMA) bonds. Customer deposits increased to EUR75 billion as of December 2014 from EUR74 billion as of December 2013. Although BoI's loan-to-deposit ratio still shows a relative reliance on wholesale funding, we believe the bank has proven its ability to raise funds from private investors since 2012 at different levels of its liability structure. As of 31 December 2014, BoI reported a Net Stable Funding Ratio of 114% and a Liquidity Coverage Ratio of 98%, which are deemed sufficient according to the current definitions. We see the improved funding profile as a relative strength and therefore, we assign a Funding score of baa2 to reflect this view.

We also believe that BOI's stock and quality of liquid assets is adequate in Ireland and the UK. As of December, the bank had a Liquid Banking Assets / Tangible Banking Assets ratio of 20.1%. Although we do not expect significant changes over the medium term in the bank's liquidity profile, we assign a score of baa3 to recognise its conservative liquidity management.

Overall our assigned BCA of ba2 is in line with our unadjusted Scorecard.

NOTCHING CONSIDERATIONS

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

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 its estimated EU-wide average of 26%. These are in line with our standard assumptions. Our advanced LGF analysis indicates that BOI's deposits and senior unsecured debt are likely to face very low loss-given-failure, due to the loss-absorption provided by subordinated debt and, potentially, by senior unsecured debt -- if deposits are treated preferentially in a resolution -- as well as the substantial volume of deposits and senior unsecured debt themselves. This results in a Preliminary Rating Assessment for BOI's deposits and senior unsecured debt of baa3, two notches above the ba2 BCA.

BOI's subordinated instruments are likely to face a high level 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. However, we note that the bank continues to increase the amount of junior liabilities after the issue of EUR750 million fixed rate perpetual additional tier 1 notes. We assigned a rating of (P)B2 (hyb) to these notes. The rating of BOI's subordinated debt and junior subordinated debt is Ba3 and B1(hyb) respectively. The rating of the non-cumulative preference shares is B3.

GOVERNMENT SUPPORT

The implementation of BRRD has caused us to reconsider the potential for government support to benefit certain creditors. We expect a moderate probability of support for BOI, which leads to one notch of uplift from the Preliminary Rating Assessments for both deposits and senior unsecured ratings to Baa2.

For other junior securities, we continue to apply a low government support assumption, and, as such, the ratings for these instruments do not include any related uplift.

COUNTERPARTY RISK 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.

The CR Assessment is positioned at Baa1(cr)/ Prime 2(cr). The CR Assessment, prior to government support, is positioned three notches above the BOI's BCA of ba2, 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 systemic 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.

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 Factors

Bank of Ireland

Macro Factors	
Weighted Macro Profile	**Strong -**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	16.1%	b3	↑	b2	Quality of assets	Collateral and provisioning coverage
Capital						
TCE / RWA	11.1%	baa3	←→	baa3	Risk-weighted capitalisation	Nominal leverage
Profitability						
Net Income / Tangible Assets	0.0%	caa2	↑↑	ba3	Expected trend	Loan loss charge coverage
Combined Solvency Score		b1		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	15.4%	baa2	←→	baa2	Market funding quality	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	20.1%	baa3	↓	baa3	Quality of liquid assets	Stock of liquid assets
Combined Liquidity Score		baa2		baa2		

Financial Profile	**ba2**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Baa1

Scorecard Calculated BCA range	**ba1 - ba3**
Assigned BCA	**ba2**
Affiliate Support notching	**0**
Adjusted BCA	**ba2**

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Deposits	2	0	baa3	1	Baa2	Baa2
Senior unsecured bank debt	2	0	baa3	1	Baa2	Baa2
Dated subordinated bank debt	-1	0	ba3	0	Ba3	Ba3
Junior subordinated bank debt	-1	-1	b1	0		B1(hyb)
Cumulative bank preference shares	-1	-2	b2	0	(P)B2(hyb)	
Non-cumulative bank preference shares	-1	-3	b3	0	B3(hyb)	B3(hyb)

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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