FitchRatings

Tagging Info

Fitch Affirms Irish Banks' IDRs; Upgrades Bank of Ireland's VR to 'b+'

Ratings Endorsement Policy
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Fitch Ratings-London-16 January 2014: Fitch Ratings has affirmed Bank of Ireland (BOI) and Allied Irish Banks, plc's (AIB) Long-term Issuer Default Ratings (IDRs) at 'BBB' with Stable Outlooks and Short-term IDRs at 'F2'. Fitch has upgraded BOI's Viability Rating (VR) to 'b+' from 'b' and affirmed AIB's VR at 'b-'. Fitch has also affirmed and withdrawn Permanent TSB P.L.C.'s (PTSB) ratings. A full list of rating actions is at the end of this rating action commentary.

The upgrade of BOI's VR reflects further improvement in the bank's risk profile, including our expectation of a return to profitability during 2014, which will support the bank's improved capital flexibility following its recent share issue and redemption and sale of its preference shares to private investors. The share issue funded the redemption of a portion of BOI's perpetual preference shares, with the rest purchased by private investors, which has improved the bank's common equity Tier 1 (CET1) solvency and further reduced BOI's dependence on government support.

PTSB's 'cc' VR and'2' Support Rating (SR) have been affirmed and withdrawn as Fitch does not consider these ratings to be relevant to its coverage.

KEY RATING DRIVERS - IDRs AND SENIOR DEBT, SRs, SUPPORT RATING FLOORS
The affirmation of BOI's and AIB's IDRs, senior debt ratings, SRs and Support Rating Floors reflects Fitch's view that there would be a high probability of support from the authorities if required. Fitch considers support to be even stronger in the short term, resulting in the banks' Short-term IDRs being affirmed at 'F2', which is the higher of two potential Short-term ratings mapping to their 'BBB' Long-term IDRs. The Stable Outlooks are based on Fitch's view that support will continue to be forthcoming, although this is sensitive to evolving developments around support for EU banks. Any downgrade of the Irish sovereign rating, which is highly unlikely in the near term, would also likely be reflected in negative rating action on BOI and AIB.

RATING SENSITIVITIES - BOI and AIB's IDRs, SRs, SUPPORT RATING FLOOR AND SENIOR DEBT
BOI and AIB's IDRs, SRs, SRFs and senior debt ratings are sensitive to any change in Fitch's assumptions about the on-going availability of extraordinary sovereign support for the banks. In Fitch's view, there is a clear intention ultimately to reduce implicit state support for financial institutions in the EU, as demonstrated by a series of legislative, regulatory and policy initiatives, most recently agreement between the European Council and Commission on the Bank Recovery and Resolution Directive. In September 2013, Fitch commented on its approach to incorporating support in its bank ratings in light of evolving support dynamics for banks worldwide (see 'Fitch Outlines Approach for Addressing Support in Bank Ratings', 'Bank Support: Likely Rating Paths', and 'The Evolving Dynamics of Support for Banks' available at www.fitchratings.com) and followed this with an update in December (see "Sovereign Support for Banks Update on Position Outlined In 3Q13').

The banks' SRFs would be revised down and their SRs, IDRs and senior debt ratings downgraded if Fitch concludes that potential sovereign support had weakened relative to its previous assessment. Given that BOI's and AIB's VRs are in the single 'b' category, any support-driven downgrades of the banks' Long-term IDRs and senior debt ratings could be by multiple notches.

KEY RATING DRIVERS- VRs (BOI and AIB)
Following its upgrade, BOI's VR is now two notches higher than AIB's, reflecting its stronger financial profile and better access to investor markets. Both BOI and AIB were able to issue unsecured senior debt during 2013 but equity-raising may prove more difficult for AIB, which is still more than 99%-owned by the Irish authorities (BOI: 14%).

At 6.6% for BOI and 4.6% for AIB at end-1H13, Fitch Core Capital (FCC) ratios are low but supported on a transitional regulatory basis by perpetual preference shares. At BOI, these perpetual preference shares added about 360bps to end-1H13 core Tier 1 capital and 540bps in AIB. Fitch expects BOI's and AIB's capital ratios to weaken in 2H13 due to losses which could be exacerbated following the Central Bank of Ireland's (CBoI) balance sheet assessment. Initial indications from the central bank's review suggest that further impairment charges are possible in 2013 earnings, which could be combined with higher risk weight requirements. According to the CBoI's estimate, the impact on capital ratios could be up to 360bp for BOI. However, once taken this should place the banks in a better position to be sustainably profitable in the medium term, ahead of the ECB's important asset quality review and the EBA's stress test in 2014.

During 2H13, BOI redeemed EUR537m of its perpetual preference shares through a share issue, leaving EUR1.3bn, which was sold to private investors. The sale of the perpetual notes means that BOI will not be liable for the 25% step-up premium that would have been triggered on 31 March 2014 and also removes the bank's ordinary stock dividend restrictions.

The VRs of both banks are constrained by capitalisation which only allows a small margin of safety, particularly in light of weak asset quality, with high levels of net impaired loans relative to FCC. Fitch considers that the current levels of provisioning and capitalisation would not be sufficient if the banks needed to realise a substantial proportion of their collateral in a short time, but this is not our base case.

RATING SENSITIVITIES - VRs (BOI and AIB)
BOI and AIB's VRs are on an upward trajectory, with Fitch expecting BOI to report profits in 2014 and AIB to be profitable on a month-on-month basis by 2H14. Improved profitability will gradually enhance the banks' capital flexibility and allow them to build on depleted capital reserves to support long-term sustainability, but this will take time to feed through into meaningful credit strengthening.

An upgrade of BOI and AIB's VRs could occur once asset quality stabilises across the sector and the banks can demonstrate a track record of sustainable profitability, which will support internal capital generation. The stabilisation of asset quality metrics would need to be supported by evidence of stabilising property prices including increased churn in the property market and evidence that the banks were resolving their stock of NPLs without significant additional impairments being required.

Downward pressure on BOI's and AIB's VRs could occur if Fitch's view that asset quality deterioration is subsiding proved to be wrong and/or if capital ratios were further eroded beyond our expectations.

KEY RATING DRIVERS- VR (PTSB)
PTSB's 'cc' VR reflects Fitch's belief that is likely to breach its minimum capital requirements over the medium term unless it receives approval for its restructuring plan. As this has not yet been received and its exact timing is unknown, Fitch has not factored the potential positive benefits of such a plan into its analysis. Fitch believes that the bank needs to continue to add provisions against its impaired assets and that structurally weak profitability continues to drag on capital. Deleveraging of low-yielding assets therefore is also a requirement before any improvement may be noted in the VR. PTSB's market position remains modest, despite the Irish government's desire for competition in the marketplace. PTSB submitted a restructuring plan to the EU Commission in June 2012. The first stage of the plan, to separate the group into three distinct business units, has been completed. However, the long-term viability of the bank is dependent on a solution for hiving off the impaired or low-yielding assets into a separate vehicle. Management's expectation is that the EU decision will be received during 2014.

KEY RATING DRIVERS AND SENSITIVITIES - GOVERNMENT GUARANTEED DEBT, COMMERCIAL PAPER AND DEPOSITS
Apart from guaranteed debt securities that are yet to mature and remain guaranteed following the withdrawal of the Eligible Liabilities Guarantee (ELG) scheme in March 2013, Fitch has withdrawn all other guaranteed asset classes for these Irish issuers as Fitch no longer considers the ratings to be relevant to the agency's coverage.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT
The subordinated debt issued by BOI and AIB is rated with reference to their respective VRs and the performance of these instruments. AIB is not paying the discretionary coupons on its subordinated notes. The 'C' ratings of these instruments reflect their non-performance and sustained economic losses with weak recovery prospects. BOI's subordinated debt has been upgraded to 'B' and BOI (UK)'s deferrable subordinated notes guaranteed by BOI have been upgraded to 'CCC' following the upgrade of BOI's VR. The ratings of all subordinated instruments are primarily sensitive to any change in the VRs of these institutions.

SUSBIDIARY AND AFFILIATED COMPANY KEY RATING DRIVERS AND SENSITIVITIES
EBS Limited and AIB Group (UK) Plc are owned by AIB and Bank of Ireland Mortgage Bank and BOI UK Plc are owned by BOI. All of these subsidiaries are wholly owned by respective parents, and to varying degrees are reliant on their parent banks for funding and capital support. Their IDRs are aligned with their parents', and are sensitive to the same factors that might drive a change in their parents' ratings.

The rating actions are as follows:

AIB
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'b-'
Support Rating: affirmed at '2'

Support Rating Floor: affirmed at 'BBB'
Senior unsecured notes: affirmed at 'BBB'
Short-term debt: affirmed at 'F2'
Commercial Paper: affirmed at 'F2'
Subordinated notes: affirmed at 'C'
Sovereign-guaranteed Long-term notes: affirmed at 'BBB+'
Sovereign-guaranteed Long-term and Short-term deposits: affirmed and withdrawn at 'BBB+'/'F2'
Sovereign-guaranteed Long-term and Short-term programmes: affirmed and withdrawn at 'BBB+'/'F2'

AIB (UK)
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'

EBS
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'
Senior unsecured notes: affirmed at 'BBB'
Short-term debt: affirmed at 'F2'
Sovereign-guaranteed Long-term/Short-term notes: affirmed at 'BBB+'/'F2'
Sovereign guaranteed commercial paper: affirmed and withdrawn at 'F2'
Sovereign-guaranteed Long-term/Short-term deposits: affirmed and withdrawn at 'BBB+'/'F2'
Sovereign-guaranteed Long-term/Short-term programmes: affirmed and withdrawn at 'BBB+'/'F2'

BOI
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Viability Rating: upgraded to 'b+' from 'b'
Support Rating: affirmed at '2'
Support Rating Floor: affirmed at 'BBB'
Senior unsecured notes: affirmed at 'BBB'
Short-term debt: affirmed at 'F2'
Subordinated debt: upgraded to 'B' from 'B-'
Sovereign-guaranteed notes: affirmed at 'BBB+'
Sovereign-guaranteed Long-term and Short-term deposits: affirmed and withdrawn at 'BBB+/F2'
Sovereign-guaranteed Long-term/Short-term programmes: affirmed and withdrawn at 'BBB+'/'F2'
BOI UK Holdings deferrable subordinated notes guaranteed by BOI: upgraded to 'CCC' from 'C'

BOI Mortgage Bank
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'

BOI UK Plc
Long-term IDR: affirmed at 'BBB'; Stable Outlook
Short-term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'
Sovereign-guaranteed Long-term and Short-term deposits: affirmed and withdrawn at 'BBB+/F2'

PTSB
Viability Rating: affirmed at 'cc' and withdrawn
Support Rating: affirmed at '2' and withdrawn

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Additional information is available on www.fitchratings.com

Applicable criteria, Global Financial Institutions Rating Criteria, dated 15 August 2012, 'Evaluating Corporate Governance', dated 12 December 2012 and 'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 5 December 2012 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
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Evaluating Corporate Governance
Assessing and Rating Bank Subordinated and Hybrid Securities

Additional Disclosure
Solicitation Status