FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms AIB Group at 'BBB'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 16 Sep 2022: Fitch Ratings has affirmed AIB Group plc's (AIBG) Long-Term Issuer Default Rating (IDR) at 'BBB' and Viability Rating (VR) at 'bbb'. Fitch has also affirmed the group's operating companies Allied Irish Banks, plc's (AIB) and AIB Group (UK) p.l.c.'s (AIBUK) Long-Term IDRs at 'BBB+'. The Outlooks on the Long-Term IDRs are Stable. A full list of rating actions is below.

Fitch has withdrawn AIBG and AIB's Support Ratings of '5' and Support Rating Floors of 'No Floor' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria in November 2021. AIBUK's Support Rating of '2' has also been withdrawn. In line with the updated criteria, Fitch has assigned Government Support Ratings (GSR) of 'no support' (ns) to AIBG and AIB, and a Shareholder Support Rating (SSR) of 'bbb+' to AIBUK.

KEY RATING DRIVERS

Satisfactory Credit Profile: AIBG's ratings reflect its leading domestic franchise in core lending and deposits in Ireland, which underpins its stable funding and liquidity, adequate capital buffers, and moderate risk profile. Profitability is variable and concentrated on the small, open and cyclical Irish economy. Asset quality has steadily improved and we expect further modest improvement in the near term, but it remains a rating weakness.

Leading Franchise: AIBG has a dominant position in the Irish banking sector with more than 30% market share of loans and deposits. Its strong brand and deposit franchise underpin its low cost of funding through the cycle. The bank is strengthening business diversification by expanding wealth management and insurance businesses through acquisitions or joint ventures, which should help reduce the bank's reliance on net interest income.

Above-Average but Improving Impaired Loans: AIBG's gross Stage 3 ratio fell to 3.8% at end-1H22 (end-2021: 4.9%; end-1H22 peer average: 3.1%), mostly due to the sale of a portfolio of legacy non-performing exposures, which have now largely been resolved. We expect further modest improvement in the ratio in the near-term to be driven by higher loan growth, primarily due to acquisitions, and curing (mostly Covid-19-affected loans), which we expect to offset increased inflows of impaired loans from borrowers vulnerable to the energy crisis.

Average Profitability: We expect AIBG's profitability to continue to benefit from high margins resulting from the group's leading market position and pricing power in the highly concentrated Irish banking sector, where pricing discipline is strong. Acquisitions and new ventures undertaken since 2021 should strengthen net interest and commission income and help diversify revenue from 2023 but the denominator effect will drag on its operating profit/risk-weighted assets ratio (RWA; end-1H22: 2.4%) in the near term.

Satisfactory Capital Buffers: Fitch expects AIBG to maintain satisfactory capital buffers above minimum regulatory requirements, given its targeted minimum fully-loaded common equity Tier 1 (CET1) ratio of 13.5% (end-1H22: 15.3%). Encumbrance by unreserved impaired loans has improved following de-risking and stronger loan loss allowances and fell to 9% by end-1H22 (end-2021: 10%).

Stable Funding and Liquidity: AIBG's funding profile is supported by ample and stable retail deposits, which fund a significant portion of assets, and by an established and sufficiently diversified wholesale-funding franchise. Customer deposits have been growing strongly in Ireland since 2020 and look set to continue in the short term. Liquidity is sound, supported by a large stock of liquid assets, including sizeable cash deposited at the central bank, and access to central bank facilities.

Holdco VR Equalised with Opco: Fitch assesses the group on a consolidated basis. AIBG acts as the holding company of the Allied Irish Banks group. AIBG's VR is aligned with the VR of its largest wholly-owned operating subsidiary, AIB, to reflect the absence of material double leverage at the holding company, prudent liquidity management, and the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements.

Debt Buffers Drive IDR Uplift: AIB's Long-Term IDR is notched up once from the bank's VR to reflect additional protection to external senior creditors afforded by the internal minimum requirements for own funds and eligible liabilities (MREL) debt buffers. These buffers (about 12% of AIB's RWA at end-1H22) are underpinned by the group's strategy to fulfil MREL exclusively with senior non-preferred and more junior debt. Under the group's single-point-of-entry resolution strategy, senior debt issued at the holding level is down-streamed to AIB as senior non-preferred debt and statutorily subordinated to external senior creditors.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Pressure on Asset Quality, Capitalisation: Fitch believes a downgrade of the VRs is unlikely in the near term given our view of satisfactory financial buffers at the current rating. However, a downgrade could be triggered by a more severe and prolonged deterioration of the operating environment for banks in Ireland than in our base case, which causes the group's impaired loan ratio to increase and be sustained above 4%, and the group's CET1 ratio to fall below 13%, following losses, or if RWAs increase without prospects for sufficient internal capital generation.

Rising Holdco Double Leverage: AIBG's VR would also be downgraded if the holding company's double leverage durably increases to above 120%, which we do not expect.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Business Profile, Earnings, Capital: An upgrade could result from a stronger operating environment, signalled in an upward revision of our operating environment assessment score, if accompanied by better assessments of the group's business and financial profiles. The former would require Irish banks to successfully weather the near-term macroeconomic challenges caused by the war in Ukraine with their financial profiles intact.

In the absence of a stronger operating environment, an upgrade would require stronger profitability and capitalisation. This could stem from increased revenue diversification that reduces earnings variability, helping the group to generate an operating profit/RWAs ratio of above 3%, and sustaining a CET1 ratio above 17%. However, we believe the latter is unlikely to happen in view of the group's current capital target under its medium-term plan.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Group Senior Debt Aligned with IDR: AIBG's Long-Term IDR and long-term senior debt ratings are aligned with the group's VR.

AIBG's Short-Term IDR and short-term senior debt ratings are the higher of two options corresponding to the group's Long-Term IDR and long-term senior debt ratings of 'BBB'. AIB's Short-Term IDR and short-term senior debt ratings are the lower of two options corresponding to the bank's Long-Term IDR and long-term senior debt ratings of 'BBB+'. This is based on our assessment of the group's funding and liquidity, which at 'bbb+', warrants 'F2' short-term ratings.

Opco DCR, Senior Debt Aligned with IDRs: AIB's DCR is aligned with the bank's Long-Term IDR because under Irish legislation, derivative counterparties have no preferential status over other senior obligations in a resolution. The senior unsecured notes are rated in line with the bank's IDR.

Junior Debt Notched Down from VR: AIBG's subordinated Tier 2 debt rating is notched down twice from the VR. This reflects the notes' poor recovery prospects arising from their subordinated status in a resolution. We do not notch for non-performance risk because the terms of the notes do not provide for loss absorption on a going-concern basis.

AIB's legacy subordinated notes are rated 'C' to reflect their non-performance. The notes have sustained economic losses, the issuer has not been paying the discretionary coupons for at least 10 years, and we do not expect the notes to become performing again before they mature.

No Sovereign Support Assumed: AIBG's and AIB's GSR of 'ns' reflect Fitch's view that senior creditors cannot rely on extraordinary support from the Irish authorities in the event that the group becomes non-viable. In our opinion, the EU's Bank Recovery and Resolution Directive and Single Resolution Mechanism provide a framework that is likely to require senior creditors to participate in losses for resolving the bank.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Sensitive to VRs: AIB's and AIBG's IDRs, senior debt ratings and DCR are sensitive to changes in the VRs, or if we no longer estimate that the resolution debt buffer provides AIB's senior creditors and derivative counterparties with additional protection.

The ratings of all subordinated instruments are primarily sensitive to changes in the VRs, or to changes in their notching if Fitch revises its assessment of loss severity or relative non-performance risk

Short-Term IDR Sensitive to Funding and Liquidity: AIBG's Short-Term IDR and short-term senior debt rating are also sensitive to a negative reassessment of the group's funding and liquidity.

An upgrade of the GSRs 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 & AFFILIATES: KEY RATING DRIVERS

High Likelihood of Support: The IDRs of AIB's fully-owned UK subsidiary, AIBUK, are equalised with AIB's. Our support assessment and AIBUK's 'bbb+' SSR are primarily based on the high level of integration of the UK subsidiary into the parent, high fungibility of capital and funding, as well as a record of unquestioned support from the parent. In addition, resolution funds raised by AIBG have been down-streamed to AIBUK through AIB to meet resolution requirements in the past, thereby protecting AIBUK's external senior creditors in a resolution. We expect intra-group resources to be prepositioned at AIBUK to meet resolution requirements, if required.

AIBUK represented around 13% of the group's gross loans at end-1H22 and is closely integrated within the group and relies on the group's systems and processes. Therefore, we do not assign AIBUK a VR as we believe it cannot be assessed meaningfully on a standalone basis.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Sensitive to AIB's Rating Changes: AIBUK's IDRs are sensitive to the same factors as AIB's IDRs. We could also downgrade AIBUK's IDRs and SSR if the subsidiary's strategic importance diminishes, resulting in weaker integration within the group and a reduction in support propensity, in our view. For example, this could be signalled by group resources no longer being made available to fulfil the subsidiary's internal MREL and thus reducing the protection of third-party senior creditors. However, we believe this prospect is unlikely.

VR ADJUSTMENTS

The Operating Environment score of 'bbb+' has been assigned below the 'aa' category implied score due to the following adjustment reasons: Size and Structure of Economy (negative), Reported and Future Metrics (negative), Level and Growth of Credit (negative)

The Asset Quality score of 'bbb-' has been assigned above the 'bb' implied score due to the following adjustment reason: Historical and Future Metrics (positive)

The Earnings & Profitability score of 'bbb' has been assigned above the 'bb' implied score due to the following adjustment reason: Historical and Future Metrics (positive)

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

AIBUK's ratings are directly linked to AIB's.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visitwww.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍		PRIOR ⬍
Allied Irish Banks, plc	LT IDR Affirmed	BBB+ Rating Outlook Stable	BBB+ Rating Outlook Stable

	ST IDR	F2	Affirmed	F2
	Viability	bbb	Affirmed	bbb
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	DCR	BBB+(dcr)	Affirmed	BBB+(dcr)
	Government Support	ns	New Rating	
subordinated	LT	C	Affirmed	C
senior unsecured	LT	BBB+	Affirmed	BBB+
senior unsecured	ST	F2	Affirmed	F2

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

AIB Group (UK) p.l.c.	EU Issued, UK Endorsed
AIB Group plc	EU Issued, UK Endorsed
Allied Irish Banks, plc	EU Issued, UK Endorsed

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