MOODY'S INVESTORS SERVICE

Credit Opinion: Allied Irish Banks, p.l.c.

Global Credit Research - 16 Jan 2014

Dublin, Ireland

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba3/NP
Bank Financial Strength	E+
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Senior Unsecured -Dom Curr	B1
Subordinate	B3
Jr Subordinate	C (hyb)
Bkd Commercial Paper -Dom Curr	NP
Other Short Term -Dom Curr	(P)NP
Allied Irish Banks, NY	
Outlook	No Outlook
Bank Deposits (ST)	--/NP
Bkd Deposit Note/CD Program	(P)Ba1/(P)NP
AIB North America, Inc.	
Outlook	Stable
Bank Deposits	Ba3/--
Bkd Senior Unsecured	Ba1
Bkd Commercial Paper	NP

Contacts

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Key Indicators

ALLIED IRISH BANKS, P.L.C. (Consolidated Financials)[1]

	[2]6-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (EUR million)	120,602.0	122,516.0	136,651.0	145,222.0	174,314.0	[3]-8.8
Total Assets (USD million)	156,764.4	161,524.1	177,392.8	194,821.6	250,095.4	[3]-11.0
Tangible Common Equity (EUR million)	8,039.0	8,886.0	13,250.0	366.7	6,784.2	[3]4.3
Tangible Common Equity (USD million)	10,449.5	11,715.2	17,200.4	491.9	9,733.6	[3]1.8
Net Interest Margin (%)	0.9	0.8	1.0	1.3	1.7	[4]1.1
PPI / Average RWA (%)	-0.2	-2.0	-0.4	0.6	1.4	[5]-0.1
Net Income / Average RWA (%)	-1.8	-4.5	-6.1	-3.8	-2.3	[5]-3.7
(Market Funds - Liquid Assets) / Total Assets (%)	10.0	16.0	23.8	31.5	17.2	[4]19.7
Core Deposits / Average Gross Loans (%)	74.2	68.1	65.8	52.7	67.6	[4]65.7
Tier 1 Ratio (%)	13.2	13.6	16.8	4.2	7.2	[5]11.0
Tangible Common Equity / RWA (%)	10.7	11.2	14.8	0.4	5.6	[5]8.6
Cost / Income Ratio (%)	109.2	464.7	122.9	69.5	47.3	[4]162.7
Problem Loans / Gross Loans (%)	34.3	32.6	25.4	12.9	6.1	[4]22.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	115.3	112.7	89.7	160.7	59.1	[4]107.5

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating of E+ to Allied Irish Banks plc, which maps to b2 on the long-term scale. Although Moody's believes that the 2011 recapitalisation following the Prudential Capital Assessment Review (PCAR) undertaken by the Irish regulator has strengthened the overall position of the bank, the ongoing asset-quality challenges could potentially place pressure on the bank's capital levels beyond the PCAR's expectations, even though Moody's acknowledges the relatively high level of provisioning compared with those of its peers. In addition, the adjustments the Central Bank of Ireland (CBI) has advised to AIB and other covered Irish financial institutions following the conclusion of the Balance Sheet Assessment (BSA) may pose further negative pressure on AIB's and those other covered financial institutions' capital ratios. The rating outlook on the BFSR is stable reflecting the balance between the continuing downside risks which led to the downgrade, as well as the positive signals stemming from stabilization in the broader Irish economy.

The B1 unguaranteed senior unsecured debt rating of AIB incorporates one-notch of uplift, reflecting Moody's moderate expectation of systemic support coming from the Irish government given that AIB is systemically important to the financial stability and economic prospects for the recovering Irish economy. In addition, as presently proposed under the draft EU Banking Recovery and Resolution Directive, the bail in of senior unsecured liabilities will not be required until 2016.

The Ba3 long-term bank deposit rating of AIB incorporates two notches of rating uplift from the stand-alone rating, reflecting the support received by the institution from the Irish government and Moody's expectation that further support for the deposits would likely be forthcoming in the event of need. This is based on the supportive attitude of the Irish government towards depositors as witnessed by the 2011 transfer orders to sell the deposits of Anglo Irish Bank and Irish Nationwide Building Society to AIB and IL&P.

Rating Drivers

Strong domestic retail and commercial banking franchise

Asset-quality challenges pose downside risks

Adequate capitalisation under current rules, but AIB still has to pass the ECB stress test and replace non-qualifying capital instruments under CRD IV

Profitability is recovering slowly

Weak albeit improving funding profile

Strong domestic retail and commercial banking franchise

Rating Outlook

The rating outlook on the BFSR is stable as described above. The outlook on the senior debt and bank deposit ratings is also stable in line with the outlook on the BFSR and on the Irish government bond rating.

What Could Change the Rating - Up

Upward pressure might develop if AIB's management takes actions that result in improvements in the bank's capital position, ahead of the ECB stress test in 2014.

Other factors that could exert upward pressure on the bank's BCA in the medium term are (1) a sustained recovery of asset-quality indicators; (2) a return to profitability and improved efficiency metrics; and (3) an improved liquidity position, with lower reliance on funding from monetary authorities.

An upgrade of the bank's debt and deposit ratings could be triggered by an improvement in its standalone financial strength.

What Could Change the Rating - Down

The bank's BCA could be adversely affected by (1) a greater-than-expected deterioration in the bank's existing capital buffers; (2) an additional capital requirement resulting from the ECB stress test exercise that could not be met organically or through management actions; (3) an unexpected deterioration in the bank's profitability metrics; and (4) a material deterioration in its liquidity or funding position.

Negative pressure on the bank's long-term debt and deposit ratings could result from a lowering of the bank's BCA.

DETAILED RATING CONSIDERATIONS

STRONG DOMESTIC RETAIL AND COMMERCIAL BANKING FRANCHISE

AIB has a strong domestic franchise in Ireland, particularly in the area of deposit-taking and commercial banking. Additionally, the group's estimated share of the domestic new residential mortgage lending for H1 2013 was approximately 46% (as estimated by AIB, including the 11% market share of EBS and keeping in mind that there is limited demand for mortgages). However, the bank still requires European Commission approval for its updated restructuring plan and we would caution that this approval process has the potential to lead to further changes in the bank's franchise. As part of the restructuring of the Irish banking sector, the authorities' aim is for AIB to be one of the `pillar banks' for the Irish economy (together with Bank of Ireland). The bank has undertaken a series of initiatives to streamline the organisation and develop a digital offering to its customers.

ASSET-QUALITY CHALLENGES POSE DOWNSIDE RISKS

The credit quality of AIB has weakened considerably as a result of the rapid deterioration in the operating environment in both Ireland and the UK over the past few years. Asset quality remains a key issue, however it appears to be stabilising: the ratio of impaired loans to gross loans rose to 34.3% at the end of June-2013 up from 32.7% at the end of 2012. Positively, the absolute amount of impaired loans has reduced slightly by 0.6% to EUR 29.2 billion. The group has maintained a high 56% provision coverage of impaired loans while improving its internal credit risk processes, leading to a release of collective provisions and an increase in specific provisions.

The main areas of concern for the bank remain the Irish mortgage and commercial lending portfolios. Irish mortgages over 90 days in arrears and/or impaired have risen to EUR 8.8 billion at the end of June-2013, representing 22.7% of the lending book. Asset quality is worse in the buy-to-let book where 48% was impaired or over 90 day in arrears at 30 June 2013, compared with 16.4% in the owner-occupied book. Moody's generally views this sector as inherently more vulnerable than other categories within the residential mortgage portfolio. We would expect losses on this portfolio to continue to be higher than on the owner-occupier portfolio. Additionally, 57% of the Irish residential mortgage book was in negative equity at 30 June 2013. At the same date, EUR 5.4 billion of Irish mortgages (which includes 35% of loans over 90 days in arrears and/or impaired) were subject to some kind of forbearance. The group intends to meet or exceed the targets set by the Central Bank on sustainable mortgage restructuring solutions.

The commercial real estate book was 65% impaired at the end of June 2013 (62% at the end of 2012), with a provision coverage of 60% (59% at the end of 2012). The non real-estate commercial and corporate lending book was 30% impaired at the end of June 2013, a level consistent with yearend 2012. The majority of the book is lending to SMEs in Ireland and we would expect to see further provisioning in this book as a result of the challenging economic conditions.

As part of its comprehensive assessment of European banks, the European Central Bank (ECB) will review AIB's key risks following an asset quality review and stress test. The result of this supervisory review is expected to be published in October 2014 (please refer to our Special Comment "European Banks: ECB's Comprehensive Assessment Is Credit Positive, But Crucial Questions Left Unanswered" for further detail).

ADEQUATE CAPITALISATION UNDER CURRENT RULES, BUT AIB STILL HAS TO PASS THE ECB STRESS TEST AND REPLACE NON-QUALIFYING CAPITAL INSTRUMENTS UNDER CRD IV

AIB reported a core tier one ratio of 15.1% as of the end of June-2013. This CT1 ratio has remained stable since year end 2012 as a result of an RWA reduction of EUR 6 billion which offset the impact of P&L losses. The proforma Basel III fully loaded common equity tier one ratio was 9.5% at the end of June 2013.

Moody's believes that the bank will remain adequately capitalised under the Basel III transitional rules even after meeting all the potential requirements outlined as a result of the BSA/AQR. Nevertheless, Moody's believes that the bank will be in a more vulnerable position to face the ECB's stress test in 2014 due to the required adjustments to impairment provisions, RWAs and expected losses. In addition, the bank's stressed ratio would face additional pressure since it should include a phased-in deduction for deferred tax assets. These remain sizable for AIB and will continue to have a negative impact on its fully loaded CET1 ratio. As a result, in Moody's opinion, the stress testing process and its yet undisclosed key parameters generate uncertainty as to how it will impact AIB and which offsetting actions management could potentially take if a capital shortfall were to result.

PROFITABILITY IS RECOVERING SLOWLY

The group's reported net interest margin improved to 106 basis points in the half year to June 2013, up from 90 bps. in 2012, mostly explained by savings from the bank's withdrawal from the Eligible Liability Guarantee (ELG) scheme which cost 22 bps. (against 34 bps. in 2012). AIB's large (EUR 16 billion) holdings of low-yielding NAMA bonds cost an additional 14 bps. of NIM.

The group made a EUR 162 million profit in the first half of 2013, before provisions, disposal losses and restructuring costs, compared with a loss of EUR 110 million for the same period of the previous year. Personnel expenses (before redundancy costs) were cut by 16%, as compared with the first half of 2012. Impairment provisions were 16% lower in the first half of 2013, at EUR 744 million compared to EUR 890 million for the same period of the previous year.

On 7 November 2013, the ECB cut its benchmark interest rate to 0.25% from 0.50%, a move which will negatively impact the NIM of AIB (as well as the other Irish lenders) since 42% of its Irish mortgage book was on tracker rates at end-June 2013. However, this is partially offset by a reduction in ECB funding costs. Notwithstanding this, our view is that AIB still remains on track to improve its profitability.

WEAK ALBEIT IMPROVING FUNDING PROFILE

The bank's gross loan to deposit ratio as calculated by Moody's stood at 131% at the end of June 2013 against 141% at the end of 2012, a result of the bank's continued deleveraging. Aside from the impact of negative net lending, we do not expect significant improvement in the loan to deposit ratio as non-core deleveraging is now complete.

Positively, the bank has managed to reduce further its reliance on ECB funding, to EUR 17.7 billion at end June 2013 (18% of total funding) from EUR 22.2 billion at end 2012 (21% of total funding). We expect the funding requirement of AIB to reduce further due to negative net lending and the near-term maturity of the NAMA bonds. We also expect AIB to increase its issuance of wholesale debt, primarily through secured transactions.

In 2012, AIB issued its first public issuance of unguaranteed debt since 2007 with a EUR 395 million UK RMBS and a EUR500 million, 3-year unguaranteed covered bond. In 2013, the bank issued a 3.5 year EUR500 million unguaranteed covered bond, another EUR500 million, 5 year unguaranteed covered bond in September, and its first EUR500 million senior unsecured bond. In addition, AIB entered into a EUR 500 million 2 year bilateral revolving funding facility secured on Irish credit card receivables. These key issuances indicate a renewed market appetite for AIB debt, potentially leading the way to a more normalised access to market funding.

Global Local Currency Deposit Rating (Joint Default Analysis)

AIB's long-term global local currency (GLC) deposit rating is Ba3. This incorporates two notches of rating uplift from the stand-alone rating, reflecting the explicit support received by the institution from the Irish government and Moody's expectation that further support for the deposits would likely be forthcoming in the event of need. This is based on the supportive attitude of the Irish government towards depositors as witnessed by the 2011 transfer orders to sell the deposits of Anglo Irish Bank and Irish Nationwide Building Society to Allied Irish Banks and Irish Life & Permanent. The outlook is stable.

Notching Considerations

As detailed above, unguaranteed senior unsecured debt is rated B1. The outlook is stable in line with that of the bank's BFSR.

Moody's recently upgraded the ratings of AIB's subordinated debt to B3 from C in line with the rating agency's guidelines for rating junior bank obligations.

Foreign Currency Deposit Rating

Moody's assigns ratings of Ba3/Not-Prime to AIB's foreign currency deposits. The outlook on the ratings is stable.

Foreign Currency Debt Rating

Moody's assigns a rating of B1/Not-Prime to AIB's unguaranteed senior unsecured foreign currency debt. The outlook on the ratings is stable.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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

ALLIED IRISH BANKS, P.L.C.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**D+**	
Factor: Franchise Value						**D**	
Market share and sustainability			**x**				
Geographical diversification				**x**			
Earnings stability					**x**		
Earnings Diversification [2]							
Factor: Risk Positioning						**D**	
Corporate Governance [2]				**x**			
- Ownership and Organizational Complexity				x			
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management				**x**			
- Risk Management				x			
- Controls				x			
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness				x			
- Quality of Financial Information		x					
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management					**x**		
Market Risk Appetite	**x**						
Factor: Operating Environment						**C+**	
Economic Stability					**x**		
Integrity and Corruption		**x**					
Legal System	**x**						
Financial Factors (50%)						**D-**	
Factor: Profitability						**E**	
PPI % Average RWA (Basel II)					-0.58%		
Net Income % Average RWA (Basel II)					-4.81%		
Factor: Liquidity						**E**	
(Market Funds - Liquid Assets) % Total Assets					23.78%		
Liquidity Management					x		

Factor: Capital Adequacy						**A**	
Tier 1 Ratio (%) (Basel II)	11.55%						
Tangible Common Equity % RWA (Basel II)	8.81%						
Factor: Efficiency						**E**	
Cost / Income Ratio					219.02%		
Factor: Asset Quality						**E**	
Problem Loans % Gross Loans					23.67%		
Problem Loans % (Equity + LLR)					121.04%		
Lowest Combined Financial Factor Score (15%)						**E**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**D**	
Aggregate BCA Score						**ba2**	
Assigned BFSR						**E+**	
Assigned BCA						**b2**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.

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