MOODY'S INVESTORS SERVICE

Credit Opinion: EBS Ltd

Global Credit Research - 17 Jan 2014

Dublin, Ireland

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba3/NP
Bkd Bank Deposits (ST) -Dom Curr	--/NP
Bank Financial Strength	E+
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Senior Unsecured -Dom Curr	B1
Subordinate MTN -Dom Curr	(P)B3
Bkd Commercial Paper -Dom Curr	NP
Other Short Term -Dom Curr	(P)NP
Parent: Allied Irish Banks, p.l.c.	
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

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Key Indicators

EBS Ltd (Consolidated Financials)[1]

	[2]12-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (EUR million)	16,319.0	18,537.0	20,209.4	21,505.6	21,377.7	[3]-6.5
Total Assets (USD million)	21,514.8	24,063.7	27,111.8	30,855.0	29,716.0	[3]-7.8
Tangible Common Equity (EUR million)	659.0	1,025.0	862.9	564.0	623.2	[3]1.4
Tangible Common Equity (USD million)	868.8	1,330.6	1,157.6	809.2	866.3	[3]0.1
Net Interest Margin (%)	0.8	1.0	0.6	0.7	0.7	[4]0.8
PPI / Average RWA (%)	-6.2	1.1	0.6	1.0	0.7	[5]-0.6
Net Income / Average RWA (%)	-7.4	-1.6	-5.7	-0.7	-0.9	[5]-3.3
(Market Funds - Liquid Assets) / Total Assets (%)	15.1	34.4	32.5	31.1	28.6	[4]28.3
Core Deposits / Average Gross Loans (%)	67.0	51.5	56.4	58.3	61.3	[4]58.9
Tier 1 Ratio (%)	7.6	10.1	9.1	6.7	7.9	[5]8.3
Tangible Common Equity / RWA (%)	7.1	10.0	8.6	5.6	6.4	[5]7.5
Cost / Income Ratio (%)	-18.9	46.2	61.8	48.5	61.3	[4]39.8

Problem Loans / Gross Loans (%)	**21.7**	**21.7**	**11.4**	**5.9**	**1.8**	[4]**12.5**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**187.1**	**197.8**	**177.8**	**235.1**	**72.6**	[4]**174.1**

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 standalone bank financial strength rating (BFSR) of E+ to EBS Ltd (EBS) that maps to a b2 standalone credit assessment. The standalone ratings reflect EBS' established position in the Irish mortgage and savings market, its position as a fully-owned subsidiary of Allied Irish Banks (AIB, rated E+/Ba3, stable outlook) as well as the challenges the bank faces in terms of funding and asset quality. The bank's capital levels are relatively light as the capital requirement generated by the 2011 PCAR (Prudential Capital Assessment Review) have been held at the parent level.

The bank deposit ratings of EBS are Ba3/NP and the unguaranteed senior unsecured debt ratings are B1/N-P. The outlook is stable. The ratings are the same as its parent's.

Rating Drivers

Profitability is negatively impacted by impairment losses and deleveraging

Mortgage asset quality remains an issue

Capital position depends on AIB

Decreasing reliance on ECB and parental funding, increasing reliance on corporate deposits

Rating Outlook

The rating outlook on the E+ 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. As detailed above, the senior ratings have a stable outlook, in line with the outlook on the BFSR, the ratings of AIB, and the outlook on the government bond rating.

What Could Change the Rating - Up

Given the challenges facing EBS, upward pressure on the bank's BCA in the medium term could be exerted by (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.

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

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 unexpected deterioration in the bank's profitability metrics; and (3) a material deterioration in its liquidity or funding position. In addition, further negative pressure could be exerted by an additional capital requirement to its parent resulting from the ECB stress test exercise that could not be met organically or through management actions.

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

DETAILED RATING CONSIDERATIONS

Data in the following sections is sourced from the 2012 annual report of EBS unless otherwise stated.

PROFITABILITY IS NEGATIVELY IMPACTED BY IMPAIRMENT LOSSES AND DELEVERAGING

EBS reported a pre-tax loss of EUR 842 million in 2012, compared to a loss of EUR 254 million in 2011. The higher loss was mostly due to a EUR 668 million loss on sale of certain loans and advances to customers in 2012 (2011: EUR nil), the non-recurrence of the 2011 EUR 159 million liability management gain as well as lower net interest income (due to lower volumes and lower margins). The reported net interest margin, which included the fees paid under the ELG scheme, was 82 bps in 2012, 21 bps lower than in 2011 (103 bps), mainly due to the higher cost of retail funding and decrease in lending margins. Adjusting for the liability exchange gain and the loss on loan disposals, the cost income ratio of EBS rose to 63% in 2012 from 40% in 2011 mainly as a result of lower net income. Impairment charges however, were lower in 2012: EUR 229 million reported in 2012, 57% less than the corresponding EUR 530 million figure for 2011.

We expect profitability to continue to be under negative pressure and further provisioning will also likely represent a drag on profits. However, the expiration of ELG, and thus the absence of the ELG-related charges, should help the margin recovery.

ASSET QUALITY OF MORTGAGES REMAIN AN ISSUE

EBS's stock of impaired loans has decreased to EUR 3 billion at end-2012, or 21.7% of gross loans, from EUR 3.5 billion at end-2011 mostly as the result of the non-core deleveraging process. The provision coverage of impaired loan was 31.0% (2011: 27.1%). At end-2012, the core portfolio consisted of EUR 13 billion of owner-occupier residential mortgages, 20.0% of which are more than 90 days in arrears and/ or impaired (up from 16.5% at end-2011). 10.4% of the total owner-occupier mortgage loan balances were in some kind of forbearance arrangement at end-2012 (2011: 8.9%). The non-core portfolio decreased to EUR 886 million, or 6.4% of gross loans, from EUR 2,746 million, or 16.8% of gross loans, at end-2011. The non-core portfolio represented exposure to residential buy-to-let (68.6%) and commercial mortgage loans (31.4%).

CAPITAL POSITION SUFFICIENT BUT DEPENDS ON AIB

The losses reported in recent years led to the injection of capital from the government in 2010 and then the 2011 PCAR process required EBS to raise a total of EUR 1.5 billion, including a buffer of EUR 0.3 billion. The requirement was met in July 2011 when AIB took over EBS and the Irish Government provided the EUR 1.5bn to AIB. Capital is now managed at the AIB level and we expect AIB to ensure that EBS remains adequately capitalised in line with the regulatory requirements. At end-2012 EBS had a core tier 1 capital ratio of 7.9%, down from 10.5% at end-2011, including the EUR 400 million AIB injected into EBS during 2012 to offset some of the losses due to loan impairments and asset sales.

DECREASING RELIANCE ON ECB AND PARENTAL FUNDING WHILE INCREASING RELIANCE ON CORPORATE DEPOSIT FUNDING

ECB funding accounted for 16% of total funding of EBS (down from 23% in 2011) which is still considered high. The bank has significantly decreased its funding reliance from AIB to 0.1% of total funding from 7% at end-2011. EBS also increased its customer deposit base by 18% to EUR 10.1 billion in 2012, representing 67% of total funding at end-2012 (50% at end-2011). However, 59% of the increase in deposits came from corporate deposits (representing 18% of total funding at end-2012 vs 10% at end-2011), an alternative to wholesale funding (15% of total funding at end-2012 vs 19% at end-2011). We note that corporate deposits are a less stable source of funding than retail deposits and that at end-2012 79.9% of EBS deposit funding had less than one year maturity (end-2011: 75.2%).

Global Local Currency Deposit Rating (Joint Default Analysis)

EBS's long-term global local currency (GLC) deposit rating is Ba3 based on Moody's assessment of a high probability of continued systemic support, through its parent. Consequently, there is a two-notch uplift for EBS's deposit rating from its b2 baseline credit assessment. The rating currently carries a stable outlook.

Notching Considerations

As detailed above unguaranteed senior unsecured debt is rated B1, incorporating one-notch uplift from the b2 standalone assessment of the bank. This reflects Moody's moderate expectation of systemic support coming from the Irish government to its parent and EBS 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.

Foreign Currency Deposit Rating

Moody's has assigned Ba3/NP ratings to the foreign currency deposits of EBS.

Foreign Currency Debt Rating

Moody's has assigned B1/NP ratings to the senior foreign currency debt of EBS.

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

EBS Ltd

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]							
- Ownership and Organizational Complexity							
- 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)					-1.52%		
Net Income % Average RWA (Basel II)					-4.92%		
Factor: Liquidity						**E**	
(Market Funds - Liquid Assets) % Total Assets					27.35%		
Liquidity Management					x		

Factor: Capital Adequacy						**B+**	
Tier 1 Ratio (%) (Basel II)		8.94%					
Tangible Common Equity % RWA (Basel II)	8.54%						
Factor: Efficiency						**A**	
Cost / Income Ratio	29.67%						
Factor: Asset Quality						**E**	
Problem Loans % Gross Loans					18.25%		
Problem Loans % (Equity + LLR)					187.54%		
Lowest Combined Financial Factor Score (15%)						**E**	
Economic Insolvency Override						**D-**	
Aggregate BFSR Score						**D-**	
Aggregate BCA Score						**ba3**	
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.