S&P Global
Ratings

RatingsDirect®

Research Update:

Outlook On Permanent TSB PLC Revised To Positive; Ratings Affirmed At 'BB/B'

Primary Credit Analyst:
Sadat Preteni, London (44) 20-7176-7560; sadat.preteni@spglobal.com

Secondary Contact:
Nigel Greenwood, London (44) 20-7176-1066; nigel.greenwood@spglobal.com

Table Of Contents

Research Update:

Outlook On Permanent TSB PLC Revised To Positive; Ratings Affirmed At 'BB/B'

Overview

- We believe that Ireland-based bank Permanent TSB Group Holdings is making steady progress in gradually improving its credit profile, operating performance, and earnings capacity.
- The bank has improved its funding and liquidity metrics, supported by the deleveraging of noncore assets and continued reductions in European Central Bank funding. We anticipate that subdued net lending and stable deposit balances may lead to further improvements in the coming 12-18 months. We have therefore revised our assessment of PTSB's funding and liquidity profile to average and adequate, from below average and moderate.
- However, we consider that nonperforming assets (NPAs) have reduced at a relatively modest pace compared to peers. We have therefore offset the improved funding and liquidity assessment by revising our assessment of the bank's risk position to weak from moderate.
- We are revising our outlook on the operating company Permanent TSB PLC and the holding company Permanent TSB Group Holdings PLC to positive from stable. We affirmed the long- and short-term ratings on Permanent TSB PLC at 'BB/B' and the long- and short-term ratings on Permanent TSB Group Holdings PLC at 'B+/B'.
- The positive outlook reflects our belief that the bank's enhanced focus on reducing NPAs will bring it more in line with the asset quality metrics of peers over the coming 12 months, on the back of its NPA strategy review. It also reflects our expectation that the bank's operating performance and earnings capacity will continue to gradually improve over this period.

Rating Action

On Aug. 3, 2017, S&P Global Ratings revised the outlook on Ireland-based Permanent TSB Group Holdings PLC and its main operating company, Permanent TSB PLC (collectively referred to as PTSB), to positive from stable. We affirmed the long- and short-term counterparty credit ratings on Permanent TSB Group Holdings PLC at 'B+/B' and the long- and short-term counterparty credit ratings on Permanent TSB PLC at 'BB/B'.

Rationale

The outlook revision reflects our expectation that the bank's enhanced focus on reducing the high stock of NPAs, aided by a supportive economic environment in Ireland but potentially including asset sales, will result in a gradually improving credit profile with stronger balance sheet metrics. In our view, PTSB reached an inflection point in 2016 with the €2.9 billion sale of its noncore U.K. and Isle of Man portfolios, marking the end of PTSB's prolonged restructuring. In our view, the absence of restructuring charges linked to noncore assets should result in a more predictable earnings profile and support a gradual recovery in its earnings capacity.

PTSB has achieved a substantial rebalancing and improvement in its funding and liquidity profile over the past financial year. This has been supported by lower funding needs due to deleveraging, as redemptions continue to exceed new lending, and the sale of noncore assets. Moreover, reliance on European Central Bank (ECB) funding has materially reduced, while current accounts and deposit balances have remained stable. We have therefore revised our assessment of its funding and liquidity profile to average and adequate, from below average and moderate.

Reported ECB borrowings stood at €1.4 billion at end-2016, down 70% from €4.7 billion at end-2015. ECB funding reduced further to €230 million at end-June 2017, representing 1% of total funding compared to 18% at end-2015. We note that the share of deposits increased to 94% of the funding base, and that retail deposits (including current accounts) comprised 68% of total funding.

As a result of these actions, PTSB's loan-to-deposit ratio improved to 110% at end-June 2017 (130% at end-June 2016), and our measure of PTSB's stable funding ratio increased to 104% at end-2016 (86% at end-2015). Our base-case expectation is that there will be further improvement in these two ratios over the coming 12-18 months due to lower funding needs, as net loan balances continue to reduce on the back of redemptions, while deposit balances remain stable. Our measure of broad liquid assets to short-term wholesale funding improved to 1.5x at end-2016 (0.7x at end-2015) following the significant reduction in ECB funding, which has also reduced the bank's asset encumbrance. In light of further reductions in ECB funding in the first half of 2017, we believe there is scope for further improvement in this ratio by end-2017. We note that over 99% of PTSB's liquidity buffer consists of government bonds, and it no longer has large or unusual liquidity needs.

That said, we still see challenges to PTSB's business model. This is because the bank's stock of NPAs is high both relative to its capital base and compared with domestic and international peers operating in economic environments facing similar risks as Ireland. Our measure of NPAs--which includes impaired loans, loans 90 days past due, and performing renegotiated loans--stood at 33.5% of average customer loans as of end-June 2017. Excluding performing renegotiated loans, PTSB's NPA ratio remains elevated at 23.6%, and we calculate a high Texas ratio of 162%, which we consider to be higher than that of peers. Moreover, we consider that asset quality improvements have been slower than those of domestic peers Allied Irish Banks (AIB) and Bank of Ireland (BOI). Against this backdrop, we have revised our assessment of PTSB's risk position to weak from moderate. We believe that resources will be tied up in reducing the large stock of NPAs and mortgage arrears, which will likely result in muted new lending volumes, but we expect the bank to make good progress on this over the coming 12-18 months in light of its NPA strategy review and an increased focus from regulators and Irish banks in this area.

Our 'bb' group credit profile on PTSB also reflects its meaningful franchise in Irish retail banking, offset by our view that its business position is weaker than market-leading peers AIB and BOI due to its lack of business diversity and franchise depth. Moreover, PTSB has a narrow reliance on retail banking in the relatively small Irish market, with challenges in restoring its market position and generating meaningful returns in a low interest rate environment. We consider that PTSB has strong capitalization, reflecting a risk-adjusted capital ratio of 11.8% at end-December 2016 (on a pro forma basis, incorporating the recent improvement in our view of Irish economic risk). We note that this ratio was barely affected by the recent update to our capital criteria (see Related Criteria, below). We project this ratio to be 12.0%-12.5% over the coming 12-18 months. PTSB is currently not eligible for rating uplift under our additional loss-absorbing capacity (ALAC) criteria; our calculation of its ALAC ratio of about 2.2% as of end-2016 remains below the 5% threshold for one notch of uplift.

Outlook

Permanent TSB Group Holdings PLC

The positive outlook reflects our view that PTSB's enhanced focus on reducing NPAs will support a gradual improvement in its asset quality profile, operating performance, and earnings capacity over the coming 12 months.

We could raise the ratings over the coming 12 months if we observed that NPAs and mortgage arrears converged toward levels more in line with those of its domestic and international peers while capitalization remained at a level commensurate with a strong assessment.

We could revise the outlook back to stable if we observed that the economic risks faced by Irish banks had increased, or if the bank's ability to reduce NPAs as well as its path to earnings recovery and business growth ambitions proceed more slowly than we currently assume.

Permanent TSB PLC

The positive outlook on Permanent TSB PLC, the primary operating company of the group, mirrors that on Permanent TSB Group Holdings PLC, the nonoperating holding company (NOHC). We could lower or raise the ratings if we revised the group credit profile downward or upward, as explained above.

While less likely in the short-term, we could also raise the ratings if we perceived a clear path to the group building a sufficiently large ALAC buffer, subject to evidence of issuance. This would only benefit the ratings on the operating company, Permanent TSB PLC, because we do not include notches for ALAC support in the ratings on NOHCs. This is because we do not believe that their senior obligations would continue to receive full and timely payment in a resolution scenario.

Ratings Score Snapshot

	To	From
Permanent TSB PLC	BB/Positive/B	BB/Stable/B
Permanent TSB Group Holdings PLC	B+/Positive/B	B+/Stable/B
SACP	bb	bb
Anchor	bbb-	bbb-
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Weak (-2)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Below Average and Moderate (-1)
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- 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
- 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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Permanent TSB PLC		
Counterparty Credit Rating	BB/Positive/B	BB/Stable/B
Certificate Of Deposit	BB/B	BB/B
Senior Unsecured	BB	BB
Permanent TSB Group Holdings PLC		
Counterparty Credit Rating	B+/Positive/B	B+/Stable/B

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@spglobal.com

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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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.