MOODY'S INVESTORS SERVICE

Credit Opinion: Bank of Ireland

Global Credit Research - 31 Mar 2015

Dublin, Ireland

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*Baa3/*P-3
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Issuer Rating	**Ba1
Senior Unsecured	**Ba1
Subordinate	Ba3
Jr Subordinate	B1 (hyb)
Pref. Stock Non-cumulative	B3 (hyb)
Commercial Paper	**NP
Other Short Term -Dom Curr	**(P)NP
Bank of Ireland (UK) Plc	
Outlook	Rating(s) Under Review
Bank Deposits	*Ba2/NP
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Bank of Ireland UK Holdings Plc	
Outlook	Stable
BACKED Pref. Stock -Dom Curr	B3 (hyb)
Avondale Securities SA	
Outlook	Stable
Senior Secured -Dom Curr	Baa3

* Rating(s) within this class was/were placed on review on March 17, 2015
** Placed under review for possible upgrade on March 17, 2015

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Key Indicators

BANK OF IRELAND (Consolidated Financials)[1]

	[2]6-14	[2]12-13	[3]12-12	[3]12-11	[3]12-10	Avg.
Total Assets (EUR million)	126,943.0	128,219.0	141,854.0	154,880.0	167,473.0	[4]-6.7
Total Assets (USD million)	173,804.0	176,678.3	187,019.1	201,056.7	224,672.3	[4]-6.2
Tangible Common Equity (EUR million)	5,745.0	5,526.9	5,897.2	8,750.4	5,064.1	[4]3.2

Tangible Common Equity (USD million)	**7,865.7**	**7,615.8**	**7,774.8**	**11,359.3**	**6,793.7**	[4]**3.7**
Problem Loans / Gross Loans (%)	**17.0**	**17.0**	**16.3**	**12.8**	**9.2**	[5]**14.4**
Tangible Common Equity / Risk Weighted Assets (%)	**9.8**	**8.4**	**8.9**	**11.4**	**6.1**	[6]**9.1**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**110.2**	**114.7**	**121.2**	**89.3**	**109.4**	[5]**109.0**
Net Interest Margin (%)	**1.7**	**1.4**	**0.9**	**0.9**	**1.2**	[5]**1.2**
PPI / Average RWA (%)	**2.4**	**2.0**	**0.1**	**0.4**	**0.2**	[6]**2.2**
Net Income / Tangible Assets (%)	**0.5**	**-0.3**	**-0.8**	**-1.1**	**-2.1**	[5]**-0.7**
Cost / Income Ratio (%)	**53.2**	**56.4**	**94.9**	**83.1**	**92.1**	[5]**76.0**
Market Funds / Tangible Banking Assets (%)	**15.3**	**23.0**	**29.4**	**39.5**	**45.8**	[5]**30.6**
Liquid Banking Assets / Tangible Banking Assets (%)	**18.4**	**19.4**	**21.5**	**18.5**	**14.9**	[5]**18.6**
Gross Loans / Total Deposits (%)	**122.8**	**124.5**	**132.3**	**146.1**	**170.3**	[5]**139.2**

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

On March 17, we placed Bank of Ireland's (BOI's) long-term deposit and senior unsecured ratings of Baa3 and Ba1 respectively on review for upgrade. Both short-term debt at Not-Prime and deposits at Prime-3 were also placed on review for upgrade.

BOI' BCA of ba2 reflects our view of the bank's improving capital and leverage metrics driven by the bank's enhanced ability to generate capital organically. This partially mitigates 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. The BCA also incorporates the bank's relatively low but improving profitability driven by a dramatic decline in impairment charges and a lower cost of funding in the UK and Ireland. We believe that the bank's funding profile has also improved as it reduces its use of funds from monetary authorities.

The review for upgrade on both deposit and senior unsecured debt ratings as well as the affirmation of the ratings of all junior instruments was underpinned by the bank's standalone credit strength, and also takes into account the introduction of the new methodology, and specifically our advanced Loss Given Failure (LGF) analysis.

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

The `Strong-` macro profile of BOI is driven by its exposure to Ireland and the UK, 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, but access to external capital remains limited. Additionally, 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

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

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

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

- Moderate probability of government support resulting in one-notch uplift from Preliminary Rating Assessment (PRA) for debt and deposits

RATING OUTLOOK

Our BCA already incorporates improvements in some areas such as capital and profitability and as such we do not expect to increase our BCA over the short term. The review on BOI's deposits and long-term senior unsecured ratings was triggered by the introduction of our new methodology, and specifically our advanced Loss Given Failure analysis, which applies to BOI given that it is subject to an operational resolution regime under the Bank Recovery and Resolution Directive (BRRD). The review will focus on the liability structure, in particular the amount of deposits, senior long-term debt outstanding, and the amount of debt subordinated to both instruments. We expect the ratings of both deposits and senior unsecured debt to be either affirmed or upgraded by one notch, depending on the degree of loss-given-failure, and to include one notch of government support, reflecting a moderate probability of support.

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 senior unsecured debt and deposit ratings could also be upgraded if the company were to issue significant amounts of long-term debt.

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 financial statements unless otherwise stated. The historic ratios displayed in the scorecard at the end of this document are calculated as of June 2014 in the case of Asset Risk and Capital and as of December 2013 in the case of Liquid Resources and Funding Structure. The Profitability ratio displayed in the same table is the average of the 2011, 2012, 2013 and half-year 2014 results.

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 January 2014 to January 2015, residential property prices in Ireland, increased by 15.5%. 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 (27.7% 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

According to our calculations and including high trigger contingent capital instruments, BoI's Tangible Common Equity/ RWA ratio was 9.8% at end-June 2014. Our calculations 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 1.7% of the total RWAs at end-June 2014.

BOI's Basel III pro-forma fully loaded CET1 ratio stood at 9.3% at end-December 2014. Despite being relatively low compared to other European banks, we note that the bank was able to increase this ratio by 300 basis points from December 2013. 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 ba2 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 and increases in the volume of higher-priced new lending. 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. Nonetheless, we expect demand for credit and thus growth in business volumes to remain limited 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. Reliance on wholesale funding reduced to EUR20 billion as of December 2014 (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 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. In addition, the bank reduced its loans-to-deposits ratio to 122% in the first half of 2014 from 125% at year-end 2013, according to our calculations. 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 baa3 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 June 2014, the bank had a Liquid Banking Assets / Tangible Banking Assets ratio of 18.5%. 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 assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. We exclude from our balance sheet at failure deposits and assets relating to Bank of Ireland UK.

For BOI' deposits, our initial LGF analysis is not conclusive and our review will consider the likely impact on loss-given-failure, due to the loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves. Our preliminary analysis indicates a potential outcome of very low loss-given-failure, which would result in a Preliminary Rating Assessment (PRA) two notches above the BCA.

Our initial analysis for BOI' senior unsecured debt is also not conclusive and therefore, our review will consider the likely impact on loss-given-failure of the combination of its own volume and the amount of debt subordinated to it. We expect this will result in a low loss-given-failure, which would result in a PRA one notch above the BCA.

For junior securities issued by BOI, our initial LGF analysis confirms a high level loss-given-failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity. As a result, the rating of BOI's subordinated debt and junior subordinated debt has been affirmed at Ba3 and B1 (hyb) respectively. The rating of the non-cumulative preference shares has also been affirmed at B3.

GOVERNMENT SUPPORT

The implementation of the BRRD has caused us to reconsider the potential for government support to benefit certain creditors. We now expect a moderate probability of government support for deposits, resulting in a one-notch uplift to the PRA. We expect to assign the same support probability to senior unsecured debt once our review is complete.

For other junior securities, we continue to believe that potential government is low and these ratings do not include any related uplift. Junior securities also include additional downward notching from the BCA reflecting coupon suspension risk ahead of a potential failure.

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	17.0%	b3	↑	b2	Quality of assets	Collateral and provisioning coverage
Capital						
TCE / RWA	9.8%	ba2	↑	ba2	Risk-weighted capitalisation	Nominal leverage
Profitability						
Net Income / Tangible Assets	-0.4%	caa2	↑ ↑	ba3	Expected trend	Loan loss charge coverage
Combined Solvency Score		b2		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	23.0%	baa3	←→	baa3	Market funding quality	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	19.4%	ba1	↑	baa3	Quality of liquid assets	Stock of liquid assets
Combined Liquidity Score		baa3		baa3		

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	--	--	--	--	Baa3 RUR Possible Upgrade	Baa3 RUR Possible Upgrade
Senior unsecured bank debt	--	--	--	--	Ba1 RUR Possible Upgrade	Ba1 RUR Possible Upgrade
Dated subordinated bank debt	-1	0	ba3	0	Ba3	Ba3
Junior subordinated bank debt	-1	-1	b1	0		B1(hyb)
Non-cumulative bank preference shares	-1	-3	b3	0	B3(hyb)	B3(hyb)

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