Moody's
INVESTORS SERVICE

Credit Opinion: Bank of Ireland

Global Credit Research - 25 Nov 2015

Dublin, Ireland

Ratings

Category	Moody's Rating
Outlook	Positive
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)
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
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Bank of Ireland UK Holdings Plc	
BACKED Pref. Stock -Dom Curr	B3

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]6-15	[2]12-14	[2]12-13	[3]12-12	[3]12-11	Avg.
Total Assets (EUR million)	127,768.0	125,540.0	128,215.0	141,854.0	154,880.0	[4]-4.7
Total Assets (USD million)	142,359.9	151,910.1	176,672.8	187,019.1	201,056.7	[4]-8.3
Tangible Common Equity (EUR million)	7,365.4	6,243.3	5,546.9	5,897.2	8,750.4	[4]-4.2
Tangible Common Equity (USD million)	8,206.5	7,554.7	7,643.4	7,774.8	11,359.3	[4]-7.8
Problem Loans / Gross Loans (%)	13.6	15.0	17.0	16.3	12.8	[5]14.9
Tangible Common Equity / Risk Weighted Assets (%)	13.2	11.1	8.5	8.9	11.4	[6]10.9
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	86.8	98.0	114.5	121.2	89.3	[5]102.0

Net Interest Margin (%)	**1.8**	**1.7**	**1.4**	**0.9**	**0.9**	[5]**1.3**
PPI / Average RWA (%)	**3.0**	**2.2**	**1.8**	**0.1**	**0.3**	[6]**2.3**
Net Income / Tangible Assets (%)	**1.0**	**1.1**	**-0.4**	**-0.8**	**-1.1**	[5]**-0.1**
Cost / Income Ratio (%)	**51.2**	**57.2**	**58.2**	**97.8**	**86.2**	[5]**70.1**
Market Funds / Tangible Banking Assets (%)	**11.5**	**15.4**	**20.4**	**27.2**	**37.4**	[5]**22.4**
Liquid Banking Assets / Tangible Banking Assets (%)	**19.4**	**20.1**	**19.6**	**21.6**	**18.5**	[5]**19.8**
Gross loans / Due to customers (%)	**116.7**	**119.6**	**125.6**	**133.3**	**149.9**	[5]**129.0**

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 unsecured debt two notches above the BCA; and (3) a moderate expectation of government support, resulting in a further notch of uplift above the PRA for both deposit and senior unsecured debt ratings.

BOI's BCA of ba2 reflects (1) the improving but still sizable stock of problem loans, as well as our expectation 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; and (3) the bank's improved funding and liquidity profiles.

RATING DRIVERS

- Still elevated stock of problem loans, albeit likely to decline further given the positive operating environment in Ireland and the UK

- Enhanced ability to generate capital organically, but subject to volatility in the pension deficit

- Improved profitability supported by the bank's strong domestic franchise in Ireland and expanding position in the UK through its partnerships with the Post Office and AA

- Strong funding profile and adequate liquid resources

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

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

RATING OUTLOOK

The positive outlook on Bank of Ireland's long-term senior deposit and debt ratings reflects our expectations that asset risk and profitability metrics will continue to improve, supported by the favourable operating environment in the UK and Ireland. It also reflects Moody's expectation that the bank's organic capital generation will mainly offset the expected decline in the TCE/RWA ratio due to the maturity of the bank's high trigger contingent capital instruments and the potential volatility arising from an unexpected increase in its pension deficit.

WHAT COULD CHANGE THE RATING - UP

Bank of Ireland's long-term debt and deposit ratings could be upgraded as a result of (1) an increase of its standalone ba2 BCA; or (2) a significant increase in the bank's bail-in-able debt.

Bank of Ireland's ba2 standalone BCA could be upgraded following (1) further reductions in the stock of non-performing loans in line with the current trend; (2) additional progress in the bank's ability to generate capital through earnings retention to offset any potential volatility in its regulatory capital ratios; and (3) maintenance of adequate funding and liquidity metrics.

Upward rating pressure on the bank's deposit and senior unsecured ratings would also develop if the bank significantly increased the amount of subordinated debt which could be bailed-in.

WHAT COULD CHANGE THE RATING - DOWN

Bank of Ireland's ratings could be downgraded as a result of (1) a lowering of its standalone ba2 BCA; or (2) redemption of maturing subordinated instruments without their replacement.

BOI's ba2 standalone BCA could be downgraded following (1) a deterioration in the bank's asset quality metrics; (2) a significant deterioration in the bank's regulatory capital metrics; (3) a decline in profitability metrics; and (4) a significant deterioration in the bank's funding or liquidity metrics.

DETAILED RATING CONSIDERATIONS

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

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

Despite being based in Ireland (macro profile of Moderate +) the bank has significant operations in the UK (Very Strong-), which in combination lead to its `Strong-` macro profile. Both countries are 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.

IMPROVING ASSET QUALITY, ALBEIT STOCK OF PROBLEM LOANS REMAINS ELEVATED

BOI continues to report improvements in its asset quality after the impaired loan ratio declined to 13.6% at end of June 2015 compared to 15% as of year-end 2014 with the total level of impaired loans declining by EUR826 million. The reduction in the amount of impaired loans is driven by improvements in the operating environment in Ireland, which have led to a significant decline in the unemployment rate, and the bank's significant effort to provide sustainable restructuring solutions to troubled borrowers. However, the overall level of impaired loans is still elevated at EUR12.6 billion at end-June 2015, exposing the bank to material downside risk. We expect a very gradual recovery given the industry-wide reluctance to repossess residential properties in Ireland. We also note that the level of provisions have deemed to be adequate by Irish and European authorities following successive asset quality reviews.

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. Residential property prices in Ireland increased by 8.9% in the year to September 2015. We believe that despite the deceleration in property prices triggered by the macro-prudential measures imposed by Ireland's Central Bank, housing supply limitations will contribute to further increases in house prices. 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 13% as of June 2015 from 15% as of December 2014. 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; 11.1% of mortgage loans in Ireland, including buy-to-let loans, were non-performing as of June 2015. In addition, as of the same date approximately 24.3% of Irish non-property SME was non-performing, while the non-property corporate book recorded an NPL ratio of 5.1%. BoI's buy-to-let portfolio continues to face challenges since defaulted loans accounted for 24.6% of the loan book at end-H1 2015 (27.2% at end- 2014).

The reduced inflow of new NPLs should continue to support 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 more conservative underwriting standards. However, given the size of the problem loan portfolio and the volatility of asset prices in Ireland, we consider the bank's asset risk remains as a relative weakness for the BCA with an assigned score of b2. The higher assigned score relative to that derived from the problem loan ratio reflects our expectation of further improvements in asset quality over the medium term.

ENHANCED ABILITY TO GENERATE CAPITAL ORGANICALLY, BUT REGULATORY CAPITAL RATIO AFFECTED BY PENSION DEFICIT VOLATILITY

BOI's capital has continued to strengthen with a tangible common equity-to-risk weighted assets (TCE/RWA) ratio, excluding the high trigger contingent convertible capital notes maturing in July 2016, increasing to 11.4% as of June 2015 from 9.3% as of December 2014. In line with our capital ratio, the bank reported an increase in the regulatory "fully loaded" Common Equity Tier 1 ratio (CET1) ratio to 11.1% from 9.3% during the same period. However, the CET1 ratio declined to 10.6% as of September 2015 driven by an increase in the defined pension deficit. While Moody's believes that the bank's regulatory metrics will remain volatile, its improved ability to generate capital organically will largely offset the uncertainty caused by the periodic movements arising from changes in its pension deficit. The bank's latest reported fully loaded leverage ratio stood at 5.4% as of June 2015. We see the bank's strong internal capital generation and its current TCE level as a relative strength for the BCA with an assigned score of baa2, which also reflects the volatility in its regulatory CET1 ratio.

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. During the first half of 2015, the bank reported a significant increase in profitability, with net income increasing to EUR624 million compared to EUR344 million for the same period in 2014. Although the increase was partly driven by a one-off gain due to the sale of assets, the decline in impairment charges, which we consider sustainable, has also contributed positively to the results. Despite some further upside potential due to lower cost of funds and increased net lending, we expect the bank's profitability to stabilise reflecting the challenges BOI will face in its core markets including potential reduction in lending rates in Ireland and increased competition in the UK.

We assign a profitability score of ba2, which is higher than the score suggested by historic ratios.

DEMONSTRATED MARKET ACCESS AND REDUCED USE OF WHOLESALE FUNDING

While the bank has significantly reduced the use of wholesale funding, it is still dependent on this source of funding to cover the negative funding gap reflected in a loan-to-customer deposits ratio of 116.7% at June 2015 according to our calculations. Wholesale funding reduced to EUR15 billion as of June 2015 from EUR20 billion at end-2014. The bank also reduced its use of funding provided by monetary authorities by EUR3 billion during the first half of 2015 with this type of funding now making up less than 10% of total wholesale funding. BOI's Market Funds/Tangible Banking Assets ratio of 11.5% at June 2015 (down from 15.4% at end-2014) compares favourably to peers.

Supported by a strong franchise in the UK and Ireland, customer deposits increased to EUR79bn in June 2015 from EUR75 billion in December 2014. The bank has also proven its ability to raise funds from private investors since 2012 at different levels of its liability structure. BOI continued to access the market in 2015 issuing about EUR3.6bn of wholesale funding, making three covered bonds issuances and one senior unsecured issuance. Overall, the bank has a diverse market funding mix, most of it is secured, and 67% of funding has maturity of over a year. The bank also issued EUR750 million of low trigger contingent capital notes. As of June 2015, BOI reported a Net Stable Funding Ratio of 118% and a Liquidity Coverage Ratio of 101%, 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 baa1 to reflect this view.

BOI's has sufficient stock and good quality of liquid assets in both Ireland and the UK. As of June 2015, the bank had a Liquid Banking Assets / Tangible Banking Assets ratio of 19.4%. 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 BOI's adequate stock of liquid assets and conservative liquidity management.

Following our rating action in November 2015, we changed the bank's scorecard-produced BCA range to baa3-ba2 from ba1-ba3 to reflect improvements in the bank's credit fundamentals. The positioning of the bank's assigned BCA of ba2 at the bottom of the range reflects the need for further confirmation that these improvements will be sustained. The positive outlook reflects likelihood of the bank's BCA moving to the middle of the range and for its long term debt and deposit ratings to be upgraded on the back of further improvements in its credit fundamentals.

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(hyb).

GOVERNMENT SUPPORT

We believe that there is a moderate probability of government support for BOI should the bank fail, which leads to one notch of uplift from the Preliminary Rating Assessments to Baa2 for both deposits and senior unsecured ratings.

For other junior securities, we continue to believe that the probability of government support is low, 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 government 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	15.5%	b3	↑	b2	Quality of assets	Collateral and provisioning coverage
Capital						
TCE / RWA	13.2%	a3	↓	baa2	Expected trend	Capital fungibility
Profitability						
Net Income / Tangible Assets	0.2%	b2	↑↑	ba2	Expected trend	Loan loss charge coverage
Combined Solvency Score		ba2		ba2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	15.4%	baa2	↑	baa1	Expected trend	Market funding quality
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	**ba1**

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	**baa3 - ba2**

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	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.