FitchRatings

RATING ACTION COMMENTARY

Fitch Revises AIB Group's Outook to Stable; Affirms Ratings

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Fitch Ratings - Milan - 04 Oct 2021: Fitch Ratings has revised AIB Group Public Limited Company's (AIBG) Outlook to Stable from Negative while affirming the banking group's 'BBB' Long-Term Issuer Default Rating (IDR) and 'bbb' Viability Rating (VR).

The agency has also affirmed the ratings of the group's operating companies Allied Irish Banks (AIB) and AIB Group (UK) PLC (AIBUK) and revised their Outlook to Stable from Negative. A full list of rating actions is below.

The Outlook change reflects our view that immediate pandemic-related risks have largely receded and that the Irish economy will continue to perform strongly after a robust rebound in the year to date, which should continue to support the bank's performance and further risk reduction.

The ratings continue to be positively influenced by the bank's robust capitalisation and funding. The Stable Outlook also acknowledges the group's strategic initiatives to further diversify revenue sources and reduce the group's cost base. It also takes into account the group's commitment to contain the level of non-performing exposures (NPEs) to counter the adverse impact on performance of the pandemic and low interest-rate environment.

Fitch expects robust economic activity to continue in Ireland, with 14% GDP growth forecast for 2021 after an exceptionally strong first quarter (10.7% yoy), before moderating to a still very strong level in 2022 and 2023. Fitch forecasts modified domestic demand, which excludes the GDP-inflating effects of multinational companies and better reflects the country's actual level of economic activity, to continue to recover as pandemic-related risks recede and confidence continues to improve in 2022, supported by the unwinding of domestic savings accumulated during the pandemic and the recovery of the worst-hit sectors, due to large fiscal support available since 2Q20.

KEY RATING DRIVERS

VRs

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 wholly-owned operating subsidiary, AIB, to reflect the absence of material double leverage at the holding company and the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements.

The VRs reflect the group's strong regulatory capital ratios, strong domestic franchise in core lending and deposits in Ireland - the latter underpinning the group's sound and stable funding - and a moderate risk appetite. Profitability is variable over the economic and interest-rate cycles and influenced by the bank's strong concentration on the small, open and cyclical Irish economy. The high NPE ratio remains the main rating weakness, but the VRs incorporate our expectations that the group will reduce its impaired loans to below pre-pandemic levels.

The group's gross stage 3 ratio of 5.8% at end-1H21 was stable from a year ago. The stock of impaired loans increased, due to migrations of stage 2 loans in 2H20, but declined following impaired loan disposals in 1H21. Stage 2 loans remain sizeable (13.3% of total loans at end-1H21), after a significant migration of business, property and construction loans from Stage 1 in 2020. Some of these exposures are subject to forbearance, and it might take time before Stage 2 loans migrate to Stage 1 loans.

The expiry of government support is likely to temporarily increase, over the next two quarters, inflows of impaired loans from borrowers most affected by the pandemic. However, AIBG retains much of the loan loss allowances (LLAs) booked in 2020 for these exposures to cover pandemic risk. The strong economic rebound should support credit quality, and the bank is committed to reducing its NPE ratio to about 3% by 2023, including through NPE disposals. Our assessment of asset quality acknowledges AIBG's record in reducing impaired loans, tested restructuring expertise, wide range of strategies and forbearance options, and portfolio-disposal capabilities.

After a large operating loss due to pandemic-driven loan impairment charges (LICs) in 2020, AIBG's profitability recovered in 1H21, on rising non-interest revenue driven by the economic recovery, and loan writebacks. Beyond the adverse impact of the pandemic and excess liquidity, 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.

Nonetheless, AIBG's revenue is less geographically diversified than peers' and more reliant on net interest income, which is eroded by low interest rates and by a large and increasing deposit surplus. Acquisitions and new ventures undertaken in 2021 should materially strengthen its net interest and commission income and diversify revenue after 2022. The negative outlook on our assessment of AIBG's profitability reflects the risk that earnings may take some time to sustainably normalise to close to pre-pandemic levels.

Our assessment of capitalisation reflects AIBG's ample capital buffers above minimum regulatory requirements. The group's 19.3% transitional and 16.4% fully-loaded common equity Tier 1 (CET1) ratios at end-1H21 (including dividend accrued for 2021) were 910bp and a 620bp above Maximum Distributable Amount requirements, respectively. Management slightly reduced their fully-loaded CET1 ratio target to above 13.5% (from previously above 14%) by end-2023. However, this does not fundamentally alter our view of how capital is managed.

AIBG's funding profile is supported by ample and stable retail deposits, which fund a significant portion of the group's assets, and by an established and sufficiently diversified wholesale-funding franchise. Customer deposits have been growing strongly in Ireland over the past 20 months. Liquidity is sound, supported by a large stock of liquid assets, including sizeable cash deposited at the central bank, and contingent access to central-bank liquidity facilities.

IDRS, DERIVATIVE COUNTERPARTY RATING (DCR) AND SENIOR DEBT

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

AIB's Long-Term IDR, DCR and long-term senior debt rating are one notch above the bank's VR to reflect the protection of AIB's senior third-party creditors that arises from the group's strategy to fulfil minimum requirement for own funds and eligible liabilities (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.

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.

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.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

AIBG's and AIB's SR of '5' and SRF of 'No Floor' 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.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

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 ten years, and we do not expect the notes to become performing again before they mature.

SUBSIDIARY AND AFFILIATED COMPANY

The IDRs of AIB's fully-owned UK subsidiary, AIB Group (UK) PLC (AIBUK), are equalised with AIB's. Our support assessment and AIBUK's SR of '2' 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 and to protect AIBUK's external senior creditors in a resolution. AIBUK, which represented 15% of the group's gross loans at end-1H21, is closely integrated within the group and relies on the group's systems and processes. Therefore, we do not assign a VR to AIBUK as we believe it cannot be assessed meaningfully on a standalone basis.

RATING SENSITIVITIES

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

IDRs, DCR AND SENIOR DEBT

The IDRs, senior debt ratings and DCR of AIB and AIBG would be upgraded if the VRs are upgraded and if the resolution debt buffer continues to provide AIB's senior creditors and derivative counterparties with additional protection.

VRs

An upgrade would require significantly strengthened company and profitability profiles. This would notably include a clear path toward generating an operating profit/risk-weighted assets (RWAs) of above 2% and reducing impaired loans to about 3% of gross loans on a sustained basis.

SR and SRF

An upgrade of the SR and upward revision of the SRF 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.

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

IDRs, DCR AND SENIOR DEBT

AIB's and AIBG's IDRs, senior debt ratings and DCR could be downgraded if the VRs are downgraded, or if we no longer estimate that the resolution debt buffer provides AIB's senior creditors and derivative counterparties with additional protection.

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.

VRs

The ratings would likely be downgraded if, as opposed to our baseline scenario, a deterioration of economic performance and the operating environment for banks in Ireland increase the group's impaired loan ratio towards 10%, and if the bank is unable to reduce its stock of impaired loans fairly quickly, and encumbrance by impaired loans increases significantly without prospects for recovery within a reasonable timeframe.

The VRs would also be downgraded if the group's CET1 ratio falls below 13%, following losses, or if RWAs increase without prospects for sufficient internal capital generation.

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

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

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.

SUBSIDIARY - AIBUK

AIBUK's IDRs are sensitive to the same factors that might drive a change in AIB's IDRs. We could also downgrade AIBUK's IDRs and SR if the subsidiary's strategic importance diminishes, resulting in weaker integration within the group and a reduction in support propensity, in our view. This could, for example, be signaled 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.

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

The ratings of AIBUK 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, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Allied Irish Banks, plc	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Negative
	ST IDR	F2	Affirmed	F2
	Viability	bbb	Affirmed	bbb
	Support	5	Affirmed	5
	Support Floor	NF	Affirmed	NF
	DCR	BBB+(dcr)	Affirmed	BBB+(dcr)
• subordinated	LT	C	Affirmed	C

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Francesca Vasciminno
Senior Director
Primary Rating Analyst
+39 02 879087 225
francesca.vasciminno@fitchratings.com
Fitch Ratings Ireland Limited Sede Secondaria Italiana
Via Morigi, 6 Ingresso Via Privata Maria Teresa, 8 Milan 20123

Adam Moncrieff-MacMillan
Analyst
Secondary Rating Analyst
+44 20 3530 2614
adam.moncrieff-macmillan@fitchratings.com

Patrick Rioual
Senior Director
Committee Chairperson
+49 69 768076 123
patrick.rioual@fitchratings.com

MEDIA CONTACTS

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

AIB Group (UK) PLC	EU Issued, UK Endorsed
AIB Group Public Limited Company	EU Issued, UK Endorsed
Allied Irish Banks, plc	EU Issued, UK Endorsed

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Banks Europe Ireland United Kingdom
