

RESEARCH

Irish Bank Rating Implications Are Uncertain Following Government's Asset Transfer Plan

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LONDON (Standard & Poor's) May 1, 2009--Standard & Poor's Ratings Services commented today on the Irish government's (AA+/Negative/A-1+) plan announced on April 7, 2009, to remove the riskiest lending from the balance sheets of the country's main commercial banks via the establishment of a National Asset Management Agency (NAMA). From the details so far available, Standard & Poor's considers that the NAMA plan provides further evidence of the government's desire to support its banking system. However, precise details regarding how the plan will work remain to be clarified. Given the complexity of the exercise being undertaken, this could take several months.

In our view, the plan may prove to be only partially successful--removing the most risky assets, but failing to sufficiently strengthen the banks' credit profiles to withstand the challenges that we expect them to continue to face from the very weak economic environment. Today, we placed the ratings on the two largest Irish banks, Allied Irish Banks PLC and Bank of Ireland, on CreditWatch with negative implications, principally as a result of the NAMA plan announcement. (For more information see the related articles "Bank of Ireland 'A' L-T Rating Put On CreditWatch Negative On Expected Asset Transfer And NAMA Plan; Hybrids Cut To 'BB'," and "Allied Irish Banks 'A' L-T Rating Placed On Watch Negative On Expected Asset Transfer And NAMA Plan; Hybrids Cut To 'BB'," published today on RatingsDirect.) The 'A-/A-1' counterparty credit ratings on Anglo Irish Bank Corp. Ltd. remain on CreditWatch with negative implications. Other Irish banks we consider likely to participate in NAMA are Irish Nationwide Building Society (not rated) and EBS Building Society (not rated). We will continue to monitor the situation and reappraise the implications for bank ratings as further details become available.

The government announced that under the plan up to €90 billion of the riskiest property-related exposures (and associated collateral) could be transferred from the domestically owned Irish banks to NAMA--a new, government-owned asset management entity, which would operate under the direction of the National Treasury Management Agency. We understand that while these exposures are likely to relate principally to development lending (in Ireland and elsewhere), some associated investment lending could also be transferred.

In return, NAMA would pay for these assets with bonds, either government-guaranteed or issued by the government directly. If, as we expect, NAMA acquires these assets at a significant discount to their current book values, this could crystallize a material loss on these exposures, depleting the banks' base of equity capital. The government has said that, if necessary, it is prepared to recapitalize the affected banks in return for ordinary shares. This could result in the government taking significant, perhaps majority, stakes in some of the affected institutions.

NAMA will, we understand, operate on a commercial basis, seeking to optimize the return on these transferred assets over time. However, if NAMA ultimately makes a loss on the acquired assets, it appears likely to be clawed back from the affected banks, but over an extended timeframe. We expect that once formulated, the NAMA plan will require approval from the European Commission under the EU's state aid rules.

We consider NAMA to be a clear indication of the scale of the problems faced by those Irish banks with material property development exposures, but also demonstrable evidence of the Irish government's support for systemically important institutions. We also think that the plan could achieve the government's stated objectives of putting the banks on a stronger footing,

restoring investor confidence in them, and improving both their liquidity and their capacity to lend to creditworthy Irish borrowers. However, whether it achieves all these aims will, we believe, depend on the fine detail relating to the execution of the plan, particularly regarding the strength of the banks' financial position after the loans have been transferred and their capital bases replenished.

In our view, the most important details of the plan which remain to be clarified are the:

- Exact nature and amount of the assets to be transferred,
- Price/discount to book value at which they will be acquired,
- Capitalization of the banks following the transfer and any subsequent capital replenishment exercise,
- Composition of their capital bases,
- Future capital policy,
- Future earnings capacity, and
- Impact on business diversity.

One particular concern for the ratings is that while some institutions currently have elevated regulatory capital ratios, with the riskiest assets transferred the authorities might decide to allow these institutions to run on significantly diminished regulatory capital ratios after the NAMA transfer against a background of a still-deteriorating economic environment.

The details cited above will allow us to ascertain whether the rated banks' financial profiles will be sufficiently robust to weather the remaining challenges that they face. These include higher than historic funding costs, a deteriorating economic environment, and weakening asset quality in the retained portion of their loan books--which would likely comprise investment property exposures, general corporate exposures, and consumer and residential mortgage exposures, mainly in Ireland but also the U.K. The deteriorating environment was one of the factors leading to our recent downward revision of the Banking Industry Country Risk Assessment on the Republic of Ireland to Group 3 (see "Irish BICRA Changed To Group 3 From Group 2 On Heightened Industry Risk," published on March 16, 2009).

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