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DBRS Comments on BoI Rating Actions – IA raised to BBB (high)

Industry: Fin.Svc.--Banks & Trusts

As detailed in the press release “DBRS Downgrades 31 European Banking Groups due to Removal of Systemic Support Uplift”, published earlier today, DBRS Ratings Limited (DBRS) confirmed the ratings of The Governor and Company of the Bank of Ireland (BoI or the Bank), including the non-guaranteed long-term debt and deposits ratings at BBB (high), and the non-guaranteed short-term debt and deposits ratings at R-1 (low). The trend on all ratings is now Stable. The confirmation reflected a change in DBRS’s support assessment for BoI to SA3, from SA2, which resulted in the removal of one notch of uplift from the Intrinsic Assessment (IA) for potential systemic support. However, concurrently, BoI’s intrinsic assessment has been raised to BBB (high) from BBB, mitigating the removal of support. This commentary provides further background to the change in the IA.

RATIONALE FOR THE CHANGE IN THE IA:

The improvement in BoI’s IA to BBB (high) reflects the continued progress of the Bank in 1H15, especially with regard to profitability, asset quality and capital. In 1H15, BoI reported income before provisions and taxes (IPBT) of EUR 884 million, a 34% increase YoY. Whilst this improvement was in part driven by EUR 228 million of additional gains, mainly from the sale of sovereign bonds (as part of rebalancing the liquid asset portfolio) and the sale of investment properties, DBRS notes that both net interest income (NII) and business income were up YoY, 5% and 12% respectively. The increase in NII was supported by 16 basis points (bps) increase in the Bank’s net interest margin (NIM), excluding fees related to the Eligible Liabilities Guarantee, to 2.21%, as a result of lower funding costs and the positive impact of new lending. Net profit of EUR 624 million in 1H15 was up 82% YoY, as BoI also benefited from a 62% YoY decrease in impairment charges, to EUR 168 million.

The Bank also continued to report material improvements in its asset quality with total impaired loans reducing by 7% in 1H15, from end-2014, with reductions evident across the majority of the Bank’s loan books, most notably in the Retail Ireland mortgage portfolio, which decreased 13% in 1H15, to EUR 2.8 billion at end-1H15. DBRS also notes that BoI’s coverage ratio increased in 1H15 to 53%. Asset quality however remains relatively weak, with a defaulted loan ratio of 14.4%, but DBRS expects the restructuring of the impaired loans, and the positive momentum in the RoI and UK

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economies, to support further reductions.

BoI has also reported further strengthening of its capital in 1H15. At end-1H15, BoI's Common Equity Tier 1 (CET1) ratio was 15.9% on a transitional basis, and 11.1% on a fully-loaded basis (which excludes the EUR 1.3 billion of remaining 2009 Preference Shares), which the Bank intends to de-recognise between January and July 2016. In addition, BoI's fully-loaded leverage ratio (excluding the 2009 Preference Shares) was 5.4% at end-1H15, up 140 bps from end-2014. The Bank also issued an Additional Tier 1 instrument of EUR 750 million in June 2015 which further boosts the Group's capital base. DBRS views positively the improvement in capital levels achieved through earnings retention and anticipates a further strengthening of the capital ratios, given the Bank's return to profitability.

RATING DRIVERS:

The Trend on the Bank's ratings is now stable. Further upward movement in the senior ratings would require continued improvement in profitability metrics and asset quality indicators. Downward pressure would be most likely to arise if the Bank were unable to improve its asset quality or if the recent improvements in profitability do not prove to be sustainable. The ratings on the Government Guaranteed debt are directly linked to DBRS's rating of the Republic of Ireland and as such, any changes in this rating would be reflected in the rating of the guaranteed debt.

SUPPORT ASSESSMENT:

The rating action concluded the rating review initiated in May 2015, and reflected DBRS's view that developments in European regulation and legislation mean that there is less certainty about the likelihood of timely systemic support. Countries across Europe continue to make progress in enacting the Bank Recovery and Resolution Directive (BRRD) into national legislation, including Ireland. BRRD has harmonised the approach that will be taken in the resolution of failing banks across Europe, and has led DBRS to conclude that there is not sufficient certainty of support to have any uplift in the senior debt ratings of European banks. Consequently the support assessment for BoI was changed to SA3 (the category for banks in countries where DBRS has no expectation of systemic support or is not confident enough that timely systemic support would be forthcoming in times of need to add a notch for systemic support) from SA2 (indicating the likelihood of timely systemic support).

RATIONALE FOR THE UPGRADE OF THE JUNIOR SECURITIES:

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DBRS earlier today upgraded the dated subordinated debt issued by BoI to BBB, from BB (high), and the Perpetual Preferred Securities issued by Bank of Ireland UK Holdings plc to BB (high) from BB (low). The upgrade reflects the improvement in the Bank's IA to BBB, from which these ratings are notched down, as well as a narrowing of the notching from the IA. The notching from the IA is now in line with the more normal DBRS practice and reflects the ongoing recovery of the Bank, as evidenced by the improved fundamentals and capitalisation.

Notes:

All figures are in EUR unless otherwise noted.

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