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Research Update:

Allied Irish Banks PLC Upgraded To 'BBB/A-2' On Growing ALAC Buffer; Holding Company Ratings Affirmed; Outlook Positive

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Overview

- We believe that the AIB group is making proactive progress in growing its additional loss-absorbing capacity buffers, which provides protection to the senior creditors of its operating bank.
- We are therefore raising the long- and short-term issuer credit ratings on the group's main operating bank, Allied Irish Banks PLC, to 'BBB/A-2' from 'BBB-/A-3', and on its subsidiary, AIB Group (UK) PLC, to 'BBB-/A-3' from 'BB+/B'.
- We are affirming the 'BB+/B' ratings on nonoperating holding company AIB Group PLC, as we do not observe any fundamental improvement in the underlying creditworthiness of the group at this time, notwithstanding the progress being made to reduce its large stock of nonperforming assets.
- The positive outlooks on all entities reflects our view that we may improve our view of Irish banking industry risk over our two-year outlook horizon.

Rating Action

On July 10, 2018, S&P Global Ratings raised its long- and short-term issuer credit ratings on Ireland-incorporated Allied Irish Banks PLC to 'BBB/A-2' from 'BBB-/A-3'. We also raised the long- and short-term issuer ratings on the U.K. incorporated subsidiary, AIB Group (UK) PLC (AIB UK), to 'BBB-/A-3' from 'BB+/B'. The outlook on both entities remains positive.

At the same time, we affirmed the 'BB+/B' ratings on the nonoperating holding company (NOHC), AIB Group PLC (AIB). The outlook remains positive.

Furthermore, we raised the long- and short-term resolution counterparty ratings (RCRs) on Allied Irish Banks to 'BBB+/A-2' from 'BBB/A-2' and affirmed the RCRs on AIB UK at 'BBB/A-2'. We do not assign RCRs to NOHCs.

Finally, we affirmed the ratings on the hybrid instruments issued by Allied Irish Banks.

Rationale

We have raised the ratings on Allied Irish Banks, the main operating bank of AIB, to reflect our view of the proactive progress that the group is making to build up its minimum requirement for own funds and eligible liabilities (MREL), which we reflect in our additional loss-absorbing capacity (ALAC) analysis.

Following the establishment of AIB's new NOHC in December 2017, we have observed two €500 million NOHC senior unsecured issues in March and June of this year, which we include in ALAC. On a pro forma basis, our ALAC ratio has therefore improved to around 4.8% from 3.4% at year-end Dec. 31, 2017 (that is, before the negative impact of IFRS 9). We now see a clear line of sight for this metric to grow further and be sustainably above our 5% threshold to qualify for one notch of uplift in the ratings on the main operating bank. We do not incorporate notches for ALAC support in the ratings on the NOHC, as we do not believe that its senior obligations would continue to receive full and timely payment in a resolution scenario. As a result, we rate the NOHC one notch below the 'bbb-' unsupported group credit profile (UGCP).

Our view of the group's underlying creditworthiness, as reflected in the UGCP, remains unchanged. We observe good progress in AIB's pre-provision earnings and a reducing stock of nonperforming assets, helped by brisk Irish economic growth, investor appetite for Irish loans, and the absence of disruptive new entrants to the banking system. We already incorporate these benefits in our broader view of the Irish banking industry, an important element of our UGCP analysis.

The principal constraint on our view of the UGCP remains AIB's still large stock of nonperforming assets, which remains a clear credit differential compared with higher-rated regional banks. Our calculation of AIB's ratio of gross nonperforming loans to gross loans was a relatively high 18.8% on Dec. 31, 2017, albeit down from 24.6% the year before. This metric compares to 10.9% at close domestic peer Bank of Ireland Group PLC, whose UGCP is one notch higher at 'bbb'. Our metric, which comprises impaired loans, 90 days past due loans, and performing forbore loans, is a little more conservative than AIB's reported nonperforming exposure ratio (NPE; 16% at end-2017). AIB targets a reduction in its NPE ratio to be in line with European banking norms, which we understand to be about 5%, by end-2019. We note good progress toward meeting that target in the year-to-date, including a portfolio sale in May 2018 with a gross value of €1.1 billion, but there is a way to go.

AIB's capitalization remains a ratings strength. AIB reported a regulatory common equity Tier 1 ratio of 17.1% on March 3, 2018, which is well above its stated medium-term target of at least 13%. We do not anticipate any near-term excess capital returns to shareholders while AIB works toward its NPE target. We capture this risk, however, at the end of our own capital projection period through end-2020, but even then, we expect the risk-adjusted capital (RAC) ratio to remain above our 10% threshold for a strong assessment. AIB's RAC

ratio was 12.1% on Dec. 31, 2017, up from 11.6% at end-2016. The excess above the 10% threshold is an important component of the pro forma ALAC ratio, as described above.

The ratings on AIB also incorporate its high and resilient shares in the Irish banking market. We further consider that the management team is making good progress in adapting the business to rapidly changing customer preferences, including digital banking needs. The group is therefore well placed to capture new business in the Irish market when net loan growth finally picks up, which now seems possible. AIB's net loan book was €60 billion on Dec. 31, 2017--down from almost €130 billion at end-2008--and we now expect the net loan book to grow in a sustainable manner, most likely from 2019. The Irish government still owns just over 70% of AIB, with no change following the IPO in mid-2017, and we assume that it will gradually reduce its stake over time.

The upgrade of AIB's wholly owned U.K. subsidiary AIB UK reflects our view that the MREL issued by the group will be beneficial to AIB UK's creditors. We continue to view AIB UK as a strategically important subsidiary as per our group rating methodology. Following several years of deleveraging, AIB UK's balance sheet profile now appears comfortable, with high levels of cash, capital, and excess deposits; the bank is profitable. Relative to its U.K. peers, AIB UK's business has a narrow focus and management has taken a cautious approach to new lending. We consider this to be a wise strategy, but it does highlight the relative reliance of the group on the small Irish market.

Outlook

AIB Group PLC

The positive outlook on AIB reflects that we may improve our view of Irish banking industry risk over our two-year outlook horizon. This could lead us to revise upward the UGCP by one notch to 'bbb' and therefore raise the ratings.

While less likely in the short term, we could also revise the UGCP upward if the group continued to make steady progress in reducing its stock of nonperforming assets, such that its asset quality metrics improved to levels similar to those of international peers in the coming 18-24 months.

We could revise the outlook to stable if we consider that an improvement in Ireland's banking industry risk will not materialize.

Allied Irish Banks PLC

The positive outlook reflects that on AIB.

A higher rating would principally depend on an upward revision of the UGCP, as described above. In addition, if the group makes more substantial progress in terms of MREL issuance than we expect, we could raise the ratings if its ALAC buffer sustainably exceeds our 8% threshold for two notches of ALAC support in

the long-term rating.

We could consider revising the outlook to stable if we took a similar action on AIB, or if the ALAC buffer remained below our 5% threshold for one notch of ALAC support, contrary to our expectations.

Ratings Score Snapshot

UGCP	bbb-
Anchor	bbb-
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding	Average (0)
and Liquidity	Adequate (0)
Support	+1
ALAC Support	+1
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And

Assumptions, Nov. 9, 2011

- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Merely A Win, No Grand Slam Glory For Irish Banks, March 26, 2018
- Banking Industry Country Risk Assessment: Ireland, Dec. 12, 2017
- Various Positive Rating Actions Taken On Irish Banks On Improving Industry Credit Profile, Dec. 12, 2017

Ratings List

Upgraded

	To	From
AIB Group (U.K.) PLC Counterparty Credit Rating	BBB-/Positive/A-3	BB+/Positive/B
Allied Irish Banks PLC Counterparty Credit Rating	BBB/Positive/A-2	BBB-/Positive/A-3
Resolution Counterparty Rating	BBB+/--/A-2	BBB/--/A-2
Senior Unsecured Commercial Paper	BBB A-2	BBB- A-3
Allied Irish Banks N.A. Inc. Commercial Paper	A-2	A-3
Commercial Paper	BBB	BBB-

Ratings Affirmed

AIB Group PLC Counterparty Credit Rating	BB+/Positive/B
Senior Unsecured	BB+
AIB Group (U.K.) PLC Resolution Counterparty Rating	BBB/--/A-2
Allied Irish Banks PLC Subordinated	BB
Subordinated	D

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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