

Research Update:

# Ireland-Based Permanent TSB PLC Upgraded To 'BBB-'; Holding Company Affirmed At 'BB-'; Outlook Stable

December 4, 2019

## Overview

- Permanent TSB Group (PTSB Group) is building a substantial buffer of loss-absorbing instruments to protect the senior creditors of the operating bank, Permanent TSB PLC.
- We are raising our long- and short-term issuer credit ratings on Permanent TSB PLC to 'BBB-/A-3' from 'BB+/B' after the group successfully placed its first issuance of senior nonpreferred notes for €300 million in September 2019.
- We are also affirming our 'BB-/B' ratings on nonoperating holding company (NOHC) Permanent TSB Group Holdings PLC.
- The stable outlook indicates that the rating is unlikely to alter over the next 12-24 months, because even a substantially higher loss-absorbing buffer than one we currently incorporate into the rating will be offset by the group's lack of business diversity and weak profitability prospects.

### PRIMARY CREDIT ANALYST

**Anastasia Turdyeva**  
Dublin  
(353) 1-568-0622  
anastasia.turdyeva  
@spglobal.com

### SECONDARY CONTACT

**Letizia Conversano**  
Dublin  
353 1 568 0615  
letizia.conversano  
@spglobal.com

## Rating Action

On Dec. 4, 2019, S&P Global Ratings raised its long- and short-term issuer credit ratings on Ireland-incorporated Permanent TSB PLC (PTSB) to 'BBB-/A-3' from 'BB+/B'. The outlook is stable.

At the same time, we affirmed our 'BB-/B' ratings on the NOHC, Permanent TSB Group Holdings PLC (PTSB NOHC). The outlook remains stable.

Furthermore, we affirmed our 'BBB/A-2' resolution counterparty ratings on Permanent TSB PLC. We do not assign these ratings to NOHCs.

## Rationale

We raised the ratings on PTSB because the group is building up its loss-absorbing cushion to fulfil its minimum requirement for own funds and eligible liabilities (MREL). In our view, the 'bb+' group stand-alone credit profile (SACP) reflects that its underlying creditworthiness is stable. The group's balance sheet structure has improved but it still displays a lack of business diversity and weak profitability prospects.

We do not incorporate notches for additional loss-absorbing capacity (ALAC) support in our ratings on Permanent TSB Group Holdings PLC, the group's NOHC, as the build-up of bail-in buffers only benefits the creditors of the operating entity. As a result, the ratings on NOHC remain two notches below the 'bb+' group SACP.

Despite the group's small size, the resolution authority has said it would go through a bail-in resolution regime. In September 2019, the NOHC issued its first €300 million of MREL-compliant senior nonpreferred notes. On a pro forma basis, our ALAC ratio has improved to 5.5% from 1.2% at year-end 2018.

Management has plans for further issuances in 2020, to meet its MREL requirement by the January 2021 deadline. We incorporate these plans into our forecast and envisage this metric will improve further, remaining sustainably above our 6% threshold to qualify for one notch of uplift in the ratings on the main operating bank. Given the concentration of maturities, we apply a higher threshold to PTSB than our standard 5.0%. We anticipate that its buffer will consist of only a limited number of instruments, combined with excess capital over our 10% risk-adjusted capital (RAC) threshold for strong capital.

Our RAC ratio is forecast to be 12.9%-13.3% through to year-end 2021, up from 11.2% at end-2018 due to the group's balance sheet clean-up and subsequent reduction of its risk-weighted assets (RWAs). We base our forecast on almost flat growth of the loan portfolio (of at most 1.5%-2.0% per year over 2020-2021); a modest impact from new loan loss provisions; a slightly reducing net interest margin on the back of planned MREL issuance; and no dividend distribution through the projection period.

The Irish government owns about 75% of PTSB's ordinary shares. We consider the government unlikely to reduce its stake in the near term. The process of returning the bank to full private ownership will probably take several years. That said, capital distribution could be discussed in one or two years. Any future capital distribution would necessitate the bank reducing its NPE ratio closer to the European average and maintaining its excess of capital due to the slow pace of growth. We anticipate a similar scenario for AIB Group.

The group SACP demonstrates our view of the group's underlying creditworthiness and remains unchanged. PTSB Group has made good progress in reducing nonperforming assets, aided by the favorable macroeconomic environment in Ireland and investor appetite. This has allowed the sale and securitization of about €4 billion of NPEs since mid-2018. The group's regulatory NPE ratio was about 7% at end-September 2019.

The principal constraints on our view of the group's creditworthiness remains its lack of business diversity; weak profitability; and the difficulty the bank will face, particular in the low-rate environment, in transforming its existing franchise in Irish retail banking into something that can deliver more-meaningful returns.

The group hopes to expand into small and midsize enterprise (SME) business and to deepen its penetration in the retail segment. It also aims to keep up with changing customer preferences by investing in digital solutions. The success of this strategy largely depends on management's

ability to shift its attention to the commercial agenda, after many years of focusing on strengthening its balance sheet and working through the bank's legacy problematic assets.

In our view, the bank has a long way to go before its efforts turn into revenue. We estimate that preprovision income to revenues will average about 17% for the next two years. By contrast, we estimate this ratio will be 35%-40% for AIB and Bank of Ireland, and 40%-50% for PTSB's international peers, over the same period. We also forecast that the return on tangible equity will not increase beyond 3% any time soon.

## **Outlook**

### **Permanent TSB Group Holdings PLC**

The stable outlook over our 12-month outlook horizon indicates that our view of the group's intrinsic creditworthiness will remain unchanged. Despite the notable progress we have observed in the group's workout of problematic exposures and its robust capitalization, its reduced scale and weak profitability makes it difficult to change materially in a low interest rate environment.

We are unlikely to raise the ratings over the next 12 months, but we could consider doing so if PTSB can demonstrate the ability to diversify its business profile and proves that its franchise can generate significantly better profitability, compatible with a higher rating level. If we revised the group SACP upward, we would likely raise the long-term issuer credit rating on the NOHC by two notches, as we only apply a one-notch differential for a NOHC rating from an investment-grade group credit profile.

We could lower the ratings if we see evidence that PTSB's business stability and growth ambitions had faltered. We could also consider lowering the rating if we observe our forecast RAC ratio falling to below 10%. This could occur if a more-aggressive capital policy is pursued, together with higher growth rates than we currently envisage.

### **Permanent TSB PLC**

The stable outlook on the group's primary operating company reflects our view that this entity's stand-alone creditworthiness will remain unchanged over the next 12-24 months. It also incorporates our belief that the NOHC will be able to maintain a buffer of bail-inable instruments comfortably above 6.0% of projected S&P Global Ratings RWAs over the next 24 months. That said, even if the ALAC buffer were above 10% of projected S&P Global Ratings RWAs, a positive rating action would depend on the bank resolving its lack of business diversity and weak profitability prospects.

We could lower the rating on the operating company if the ALAC buffer protecting senior creditors was predicted to fall below 6.0% of our RWAs over the outlook horizon. This could occur if capital distribution were to resume or the NOHC was unable to issue the planned MREL instruments.

We could also take rating actions in line with revisions to the group SACP, as explained above.

## **Ratings Score Snapshot**

## Rating Score Snapshot

	To	From
<b>Permanent TSB PLC</b>		
Issuer Credit Rating	BBB-/Stable/A-3	BB+/Stable/B
<b>Permanent TSB Group Holdings PLC</b>		
Issuer Credit Rating	BB-/Stable/B	BB-/Stable/B
Group SACP	bb+	bb+
Anchor	bbb	bbb
Business Position	Weak (-2)	Weak (-2)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	(+1)	0
ALAC Support	(+1)	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors (0)	0	0

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Ratings Affirmed

#### Permanent TSB PLC

Resolution Counterparty Rating	BBB/--/A-2
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#### Permanent TSB Group Holdings PLC

Issuer Credit Rating	BB-/Stable/B
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#### Permanent TSB Group Holdings PLC

Senior Unsecured	BB-
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### Upgraded

	To	From
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#### Permanent TSB PLC

Issuer Credit Rating	BBB-/Stable/A-3	BB+/Stable/B
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#### Permanent TSB PLC

Senior Unsecured	BBB-	BB+
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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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.

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