Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Bank of Ireland

Bank of Ireland

Dublin, Ireland

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	Aa3/P-1
Bank Financial Strength	C
Issuer Rating	Aa3
Senior Unsecured -Fgn Curr	Aa3
Senior Unsecured -Dom Curr	Aa3
Subordinate	A1
Jr Subordinate	A1
Preference Stock	A2
Commercial Paper	P-1
Other Short Term	P-1
ICS Building Society	
Outlook	Negative
Bank Deposits	A1/P-1
Bank Financial Strength	C
Bank of Ireland, Connecticut Branch	
Outlook	Negative
Deposit Note/CD Program	Aa3/--
Bkd Deposit Note/CD Program	Aaa/--

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Key Indicators

Bank of Ireland

	[1]2008	2008	2007	2006	2005	Avg.
Total assets (EUR billion)	204.28	197.43	188.81	162.35	127.78	[2]17.19
Total capital (EUR billion)	14.91	14.33	14.57	11.87	8.50	[2]15.44
Return on average assets	0.61	0.87	0.94	0.89	0.90	0.92
Recurring earnings power [3]	1.02	1.06	0.96	1.02	1.07	1.10
Net interest margin	2.05	1.76	1.66	1.70	1.83	1.80
Cost/income ratio (%)	50.32	50.91	56.14	57.70	62.17	56.36
Problem loans % gross loans	1.31	0.78	0.54	0.78	0.89	0.71
Tier 1 ratio (%)	--	7.60	7.90	7.50	7.90	7.62

[1] As of September 30. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

RECENT CREDIT DEVELOPMENTS

In November 2008 Moody's assigned backed-Aaa ratings to certain debt securities of six Irish institutions, including Bank of Ireland (BoI), as a result of the guarantee that has been put in place by the Irish government. Existing long-term senior unsecured and dated subordinated debt securities of BoI that mature prior to 29 September 2010, have been assigned a backed-rating of Aaa. These backed-Aaa ratings reflect the fact that these obligations are guaranteed by the Republic of Ireland, rated Aaa. The outlook for the backed-Aaa ratings was changed to negative from stable in February 2009 line with the change in the outlook of Ireland.

On February 12 2009 the long-term senior debt and bank deposit ratings of BoI were downgraded to Aa3 from Aa2 and the bank's financial strength rating (BFSR) was lowered to C (mapping to a baseline credit assessment of A3) from B- (mapping to a baseline credit assessment of A1). Subordinated debt and preferred stock of the bank were downgraded to A1 and A2 respectively and the backed preferred stock of the bank's subsidiaries was downgraded to A2. The short term debt and deposit ratings were affirmed at Prime-1. The senior and dated subordinated debt covered by the Irish government guarantee maturing prior to September 29 2010, rated Aaa with a negative outlook, was unaffected by this action.

The downgrade of the BFSR reflected Moody's expectation of a substantial increase in impairments in both Ireland and the UK, especially from the relatively large exposure to property and construction and to non-standard mortgage lending.. In addition the slowdown in the bank's major markets is likely to result in lower profitability reducing the bank's ability to generate capital and reserves internally. The downgrade of the bank's long-term rating to Aa3 reflects the weaker BFSR, but also incorporates Moody's view on the long-term probability of very high ongoing support from the Irish Government as evidenced by the announcement of a EUR3.5 billion preference share investment in the bank as well as the two year government guarantee. See "Moody's downgrades Bank of Ireland to Aa3/C" published on February 12 2009.

SUMMARY RATING RATIONALE

Moody's has assigned a bank financial strength rating (BFSR) of B- to Bank of Ireland (BoI), which translates into a baseline credit assessment of A1. The rating reflects the group's strong domestic market position where it is one of the two predominant institutions, as well as its established presence in the UK, where it offers a range of retail and business banking services. The strength of the group's domestic franchise is reflected by its diversified product focus, encompassing retail banking, business and corporate banking and life assurance businesses as well as its strong market shares especially in current accounts, business banking, mortgages, life assurance and retail deposits.

The rating also takes into account Moody's expectation that impairments in the commercial property and corporate loan books will accelerate in both Ireland and the UK and the expectation of a rise in unemployment will also affect the residential mortgage books, especially in the non standard mortgage lending book in the UK. The bank's exposure to construction and property is around EUR38 billion and in particular Moody's would expect substantial impairments to arise on the EUR5.8 billion Irish and EUR4.7 billion UK residential development and landbank loan books. At the bank's current rating level we consider the tolerance for further impairment charges and losses to be around EUR6 billion, assuming a reduction in pre-provision income of up to 25%. Losses above this level would increase the downward rating pressure.

The EUR3.5 billion preference share investment in the bank by the Irish Government provides a further buffer against the expectation of further losses, however it does increase the non-equity component of the bank's capital base, and Moody's views this type of capital as lower quality than common equity.

Bank of Ireland's long-term global local currency (GLC) deposit rating is Aa3 based on Moody's assessment of a very high probability of systemic support in the event of a stress situation in accordance with the medium country support guideline for Ireland. Consequently, there is a three-notch uplift for Bank of Ireland's GLC deposit rating from its A3 baseline credit assessment.

Credit Strengths

Strong and well-diversified domestic franchise

Established position in the UK with potential to grow the Post Office based business

Solid pre-provision earnings profile

Stable and growing deposit funding base

Credit Challenges

Significant degree of exposure to the domestic and UK property market, including non-standard UK mortgage lending

Substantial increases in impairments as a result of the deteriorating economic environment especially on residential development lending

Still relatively high reliance on wholesale funding, albeit reducing

Rating Outlook

The negative outlook on the C BFSR reflects the remaining significant uncertainty associated with potential further impairments beyond Moody's base stress assumptions given the difficult economic environment in the bank's main markets. The negative outlook on the Aa3 long-term senior ratings reflects that a further downgrade of the bank's BFSR could also lead to a similar action on the long-term senior ratings.

What Could Change the Rating - Up

A reduction in exposure to the construction and property markets while maintaining good underlying profitability could put upward pressure on the ratings. However given the difficult environment and the large exposure to construction and property an upgrade in the medium-term is unlikely.

What Could Change the Rating - Down

Further impairment charges and losses beyond EUR6 billion would be likely to have further rating implications.

Recent Results and Developments

In its Interim Management Statement of February 2009 the bank announced that it is likely to make an underlying loss for the six month period to end-March 2009 primarily as a result of the substantial increase in impairments, however the bank will report a profit for the full year. Following the EUR3.5 billion preference share issue to the Irish government the pro-forma tier 1 ratio at end-September 2008 would have been 11.7%, up from 8.7%. Pre-tax in the six months to 30 September 2008 was EUR706 million, down 35% on the EUR1.091 billion in the same period of 2007.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Bank of Ireland's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's has assigned a C BFSR (negative outlook) to Bank of Ireland, two notches below the financial strength scorecard result. This reflects Moody's expectations of substantial impairment charges and losses in the future given the banks exposure to property and construction and the difficult economic environment.

Qualitative Factors (50%)

Factor: Franchise Value

Trend: Neutral

Bank of Ireland is the second largest banking group in the Republic of Ireland (RoI) in terms of equity and operates a well-diversified franchise, encompassing retail banking, business and corporate banking and life assurance businesses. Although BoI faces strong competition in all its business lines, the strength of its domestic franchise is reflected by its strong market shares including mortgages (19%), life and pensions (24%), SME lending (26%) and retail deposits (25%). BoI is also well established in the UK, offering a range of retail and business banking services, and the UK business line accounted for approximately 20% of group profits in the period to end-September 2008. The bank's UK franchise has three main business lines, business banking, mortgages and consumer finance, including through its joint venture with the UK Post-Office. The bank previously had a long-term target that more than 50% of the bank's profits will come from outside Ireland, but given that it is winding down its UK broker introduced mortgage business this target is unlikely to be met in the short to medium term. In the half year to end-September 2008 this was 45%.

Bank of Ireland scores B for franchise value.

Factor: Risk Positioning

Trend: Neutral

There are no corporate governance issues at BoI, in Moody's view. The score for risk positioning is constrained by some borrower risk concentrations however this risk concentration is mitigated to some extent if we adjust for highly rated exposures. Moody's regards BoI's risk management practices and controls as satisfactory and commensurate with its risk profile. In particular, we note the fact that risk is independently reviewed by a dedicated risk management function. BoI has extended its risk management capabilities, by the establishment of committees with specific risk management responsibilities. These include a portfolio review committee and a risk measurement committee. Liquidity management is good reflecting the group's solid funding profile and good liquidity management. Trading-related market risk is contained and Moody's notes that a significant portion of the group's capital base is in currency other than euros in order to minimise the sensitivity of the group's capital ratios to exchange rate movements.

Overall, Bank of Ireland scores C+ for risk positioning.

Factor: Operating Environment

Trend: Neutral

Moody's financial strength scorecard produces a score of B+ for the Irish operating environment. The assessment of BoI's operating environment reflects our view of the different countries where the group operates, primarily Ireland and the UK.

Quantitative Factors (50%)

Factor: Profitability

Trend: Weakening

BoI benefits from a diversified revenue stream both in terms of business segment and product offering. As at 30 September 2008, 40% of profit was generated by the domestic retail operation, 20% by the UK Financial Services division, 1% by the life subsidiary and the remainder from the capital markets division which includes larger corporates. Although the group's net interest margin has declined in recent years, susceptibility to margin attrition is countered by the institution's sizable portion of non-interest income. Furthermore, we note that the group saw a rise in the net interest margin in the six months to end-September 2008 due to the repricing of credit.

Pre-provision profitability is likely to reduce in the next reporting periods as a result of the substantial slowdown in the Irish and UK economies, although we believe it will remain relatively strong. Net profits will also be affected by the need for a significant rise in provisions as credit quality, especially in the residential development sector, weakens.

BoI scores C for profitability.

Factor: Liquidity

Trend: Neutral

Looking quantitatively at BoI's liquidity, we note the impact of its growing reliance on market funding in recent years, although we note that this has now begun to reduce. However the growth of market funding in recent years has let to a deterioration in the liquidity ratio of the bank ((Market funds - Liquid Assets) % Total Assets). At end-September 2008 this was 18.25%, compared to 5.0% in 2004 although we note that in mitigation, the bank has developed a significantly more diversified range of wholesale funding resources including an EMTN programme, a covered bond programme, a US MTN programme and a variety of CP and CD programmes as well as extendible notes. We also note that the bank has continued to fund itself comfortably through the recent difficult period, albeit with a shorter maturity profile than was previously the case. In addition BoI benefits from a solid retail and commercial deposit-funding base, which accounted for 47% of total funding requirements as at 30 September 2008, up from 41% as at 30 September 2007.

Despite the recent improvement we believe the reliance on market funds will continue to be relatively high although the slowdown in the rate of growth in Ireland is likely to mitigate this and we also note the strong deposit franchise of the bank in Ireland, and through the Post Office in the UK is enabling the bank to grow its retail deposit base.

The bank also has a large liquid assets portfolio and a substantial amount of collateral that it can use in central bank funding programmes.

Bank of Ireland scores C+ for liquidity.

Factor: Capital Adequacy

Trend: Improving

The bank's capitalisation levels will be boosted by the recent EUR3.5 billion preference share investment by the Irish government, although we note that this has increased the non-equity component of the bank's capital base, and Moody's views this type of capital as lower quality than common equity.

At end-September 2008 BoI's core Tier 1 and Tier 1 capital ratios (on a Basle II basis) were 6.3% and 8.7% respectively, up from 5.7% and 8.1% at end-March 2008 however the EUR3.5 billion of new preference shares will see these ratios rise to around 9.3% and 11.7% (on a pro-forma basis at end-September 2008). Prior to the government preference shares, hybrid and similar capital already accounted for over 30% of the tier 1 capital base of the bank, and this has now increased to almost 50%. This high level of non-equity capital is higher than many similarly rated peers and will limit the tangible common equity ratio.

With the new capital BoI would be likely to score A for capital adequacy, although adjusting for expected future loan losses the score will be lower.

Factor: Efficiency

Trend: Neutral

BoI's cost-to-income ratio was 50% in the six months to end-September 2008, a slight improvement on the full year to end-March. The bank is extremely cost focussed, especially in light of the more difficult economic conditions, and therefore we would not expect to see a substantial deterioration in this metric. Nevertheless, further efficiency gains may be difficult to realise in view of ongoing investment needs, wage inflation and the challenge of having to sustain current earnings growth over the long term, especially in a less buoyant market environment in Ireland and the UK.

Bank of Ireland scores B for efficiency.

Factor: Asset Quality

Trend: Weakening

BoI's credit quality is weakening as the markets in both Ireland and the UK deteriorate. At end-September 2008 impaired loans were 1.3%, up from 0.8% at end-March 2008, although this is still relatively strong by European standards. However in its IMS of February 2009 the group announced that it expects to take impairment charges of EUR4.5 billion in the three years to end-March 2011 and the downside risk to this estimate is a further EUR1.5 billion. The group's loan portfolio is well diversified in terms of products, with residential mortgage lending accounting for the largest part of the total book at 44%. Property investment and development accounted for an additional 26% of the group's loan book. In relation to the UK property book, at end-September the total book was EUR19.4 billion of which around one third (31%) was for development and landbank and two thirds (69%) for investment. The UK property development book consists of 32% landbank, 47% residential development and 22% commercial development.

Regarding residential mortgage lending, we would note that this market has slowed significantly in Ireland and to date house prices have fallen around 16% from their 2007 peak following over a decade of price rises. We believe however that BoI should be relatively well insulated from any deterioration given the lower than average original LTVs, and with 100% LTV mortgages representing less than 3% of the domestic mortgage loan book (provided on a selective basis, in the main to first time buyers with professional qualifications, and government employees). The bank is also active in the UK buy-to let market and this accounted for about 35% of UK mortgage advances at 30 September 2008. Moody's views this sector as inherently more vulnerable than other categories within the residential mortgage portfolio in the event of an economic downturn, however we note the good performance to date of this portfolio and that the underwriting remains relatively conservative with an average LTV on new business of 70%.

The low-risk nature of the group's life operations is primarily attributable to the fact that the life business is predominantly unit-linked. The institution's non-linked business is conservatively invested in euro government fixed-interest only securities (mainly long term). Free Assets are invested in cash deposits and gilts.

Bank of Ireland scores B for asset quality, although we expect this to weaken.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's has assigned a global local currency (GLC) deposit rating of Aa3 to Bank of Ireland. The rating is underpinned by the bank's Baseline Credit Assessment of A3. In view of Bank of Ireland's domestic market share and importance to the Irish banking system, Moody's assesses the probability of systemic support for the bank in the event of a stress situation as "very high" in accordance with the medium system support guideline for Ireland. Consequently, Bank of Ireland receives a three-notch uplift from its Baseline Credit Assessment, bringing the GLC to Aa3.

Notching Considerations

Junior obligations are notched from the supported deposit rating.

Foreign Currency Deposit Rating

Moody's has assigned Aa2 foreign currency deposit rating to Bank of Ireland

Foreign Currency Debt Rating

Moody's has assigned Aa2 foreign currency debt rating to Bank of Ireland.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Bank of Ireland

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**B-**	
Factor: Franchise Value						**B**	**Neutral**
Market Share and Sustainability		**x**					
Geographical Diversification		**x**					
Earnings Stability		**x**					
Earnings Diversification [2]							
Factor: Risk Positioning						**C+**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity	--	--	--	--	**--**		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management			**x**				
- Risk Management			x				
- Controls		x					
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness		x					
- Quality of Financial Information		x					
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		**x**					
Market Risk Appetite	**x**						
Factor: Operating Environment						**B+**	**Neutral**
Economic Stability		**x**					
Integrity and Corruption		**x**					
Legal System	**x**						
Financial Factors (50%)						**C+**	
Factor: Profitability						**C**	**Weakening**
PPP % Avg RWA - Basel II			1.68%				
Net Income % Avg RWA - Basel II			1.49%				
Factor: Liquidity						**C+**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets				16.16%			
Liquidity Management		x					
Factor: Capital Adequacy						**C**	**Improving**
Tier 1 ratio (%) - Basel II			7.67%				

Tangible Common Equity / RWA - Basel II			4.66%				
Factor: Efficiency						**B**	**Neutral**
Cost/income ratio		54.91%					
Factor: Asset Quality						**B+**	**Weakening**
Problem Loans % Gross Loans	0.70%						
Problem Loans % (Equity + LLR)		12.83%					
Lowest Combined Score (15%)						**C**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**B-**	
Assigned BFSR						**C**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information
[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral