

Research Update:

Bank of Ireland 'BB+' Long-Term Ratings Placed On Watch Negative Following Sovereign Action

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Overview

- On Dec. 5, 2011, we placed the long- and short-term sovereign credit ratings on the Republic of Ireland on CreditWatch with negative implications.
- As a result, we are also placing the long-term counterparty credit rating on Bank of Ireland (BOI) on CreditWatch with negative implications.
- Under our revised bank criteria (published on Nov. 9, 2011), our ratings on BOI reflect our view of its strong business position, weak capital and earnings, adequate risk position, and average funding and moderate liquidity.
- The ratings also reflect our view of BOI's "high" systemic importance in Ireland and our assessment of the Irish government as "supportive," as defined by our criteria.
- We intend to resolve the CreditWatch placement after we have resolved that on the sovereign. At this time, we would expect to either lower the long-term rating on BOI by one notch or affirm it at 'BB+'.

Rating Action

As we previously announced on Dec. 8, 2011, Standard & Poor's Ratings Services has placed its 'BB+' long term counterparty credit ratings on Republic of Ireland-based Bank of Ireland (BOI) on CreditWatch with negative implications.

Rationale

The CreditWatch placement follows that on the Republic of Ireland on Dec. 5, 2011. It reflects the risk of a one-notch reduction in the level of sovereign support that we factor into the long-term ratings on BOI, in accordance with our criteria.

Standard & Poor's bases its ratings on BOI on its "strong" business position, "weak" capital and earnings, "adequate" risk position, "average" funding, and "moderate" liquidity, as our criteria define these terms.

The 'bb+' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the economic and industry risks in the countries where BOI operates, principally the Republic of Ireland and the U.K. Our bank criteria use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR).

Our anchor for a commercial bank operating only in Ireland is 'bb', based on an economic risk score of '7' and an industry risk score of '7'. To assess the economic risk for BOI, we used the weighted average of its private-sector loans to nonbanks in each country where it operates. BOI conducts about one-half of its lending in countries with stronger economic risk scores than that of Ireland. Consequently, the weighted economic risk score of '5' for BOI is stronger than that for lending institutions in Ireland that have higher proportions of domestic loans.

The BICRA economic risk score for Ireland reflects our view of it as a fundamentally resilient, flexible, and open economy, but which is undergoing a painful correction following the decade-long boom that ended in 2007. This has severely strained the government's finances and left domestically focused banks dealing with a considerable overhang of private-sector leverage and depleted asset prices. With regard to industry risk, the Irish banking industry is increasingly concentrated among a handful of key players, but profitability is undermined by high competition for deposits and shrinking loan books. Our view is further clouded by the regulatory weaknesses that contributed to the economic crisis, as well as the system's relatively weak funding position, where monetary authorities and foreign-owned parents now fill the gap left by the exit of a substantial number of overseas investors.

We view BOI's business position as "strong". BOI has resilient franchises and high market shares across all retail and commercial banking lines in Ireland. Moreover, we believe that this status has been reinforced and will persist as a result of the recent exit of a number of banks and the fact that BOI was named in March 2011 as one of the two "pillar" banks in Ireland following a major government review of the industry. BOI's U.K. business, which includes a useful source of customer deposits, improves its diversity in our view. On a relative basis, we recognize that management has adopted a more proactive and realistic approach over the past year. Nevertheless, we note that the long-planned turnaround in BOI's performance remains susceptible to setbacks in the Irish or U.K. economies.

We assess BOI's capital and earnings as "weak". BOI has undergone significant changes to its balance sheet to restore its health, including a large capital raising in July 2011. As a result, its regulatory pro forma core Tier 1 ratio was 15.4% at June 30, 2011. We note that, unlike peers, BOI was able to generate material common equity from private investors such that the government's stake in BOI dropped to a more modest 15%. Nevertheless, we expect that by end-2011 BOI's risk-adjusted capital (RAC) ratio will be much lower, about 5%, mainly reflecting our much higher risk weightings on credit exposures. Moreover, we project the RAC ratio could fall as low as 4.0%-4.5% by end-2013. This reflects our expectation of further losses and allows for planned de-leveraging. We anticipate that BOI may be able to generate retained earnings toward the end of 2013, which is based on our view that the current elevated level of impairments should gradually abate. We also note that BOI has additional flexibility from state-owned preference shares and contingent capital. We expect BOI's regulatory capital ratios to remain high through 2013.

Our assessment of BOI's risk position as "adequate" should be considered in relation to its high blended economic risk score. Our assessment incorporates our expectation of further de-leveraging over the coming two years, good risk type diversification, and a relatively straightforward operating model. BOI was required to raise significantly less capital by its regulator than the other designated Irish "pillar" bank, Allied Irish Banks PLC (BB/Negative/B), reflecting its relatively better underwriting, a view which we share. Even so, BOI's domestic loan book is skewed to residential mortgages, where we expect high impairments to persist.

Our assessment of BOI's funding as "average" and liquidity as "moderate" should be viewed in the context of our systemwide funding assessment of very high risk within Ireland's BICRA. We consider BOI's funding to be average compared with its domestic peer group, and our view here will only improve to the extent to which it outperforms peers as it de-levers over the next two years. Our view of BOI's liquidity position as moderate reflects the fact that BOI remains heavily reliant on monetary authority funding sources, but that we expect this to reduce. BOI is required by its regulator to achieve a loan-to-deposit ratio of less than 122.5% by end-2013, compared with a reported 153% at Sept. 30, 2011. We consider this to be plausible, given that BOI has already announced the sale of a number of loan portfolios, most of the flighty element of its deposit base has already exited and, we understand, the bank has made meaningful progress on deposit gathering since June 2011.

The long-term counterparty credit rating is one notch higher than the SACP, reflecting our view of BOI's "high" systemic importance in Ireland and our assessment of the Irish government as "supportive".

CreditWatch

The CreditWatch placement of BOI reflects that on the sovereign. If we lower the long-term sovereign credit rating by more than one notch, we would likely lower the long-term counterparty credit rating on BOI by one notch to 'BB', thus reducing the notches of uplift from the SACP to zero from one in accordance with our criteria.

If we lower the long-term sovereign credit rating by one notch, or affirm it, we would affirm the 'BB+' long-term counterparty credit rating on BOI. We would expect to assign a negative outlook to the long-term rating on BOI on resolution of the CreditWatch. This would reflect our view that BOI is still at a relatively early stage in implementing its turnaround strategy, has undergone a period of significant stress to its balance sheet, and that its recovery may lag our expectations.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Watch Neg/B
SACP	bb
Anchor	bb+
Business Position	Strong (+1)
Capital and Earnings	Weak (-1)*
Risk Position	Adequate (0)
Funding and Liquidity	Average and Moderate (-1)
Support	1
GRE Support	0
Group Support	0
Sovereign Support	1

Additional Factors 0

*When a bank's anchor, derived from our BICRA methodology, is in the 'bb' category and its common equity regulatory Tier 1 ratio is greater than the local regulatory requirements, a "weak" assessment of capital & earnings has a minus one notch impact on the SACP, rather than two (see paragraph 88 of our bank criteria).

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology For Banks, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- BICRA On Ireland Revised To Group '7' From Group '6', Nov. 9, 2011
- BICRA On The U.K. Maintained At Group '3', Nov. 9, 2011
- Ireland's 'BBB+' Long-Term And 'A-2' Short-Term Ratings Placed On CreditWatch Negative, Dec. 5, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Bank of Ireland		
Counterparty Credit Rating	BB+/Watch Neg/B	BB+/Negative/B
Certificate Of Deposit	BB+/Watch Neg/B	BB+/B
Bank of Ireland		
Senior Unsecured	BB+/Watch Neg	BB+

Ratings Affirmed

Bank of Ireland	
Subordinated	D
Junior Subordinated	C
Preference Stock	C
Preference Stock	CC
Certificate Of Deposit	B
Commercial Paper	B
BOI Capital Funding (No.1) LP	
Preferred Stock	C
BOI Capital Funding (No.2) LP	
Preferred Stock	C
BOI Capital Funding (No.3) LP	
Preferred Stock	C
BOI Capital Funding (No.4) LP	
Preference Stock	C
Bank of Ireland U.K. Holdings PLC	
Junior Subordinated	C

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