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Permanent TSB Group Holdings PLC

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Permanent TSB Group Holdings PLC

UGCP	bb		+	Support	0	+	Additional Factors	0

Anchor	bbb-	
Business Position	Moderate	-1
Capital and Earnings	Strong	+1
Risk Position	Weak	-2
Funding	Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BB/Positive/B
Resolution Counterparty Rating
BBB-/--/A-3
Holding Company ICR
B+/Positive/B

UGCP—The unsupported group credit profile of the Permanent TSB group. The holding company issuer credit rating (ICR) shown applies to Permanent TSB Group Holdings PLC, and is two notches below the UGCP. The ICR and the resolution counterparty rating shown apply to the core bank operating subsidiary, Permanent TSB PLC.

Major Rating Factors

Issuer Credit Rating
B+/Positive/B

Strengths:	Weaknesses:
• Strong capitalization. • Meaningful position in the Irish mortgage market, with useful current account and savings franchises.	• Although reducing, the stock of nonperforming assets (NPAs) is still high relative to domestic and international peers. • Narrow reliance on retail banking in a relatively small market. • Remaining challenges in restoring market position and generating meaningful returns in a low interest rate environment.

Outlook

Permanent TSB Group Holdings PLC

The positive outlook on Permanent TSB Group Holdings (PTSB, or the group) reflects the at least one-in-three chance that our view of Irish banking industry risk could improve over the coming two years. All other factors remaining the same, an improved view of the banking industry in Ireland could lead us to revise upward PTSB's unsupported group credit profile (UGCP)--and therefore raise the ratings--by one notch, given PTSB's domestic focus.

Although less likely over our 12-month outlook horizon, we could raise the ratings on PTSB if we observed that its NPAs and mortgage arrears had 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. This would be measured by our risk-adjusted capital (RAC) ratio of above 10%. This reflects our view that PTSB's enhanced focus on reducing NPAs should support improvements in its asset quality, operating performance, and earnings capacity.

We could revise the outlook back to stable if we consider that the prospect of an improvement in Ireland's banking industry risk won't materialize. We could also revise the outlook to stable if we considered that PTSB's efforts to reduce NPAs had derailed its path to earnings recovery and its ability to maintain capital sustainably above 10%.

Permanent TSB PLC

The positive outlook on the primary operating company of the group mirrors that on PTSB. We could lower or raise the ratings if we revised the UGCP downward or upward, as explained above.

While less likely in the short term, we could also raise the ratings if we believed the bank could build a sufficiently large additional loss absorbing capacity (ALAC) buffer, subject to evidence of issuance. This would only benefit the ratings on the operating company because we do not include notches for ALAC support in the ratings on non-operating holding company ratings such as PTSB.

Rationale

The starting point for our ratings on PTSB is based on our view of the banking system in the Republic of Ireland, which reflects PTSB's domestic focus. We consider that PTSB has a meaningful franchise in Irish retail banking, but that its business position is weaker than that of market-leading peers AIB Group PLC (AIB) and Bank of Ireland Group PLC (BOI) due to its lack of business diversity and franchise depth. We consider that PTSB has strong capitalization, reflected in a RAC ratio of 12.2% at end-December 2017, and our expectation that it will remain above our 10% threshold for a strong assessment even as PTSB works through its NPA reduction strategy.

Successful execution of its NPA reduction strategy is a key ratings consideration. This is because we consider that the bank's stock of NPAs--31.4% of loans by our measures at Dec. 31, 2017--is high both relative to its capital base as well as compared with domestic and international peers'. We take some comfort from the fact that PTSB's funding and liquidity profile is broadly comparable to that of domestic peers' and the industry average in Ireland, reflecting significant improvements in the loan-to-deposit ratio and S&P Global Ratings' funding and liquidity ratios, supported by deleveraging and a material reduction in ECB funding reliance.

PTSB is currently not eligible for rating uplift under our ALAC criteria because our calculation of its ALAC ratio, about 2.3% as of end-2017, remains below the 5% threshold for one notch of uplift, and we have yet to see evidence of MREL issuance.

Anchor: 'bbb-' for a commercial bank operating mainly in Ireland

In our view, the economic risk trend in Ireland is stable. This reflects our assumption that Ireland's GDP growth rate will remain brisk, which in turn will continue to feed through to further property price appreciation and reduction in unemployment, all of which should help to improve the resilience of banks' balance sheets. We assume that the era of household and corporate deleveraging is now largely over. We would need to see evidence of a substantial further reduction in NPAs before we could consider an improved assessment and this seems unlikely over the next two years. Continued house price inflation above 10% and any potential risks to Ireland from its close trading partner, the U.K., leaving the EU, may also cause us to delay a stronger assessment.

The positive industry risk trend relates to the improved funding profile of most Irish banks, though we note that deleveraging and benign funding conditions have helped. In our view, regular access to wholesale markets remains unproven, and we would need to observe firmer evidence over the next one-to-two years that our metric of deposits to loans will remain above 75% on a sustainable basis, as lending growth revives, before we improve our assessment. The positive trend also assumes that the recent recovery in pre-provision profitability will not reverse despite low interest rates and, in some cases, the regulatory requirement to build up loss-absorbing buffers, as well as banks' ongoing need to invest in their operations and digital capability. We also assume that the long-standing government stakes in a large part of the banking system will only reduce to zero during the 2020s.

An improvement in our view of industry risk would result in PTSB's anchor improving to 'bbb' from 'bbb-'.

Table 1

Permanent TSB Group Holdings PLC Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Adjusted assets	22,734	23,567	29,284	36,225	37,508
Customer loans (gross)	20,616	21,368	25,718	30,928	33,316
Adjusted common equity	1,511	1,488	1,709	1,723	1,755
Operating revenues	444	434	381	316	240
Noninterest expenses	320	335	322	394	305
Core earnings	60	127	33	(90)	(587)

Business position: Less diversified than larger Irish peers

Our assessment of PTSB's business position as moderate is based on its lack of business diversity and franchise depth relative to industry leading peers, AIB and BOI. Other than AIB and BOI, PTSB's main rated peers active in the Irish banking industry include foreign-owned banks Ulster Bank Ireland DAC and KBC Bank Ireland PLC. Peers outside

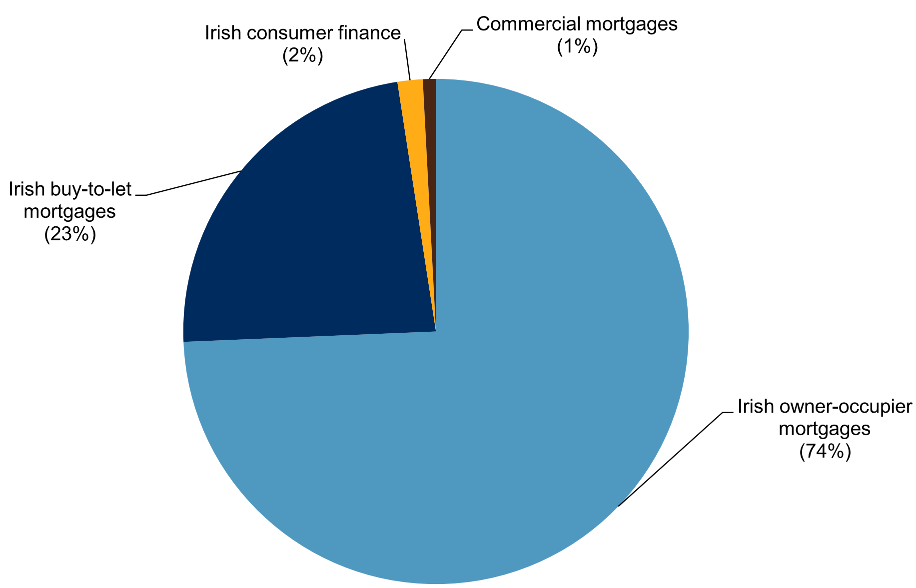
Ireland include Portugal-based Banco Comercial Portugues, S.A. and Banco BPI S.A.; U.K.-based CYBG PLC; and Slovenia-based Nova Ljubljanska Banka D.D. These banks have broadly similar business models to PTSB and operate in systems with fairly similar economic and industry risks as Ireland.

The key supportive factor is what we view as PTSB's meaningful franchise in Irish retail banking. This franchise is underpinned by its sizable share of outstanding Irish mortgage stock of around 15%-20% (market share of gross new lending in 2017 was 12.6% and on an improving trend), and useful market share of Irish retail deposits, current accounts, and other retail lending products. However, our assessment is affected by the bank's prolonged work to restructure and stabilize the business, constraining the size of its loan portfolio.

PTSB completed the European Commission (EC) mandated deleveraging of its non-core business--comprised of its U.K. and Isle of Man portfolios--in 2016 and is now a fully-domestic Irish retail bank (see chart 1).

Chart 1

Net Loans As Of Dec. 31, 2017 (€18.4 billion)



Note: Excludes assets held for sale and other assets pending derecognition at balance-sheet date.
Data as reported by the company and not adjusted by S&P Global Ratings.

The Irish government owns around 75% of PTSB's ordinary shares. However, we believe that the government is unlikely to reduce its stake further in the near term, and that the process to return the bank to private ownership will take several years.

We think that PTSB's management team has proved its capability over the past couple of years by completing the EC mandated restructuring plan and stabilizing the business, improving the balance-sheet profile, laying out a plausible long-term retail banking strategy, and running an effective mortgage arrears and collections function.

The management team continues to be tested as we understand it is under regulatory pressure, like other Irish banks, to more substantially progress a reduction in its NPAs; its regulatory nonperforming exposure (NPE) ratio was 26% at end-2017, which compares with 16% at AIB and 8% at BOI. The first key test will be the successful execution this year of Project Glas, a proposed €2.2 billion NPE portfolio sale.

Even if good progress is made with NPE reductions, whether the bank can demonstrate recurring returns in a low interest rate environment, at a level that might satisfy private investors, remains to be seen.

Capital and earnings: Absence of dividends supports our assessment

We view PTSB's capital and earnings as strong and project that its RAC ratio will stand around the 12% mark over our 12-18 month forecast horizon. There is an element of uncertainty in this projection given the scale of PTSB's NPE task. However, the likely absence of dividend payouts through the projection period supports our assessment.

PTSB's RAC ratio at Dec. 31, 2017 was 12.2%, up from 11.8% the year before (pro forma the improvement in our assessment of Ireland's economic risk in January 2017). PTSB's RAC ratio has benefitted from a significant reduction in S&P Global Ratings' risk-weighted assets, due to continued net deleveraging and internal capital generation driven by statutory profit reported in 2017.

PTSB's capitalization is somewhat weaker under our RAC framework compared to its regulatory Common Equity Tier 1 ratio, which was a reported 15.0% on a fully loaded basis at end-December 2017. The material difference between our capital measure and PTSB's regulatory ratios, at this date, is that we largely apply more-conservative risk weights to reflect our view of economic risk in Ireland. We also exclude €343 million of tax loss carry-forwards from our measure of capital.

PTSB has stated that the fully loaded impact of IFRS9 is just over 1% (though it benefits from transitional relief, like other banks), and that it expects regulatory changes to risk weightings on Irish assets (TRIM) to reduce CET1 by around 2.5% in 2018. PTSB reported a pro forma fully loaded CET1 ratio of 13.2% at March 31, 2018, after incorporating 1.1% of the total TRIM reduction.

The key assumptions underpinning our RAC forecast through end-2019 are as follows:

- A reduction in the net loan book to roughly €15.5 billion from €18.7 billion at end-2017, though we recognise that the timing and size of this projection is not an exact science.
- Pre-provision income to be around one-third lower than our calculation of €124 million in 2017.
- A modest impact from new loan loss provisions.
- S&P Global Ratings' risk-weighted assets (RWAs) to decline broadly in line with the reduction in the loan book.
- We have incorporated the full negative day one impact of International Financial Reporting Standard (IFRS) 9 on total adjusted capital (TAC), a reported figure of around €100 million post tax.

PTSB returned to a moderate net statutory profit for full-year 2017; however we expect a net loss for full year-2018 driven by expected losses from the sale of assets under Project Glas.

We consider PTSB's quality of capital to be relatively solid because 93% of the capital base comprises common equity. We include the €122 million of AT1 securities in our calculation of TAC. They receive intermediate equity credit as they are perpetual instruments with loss-absorption features on a going-concern basis, giving the bank the ability to suspend coupons at any time.

However, while we consider that PTSB's underlying earnings profile is more predictable than before, we note that its earnings buffer is negative. This indicates the inability of underlying pre-provision earnings to cover normalized losses (€111 million in 2017, as per our RAC framework). We incorporate the negative earnings buffer into our RAC projection by subtracting the deficiency from TAC.

Table 2

Permanent TSB Group Holdings PLC Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Criteria reflected in RAC ratios	2017 RAC Criteria	2017 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria
Tier 1 capital ratio	15.5	15.7	16.0	14.2	15.3
S&P RAC ratio before diversification	12.2	N.M.	10.2	7.8	6.3
S&P RAC ratio after diversification	8.1	N.M.	7.5	6.5	5.2
Adjusted common equity/total adjusted capital	92.5	92.4	93.3	100.0	100.0
Net interest income/operating revenues	91.2	89.9	90.4	85.5	85.0
Fee income/operating revenues	8.8	9.0	10.2	11.7	15.0
Market-sensitive income/operating revenues	(0.7)	0.7	(1.1)	1.6	(0.8)
Noninterest expenses/operating revenues	72.1	77.2	84.6	124.8	127.1
Preprovision operating income/average assets	0.5	0.4	0.2	(0.2)	(0.2)
Core earnings/average managed assets	0.2	0.4	0.1	(0.2)	(1.3)

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 3

Permanent TSB Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data

(Mil. €)	**Exposure***	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government and central banks	3,151	50	2	88	3
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	1,163	350	30	335	29
Corporate	256	213	83	261	102
Retail	21,154	8,750	41	10,507	50
Of which mortgage	20,354	8,413	41	9,507	47
Securitization§	65	0	0	13	20
Other assets†	774	425	55	1,191	154

Table 3

Permanent TSB Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data (cont.)

Total credit risk	26,563	9,788	37	12,396	47
Credit valuation adjustment					
Total credit valuation adjustment	--	138	--	0	--
Market risk					
Equity in the banking book	11	38	341	83	750
Trading book market risk	--	0	--	0	--
Total market risk	--	38	--	83	--
Operational risk					
Total operational risk	--	600	--	868	--
(Mil. €)		**Basel III RWA**		**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification		10,588		13,346	100
Total Diversification/Concentration Adjustments		--		6,799	51
RWA after diversification		10,588		20,145	151
(Mil. €)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		1,642	15.5	1,633	12.2
Capital ratio after adjustments‡		1,642	15.5	1,633	8.1

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2017, S&P Global.

Risk position: NPAs will need to reduce substantially for us to change our assessment

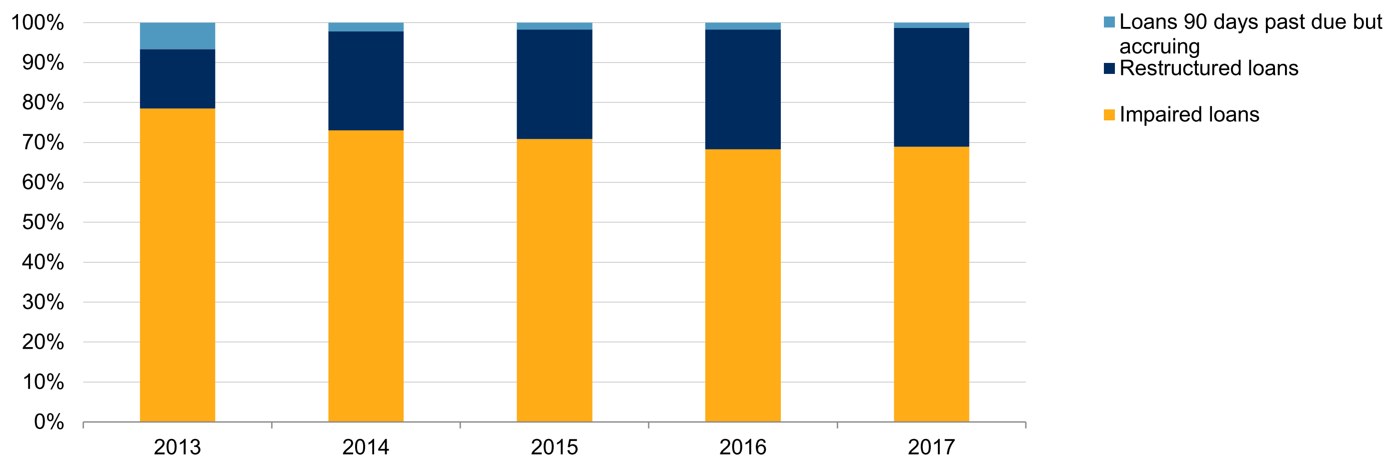
We compare PTSB's risk position with the same peers as for its business position because they have a generally similar product mix to PTSB and operate in banking systems with fairly similar economic risk to Ireland. We consider PTSB's risk position to be weak compared with that of peers due to its relatively large stock of NPAs.

We understand that Irish banks are required to use the European Banking Authority's (EBA) regulatory definition of NPEs for regulatory reporting, EBA stress testing, and for capital planning. In addition to impaired loans, the EBA's measure of NPEs includes performing loans that are 90 days past due, probationary loans (restructured loans held as nonperforming for 12 months thereafter), and collateral disposals.

Our more conservative measure of PTSB's NPAs--which includes impaired loans, loans 90 days past due, and performing renegotiated loans--stood at 31.4% of average customer loans as of year-end 2017 (see chart 2). Excluding performing renegotiated loans, PTSB's NPAs remain elevated at 22.1%, which is higher than that of European and international peers with similar economic risk and business mix. It is also higher than those of domestic peers BOI and AIB, for which we calculate NPA ratios of 10.9% and 18.8%, respectively as of year-end 2017. We also note that PTSB reported a Texas ratio of 157% as of year-end 2017, which remains high on an absolute and relative basis compared with BOI (85%) and AIB (81%). The Texas ratio measures NPAs (including performing forborne loans) to tangible common equity and loan loss reserves.

Chart 2

Nonperforming Asset Composition For PTSB (Mil. €)



Source: S&P Global Ratings.

Irish mortgages (of which 75% are owner-occupied and 25% BTL) dominate PTSB's net loan book. As of year-end 2017, they accounted for 97% of total lending. Consumer finance and CRE represented the remainder at about 2% and 1%, respectively.

About 22% of the mortgage book was reported as impaired at year-end 2017, which we consider to be higher than peers. We also consider the profile of this book to be weaker. For example, there is a bias toward weaker performing BTL mortgages (25% of the Irish mortgage book), negative equity (29% of the book), and the vintage profile is weaker.

We expect that PTSB will keep focusing on actively managing down NPAs in light of its targeted sale of NPLs via Project Glas, and other initiatives. Apart from the sales strategy mentioned above, we expect the reduction in the stock of NPAs to be gradual as the remaining untreated cases largely comprise long-term arrears and/or cases in the legal process.

PTSB reported a credit impairment charge of €49 million for 2017 compared to a net provision write-back of €68 million in 2016. In 2016, PTSB had updated its model parameters, including model assumptions on house price inflation leading to the write-backs. We do not expect any further material provision releases over our 12-month forecast horizon.

Table 4

Permanent TSB Group Holdings PLC Risk Position					
	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	(3.5)	(16.9)	(16.8)	(7.2)	(4.6)
Total diversification adjustment / S&P RWA before diversification	50.9	N.M.	35.4	19.9	21.1
Total managed assets/adjusted common equity (x)	15.7	18.7	21.6	26.2	27.6
New loan loss provisions/average customer loans	0.2	(0.3)	0.1	(0.1)	2.7
Net charge-offs/average customer loans	0.3	0.5	0.4	0.5	0.5
Gross nonperforming assets*/customer loans + other real estate owned	31.4	33.7	29.8	33.1	30.2
Loan loss reserves/gross nonperforming assets*	34.7	34.5	35.1	36.4	40.2

*Impaired loans plus 90 days past due loans and renegotiated loans. N.M.--Not meaningful.

Funding and liquidity: Improved funding and liquidity profile due to deleveraging and reduced reliance on monetary authorities

We regard PTSB's funding as average and its liquidity position as adequate. We primarily compare funding with the domestic industry average, while liquidity is an absolute assessment.

PTSB's funding profile has improved substantially over the past few years. This has been supported by lower funding needs due to deleveraging, as redemptions continue to exceed new lending, and the sale of non-core assets. At the same time, current accounts and deposit balances have been resilient.

Accordingly, PTSB's loan-to-deposit ratio improved to 108% at year-end 2017, from 111% at year-end 2016 and over 200% in 2011. PTSB's improved funding profile is also evident from its stronger S&P Global Ratings-adjusted stable funding ratio, which increased to 106% at end-2017, from 104% in 2016 and 46% in 2011. Our base-case expectation is that there is room for further improvement in these two ratios over the coming 12 months due to lower funding needs, as net loan balances continue to reduce on the back of redemptions and asset sales, while deposit balances remain stable.

Our adequate liquidity assessment reflects PTSB's improved liquidity position. It has achieved this via a significant reduction in ECB funding and deposits from other financial institutions (mainly institutional deposits and repos with Ireland's National Treasury Management Agency). ECB funding reduced significantly to €230 million at year-end 2017 (€1.4 billion in 2016), representing only 1% of total funding.

We note that the share of deposits now represent a high 83% of the funding base, and that current accounts represent a useful 22% of customer deposits. In the future, we believe that the bank's funding base will primarily comprise customer deposits and possibly a greater variety of long-term capital market funding.

The improvement in PTSB's liquidity position is reflected in our ratio of broad liquid assets to short-term wholesale funding, which rose to 1.8x at end-2017, from 1.5x at end-2016. This metric incorporates a €300 million senior unsecured bond (issued by the operating bank) which matured in the first half of 2018, leaving effectively no medium-term notes outstanding.

Table 5

Permanent TSB Group Holdings PLC Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	82.9	80.0	67.0	55.6	49.9
Customer loans (net)/customer deposits	108.1	111.2	130.5	146.8	169.1
Long term funding ratio	91.5	89.5	73.2	63.7	78.4
Stable funding ratio	106.4	104.3	86.1	76.4	92.8
Short-term wholesale funding/funding base	9.4	11.5	29.2	38.7	23.1
Broad liquid assets/short-term wholesale funding (x)	1.8	1.5	0.7	0.5	0.8
Net broad liquid assets/short-term customer deposits	9.8	8.9	(14.2)	(33.2)	(7.7)
Short-term wholesale funding/total wholesale funding	53.3	55.8	87.2	87.2	46.0
Narrow liquid assets/3-month wholesale funding (x)	2.6	1.5	0.9	1.0	1.2

Support: No uplift for ALAC support

We have not included notches in the long-term rating on the main operating bank under our ALAC criteria because PTSB does not yet exceed our required 5% threshold for one notch of support, nor have we seen evidence of MREL issuance. Management has indicated that its required MREL issuance is around €900 million.

We do not include notches for ALAC support in the ratings on non-operating holding companies, such as PTSB, because we do not believe that their senior obligations would continue to receive full and timely payment in a resolution scenario. Therefore, potential future ALAC support would only benefit the ratings on the operating company, Permanent TSB PLC.

We calculate PTSB's ALAC ratio at about 2.3% of S&P Global Ratings' risk-weighted assets at year-end 2017. Our calculation of PTSB's ALAC stock primarily includes the amount of TAC above the amount needed to maintain our current assessment of capital and earnings at strong. We include in our calculation PTSB's €125 million AT1; otherwise PTSB does not have material amounts of other eligible instruments.

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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

Related Research

- 31 European Banking Groups Assigned Resolution Counterparty Ratings; Four Collateralized Notes Upgraded; UCO Removed, June 12, 2018
- Resolution Counterparty Ratings Jurisdiction Assessment For Ireland Completed, June 11, 2018
- Merely A Win, No Grand Slam Glory For Irish Banks, March 26, 2018
- Banking Industry Country Risk Assessment: Ireland, Dec. 12, 2017
- Various Positive Rating Actions Taken On Irish Banks On Improving Industry Credit Profile, Dec. 12, 2017

Ratings Detail (As Of July 12, 2018)	
Permanent TSB Group Holdings PLC	
Issuer Credit Rating	B+/Positive/B
Senior Unsecured	B+
Short-Term Debt	B
Issuer Credit Ratings History	
03-Aug-2017	B+/Positive/B
13-Jan-2017	B+/Stable/B
21-Dec-2016	B/Stable/B
Sovereign Rating	
Ireland	A+/Stable/A-1
Related Entities	
Permanent TSB PLC	
Issuer Credit Rating	BB/Positive/B
Resolution Counterparty Rating	BBB-/--/A-3
Senior Unsecured	BB
Senior Unsecured	BB/B

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.