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Research Update:

Allied Irish Banks Outlook Revised To Pos On Government Support Review And Capital Restructuring; Affirmed At 'BB+/B'

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Overview

- We believe the prospect of extraordinary government support for Irish banks is now uncertain in view of the country's well-advanced and effective resolution regime.
- We are therefore removing the two-notch uplift for government support as well as the negative adjustment we had previously applied to our long-term counterparty credit ratings on Allied Irish Banks (AIB).
- AIB recently announced a capital restructuring on the back of regulatory approval from the Single Supervisory Mechanism for a number of capital actions that will simplify and strengthen the group's regulatory capital position, including a conversion of part of the government preference shares into common shares.
- At this stage, we consider that AIB is unlikely to increase its additional loss-absorbing capacity above our required threshold, despite the recent issuances of Tier 2 and Additional Tier 1 capital instruments.
- However, we believe that the announced capital restructuring, alongside the bank's return to profitability, will lead to a material improvement in AIB's capital and earnings position. We have therefore revised our assessment of AIB's stand-alone credit profile to 'bb+' from 'bb'.
- Consequently, we have raised our debt ratings on AIB's recent Tier 2 issue to 'B+' from 'B'.
- In addition, we are revising our outlook on AIB to positive from stable and affirming the 'BB+/B' long- and short-term counterparty credit ratings.
- The positive outlook on AIB reflects our expectation that the strengthening macroeconomic environment in Ireland may lead to an improvement in the bank's creditworthiness within the next two years.

Rating Action

As previously announced on Dec. 2, 2015, Standard & Poor's Ratings Services has revised the outlook on Allied Irish Banks PLC (AIB) to positive from stable and affirmed the 'BB+/B' long- and short-term counterparty credit ratings.

At the same time, we affirmed the 'BB+/B' long- and short-term ratings on AIB Group (U.K.) PLC (AIB UK), AIB's wholly owned subsidiary. The outlook on AIB UK remains stable.

In addition, we raised our debt ratings on AIB's recent Tier 2 issue to 'B+' from 'B'.

Rationale

We believe that the prospect of extraordinary government support for the Irish banking sector is now uncertain following the expected full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, from Jan. 1, 2016. We do not completely exclude the possibility of such support, and we consider that systemically important Irish institutions, such as AIB, face several more years of structural and balance sheet reforms to address their "resolvability" (mitigating the systemic impact if they fail). Nevertheless, we believe the Irish government's ability and willingness to provide support is lower and less predictable under the enhanced resolution framework. We have therefore reclassified the tendency of the Irish government to support private sector commercial banks as "uncertain" under our criteria, and removed the uplift that we previously included for government support in the long-term counterparty credit rating on AIB.

We view the Irish resolution regime as "effective" under our additional loss-absorbing capacity (ALAC) criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. However, we have not included notches in the long-term rating on AIB under our ALAC criteria, because, at this stage, we have limited visibility on whether AIB's future issuance plans will lead to an ALAC ratio exceeding our required threshold over a four-year projection period (4% with an anchor of 'bb+' and 5% with an anchor of 'bbb-' or above).

We believe that our risk-weighted assets assessment adequately captures the risks AIB is exposed to, and we consider that AIB's group structure is relatively simple. We extended the projection period to four years, because we believe the Republic of Ireland is in an extended regulatory transition period in which banks will progressively build larger buffers of loss-absorbing capacity.

We estimate that AIB's ALAC ratio will be short of 2% of Standard & Poor's risk-weighted assets at year-end 2016. We include in this estimate the recent €750 million Tier 2 issuance and €500 million Additional Tier 1 (AT1) issuance, but exclude the €1.6 billion contingent capital notes issued in 2011 to the Irish authorities, as we understand these will be redeemed in the coming months. Our estimate also includes the small residual amounts of two legacy subordinated notes that were subject to liability management exercises in 2011, and we understand AIB continues to not pay coupons on these notes. We believe these issues have the capacity to absorb losses without triggering a default on senior obligations. Our projection does not incorporate any potential further issuance of subordinated debt.

On Nov. 6, 2015, AIB announced that it had received regulatory approval from the Single Supervisory Mechanism for a number of capital actions, including a conversion of part of the government preference shares into common shares. As a result, we have raised our stand-alone credit profile (SACP) for AIB to 'bb+' from 'bb'. This is based on our expectation that AIB's capital and earnings position will materially improve following the completion of its capital restructuring, which is also supported by the bank's return to profitability. We consequently revised up our capital and earnings assessment to adequate from weak, reflecting our anticipation that our risk-adjusted capital (RAC) ratio will increase to 7.5%-7.9% in the next 12-18 months, based on the recent issuance of €500 million AT1 capital notes and our expectation of retained earnings outpacing growth in risk exposures.

In addition, the upward revision of AIB's SACP to 'bb+' from 'bb' prompted us to raise our debt ratings on AIB's recent Tier 2 issue to 'B+' from 'B'.

The starting point for our ratings on AIB is our 'bb+' anchor, which reflects AIB's focus on Ireland. Given the revised capital and earnings assessment, our assessment of AIB's SACP is now at the same level as the issuer credit rating.

We also take into account in the SACP AIB's position as one of the two "pillar" banks in Ireland, and our view that AIB's asset quality is broadly in line with peers with a similar economic risk and product mix. AIB's funding and liquidity benefits from the rapid decrease in the bank's reliance on monetary authorities and its progress in reducing the funding gap.

Also, we have affirmed our ratings on AIB's strategically important banking subsidiary AIB UK. The subsidiary's long-term counterparty credit rating is based on our assessment of its SACP, which is at the same level as the parent's group credit profile of 'bb+'.

Outlook

The positive outlook reflects our view that, in the coming 12-18 months, we could revise up our anchor for commercial banks in Ireland, including AIB, to reflect the decreasing macroeconomic risks that they face in their domestic market. This would follow an improvement of our economic risk assessment for Ireland under our Banking Industry Country Risk Assessment methodology.

Although less likely at this stage, an upgrade could arise if we include a notch of ALAC support into our long-term rating on AIB. The bank's ALAC buffer would need to increase substantially to exceed the required thresholds (4% if the anchor remains at 'bb+', 5% if it improves to 'bbb-').

We could revise the outlook to stable if we observed that the economic recovery stalled, indicating that the economic risks faced by Irish banks were not declining.

The stable outlook on AIB UK reflects our view of its steady intrinsic

creditworthiness.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BB+/Positive/B	BB+/Stable/B
SACP	bb+	bb
Anchor	bb+	bb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Adequate (0)	Weak (-1)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	0	+2
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	+2
Additional Factors	0	-1

Related Criteria And Research

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Use of 'C' and 'D' Issue Credit Ratings For Hybrid Capital and Payment-In-Kind Instruments, Oct. 24, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign-Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Assessing Bank Branch Creditworthiness, Oct. 14, 2013

- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Most European Bank Ratings Affirmed Following Government Support And ALAC Review, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December 2015, Oct. 1, 2015
- Government And ALAC Support Ratings Uplift For Systemically Important European Banking Groups, Oct. 1, 2015
- How The Regulatory Reform Process Could Reshape Banks' Business Models And Affect Issuer Ratings, Aug. 18, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Allied Irish Banks PLC Counterparty Credit Rating	BB+/Positive/B	BB+/Stable/B

Ratings Affirmed

AIB Group (U.K.) PLC Counterparty Credit Rating	BB+/Stable/B
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Allied Irish Banks PLC Senior Unsecured	BB+
Subordinated	D
Commercial Paper	B

Allied Irish Banks N.A. Inc. Commercial Paper*	B
Commercial Paper*	BB+

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Upgraded	To	From
Allied Irish Banks PLC Subordinated	B+	B

*Guaranteed by Allied Irish Banks PLC.

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