FITCH DOWNGRADES IRISH BANKS' IDRS; UPGRADES 3 VRS

Fitch Ratings-London-19 May 2015: Fitch Ratings has downgraded Bank of Ireland's (BOI) and Bank of Ireland UK plc's (BOI UK) Long- and Short-term Issuer Default Ratings (IDR) to 'BB+'/'B' from 'BBB'/ 'F2', and Allied Irish Banks plc's (AIB) and AIB UK's (AIBUK) Long- and Short-term IDRs to 'BB'/ 'B' from 'BBB'/'F2'. The Outlook for the Long-term IDRs are Positive.

At the same time, Fitch has upgraded BOI's and BOI UK's Viability Rating (VR) to 'bb+' from 'bb-' and AIB's VR to 'bb' from 'b+'.

The rating actions are in conjunction with Fitch's review of sovereign support for banks globally, which the agency announced in March 2014. In line with its expectations announced in March last year, and communicated regularly since then, Fitch believes legislative, regulatory and policy initiatives have substantially reduced the likelihood of sovereign support for US, Swiss and European Union commercial banks. Following the revision of our expectation for state support, the IDRs are now driven by these banks', or their parents' VRs.

The rating actions are also part of a periodic portfolio review of the Irish banking groups rated by Fitch.

A full list of rating actions is available at the end of this rating action commentary.

KEY RATING DRIVERS - IDRs, VRs AND SENIOR DEBT RATINGS
The Long-term IDRs of BOI, BOI UK and AIB are driven by these banks' stand-alone creditworthiness as expressed in their VRs, which Fitch has today upgraded. The ratings reflect on-going improvements in these banks' asset quality, business prospects, profitability and enhanced capital flexibility.

While a number of credit metrics remain weak, with significant legacy assets that are either non-performing or low-yielding, such assets have been declining rapidly and profitability has been following an upward trend over the last two years and is set to continue into the medium-term. As a result these banks' capital flexibility will likely be enhanced further over the next 12-18 months.

However, both BOI and AIB continue to hold large stocks of impaired loans (end-2014: BOI reported an impaired loan ratio of 15.0%, AIB 29.2%) and while coverage has improved significantly, the proportion of net impaired loans to Fitch Core Capital (FCC) FCC remains high. Nonetheless, property-secured lending should continue to benefit from an expected pick up in real estate prices and from increasing volumes of house sales, both of which are supported by Ireland's improving macro-economic environment.

The rating differential between BOI and AIB reflects AIB's greater vulnerability to its capital from negative unexpected falls in asset values. Furthermore, BOI's large exposure to UK residential mortgage loans has allowed it to benefit from the strong improvement in the performance and profitability of these assets over the past two years.

Fitch expects that both BOI's and AIB's profitability will continue to improve in 2015, driven by low loan impairment charges and widening net interest margins on the back of lower funding costs across the sector since 2H12. However, we expect net interest revenue to suffer from the effect of competitive pressure on domestic mortgage loans. Efficiency at both banks remains low, in Fitch's opinion, as business volumes have been affected by sharp asset deleveraging and relatively low business generations since the global financial crisis. However, cost-cutting measures are being addressed by both banks, with increased investment in technology and/or digitalisation planned and supported by lower staff costs.

FCC ratios have increased significantly at both BOI and AIB over the past year and are reaching levels which we consider to be in line with their risk profile. However, the improvements have been faster at BOI than at AIB: at end-2014, BOI's FCC/ Fitch adjusted risk-weighted assets (RWA) ratio stood at nearly 10%, up from 6.8% at end-2013. AIB's capitalisation continues to be supported by a large stock of perpetual government-held preference shares. While its FCC/RWA ratio remained a low 7.26% at end-2014, its Fitch Eligible Capital/RWA ratio which includes the preference shares was a healthier 13.18%. Conversion of these perpetual preference share to equity would boost its regulatory CET1 ratio, but it is possible that the bank may begin to redeem these shares as its profitability improves.

KEY RATING SENSITIVITIES - IDRs, VRs AND SENIOR DEBT RATINGS

BOI's and AIB's VRs and IDRs take account of Fitch's expectations of improving internal capital generation through stronger profitability in 2015 and onward, and stable or improving asset quality and capital ratios. Continued rehabilitation and curing of legacy problem loans or significant non-recourse sale of portfolios could result in positive rating action.

The Positive Outlook on BOI's Long-term IDR reflects Fitch's expectation that the tail risk relating to its large stock of unreserved impaired loans will likely reduce over the next 12-18 months as deleveraging of non-core assets continues and improved profitability further enhances the banks' capital base. As a result, the proportion of the bank's unreserved non-performing loans to FCC should fall to below 100%, at which point we expect the rating to no longer be constrained to below investment-grade. However, achieving this objective partly depends on continued sound performance of the Irish economy, which renders BOI vulnerable to any unexpected adverse changes to the Irish economy.

The Positive Outlook on AIB's rating reflects our expectation that the ratings may be upgraded further over the next 12-18 months as improvements continue to feed through to its credit profile. A strengthened capital profile might also include the conversion of a proportion of its preference shares into equity but the amount and timing of any conversion or buy-back is still unclear.

The IDRs and VRs could face negative pressure if any of our expectations are not met, or if macro-economic conditions reverse and cause further weakening of asset quality to the extent that impairment charges would compromise the banks' profitability and hence capital flexibility.

KEY RATING DRIVERS AND SENSITIVITIES- SUPPORT RATINGS AND SUPPORT RATING FLOORS

The downgrade of BOI and AIB's SRs to '5' from '2' and revision of their Support Rating Floors (SRF) to No Floor' from 'BBB' reflects Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that either bank becomes non-viable.

In Fitch's view, the EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) are now sufficiently progressed to provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support. In the EU, BRRD has been effective in member states since 1 January 2015, including minimum loss absorption requirements before resolution financing or alternative financing (eg, government stabilisation funds) can be used. Full application of BRRD, including the bail-in tool, is required from 1 January 2016.

An upgrade to the SR and upward revision to the SRF would be contingent on a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely in Fitch's view.

SUBSIDIARIES AND AFFILIATED COMPANIES-KEY RATING DRIVERS AND SENSITIVITIES

EBS Limited and AIB Group (UK) Plc are wholly-owned by AIB, and Bank of Ireland Mortgage Bank are wholly-owned by BOI. All of these subsidiaries are, to varying degrees, reliant on their respective parents for funding and capital support. Their IDRs are therefore based on support and are equalised with their parents', and are sensitive to the same factors that might drive a change in their parents' ratings.

Fitch has not assigned VRs to EBS Limited, AIB Group (UK) and Bank of Ireland Mortgage Bank as we believe that these subsidiaries are closely integrated within their respective parents that they cannot be analysed meaningfully on a stand-alone basis.

BOI UK's IDR, on the other hand, is based on its own VR, which, in turn, is equalised to BOI's due to high level of integration of systems and processes across the group and BOI UK's large size relative to the group. However, BOI UK has its own funding franchise through the UK Post Office, as well as stronger capitalisation and asset quality by virtue of a more benign operating environment than its parent, BOI. Further improvement in its stand-alone profile could support rating upgrades ahead of its parent.

Upward pressure on BOI UK's VR and IDR to levels higher than its parent is possible in the longer-term, but this would be contingent on increased independence from the group and a longer track record as a standalone entity.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated debt and other hybrid capital issued by BOI and AIB are notched off their issuer's respective VRs and reflect 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 is notched once off BOI's VR, reflecting the higher loss severity. Its upgrade follows that of BOI's today. BOI UK Holding's deferrable subordinated notes guaranteed by BOI are notched three times off BOI's VR, twice for non-performance given the notes cumulative and deferrable coupon payments at the issuer's discretion and once for loss severity given the absence of write down or equity conversion features. Their upgrade mirrors that of BOI's VR.

The ratings of all subordinated instruments are primarily sensitive to any change in the VRs of these institutions, or to changes in their notching.

The rating actions are as follows:

AIB
Long-term IDR: downgraded to 'BB' from 'BBB'; Outlook Positive
Short-term IDR: downgraded to 'B' from 'F2'
Viability Rating: upgraded to 'bb' from 'b+'
Support Rating: downgraded to '5'
Support Rating Floor: revised to 'No Floor' from 'BBB'
Senior unsecured notes: downgraded to 'BB' from 'BBB'
Short-term debt: downgraded to 'B' from 'F2'
Commercial paper: downgraded to 'B' from 'F2'
Subordinated notes: affirmed at 'C'

AIB (UK)
Long-term IDR: downgraded to 'BB' from 'BBB'; Outlook Positive

Short-term IDR: downgraded to 'B' from 'F2'
Support Rating: downgraded to '3' from '2'

EBS
Long-term IDR: downgraded to 'BB' from 'BBB'; Outlook Positive
Short-term IDR: downgraded to 'B' from 'F2'
Support Rating: downgraded to '3' from '2'
Senior unsecured notes: downgraded to 'BB' from 'BBB'
Short-term debt: downgraded to 'B' from 'F2'

BOI
Long-term IDR: downgraded to 'BB+' from 'BBB'; Outlook Positive
Short-term IDR: downgraded to 'B' from 'F2'
Viability Rating: upgraded to 'bb+' from 'bb-'
Support Rating: downgraded to '5'
Support Rating Floor: revised to 'No Floor' from 'BBB'
Senior unsecured notes: downgraded to 'BB+' from 'BBB'
Short-term debt: downgraded to 'B' from 'F2'
Commercial paper: downgraded to 'B' from 'F2'
Subordinated debt: upgraded to 'BB' from 'B+'
BOI UK Holdings deferrable subordinated notes guaranteed by BOI: upgraded to 'B+' from 'B-'

BOI Mortgage Bank
Long-term IDR: downgraded to 'BB+' from 'BBB'; Outlook Positive
Short-term IDR: downgraded to 'B' from 'F2'
Support Rating: downgraded to '3' from '2'

BOI UK Plc
Long-term IDR: downgraded to 'BB+' from 'BBB'; Outlook Positive
Short-term IDR: downgraded to 'B' from 'F2'
Viability Rating: upgraded to 'bb+' from 'bb-'
Support Rating: downgraded to '3' from '2'

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Additional information is available on www.fitchratings.com

Applicable criteria, Global Bank Rating Criteria , dated 20 March 2015, is available at www.fitchratings.com.

Applicable Criteria and Related Research:
Global Bank Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501