MOODY'S
INVESTORS SERVICE

CREDIT OPINION
15 May 2018

Update

Rate this Research

RATINGS

Al Rayan Bank PLC

Domicile	United Kingdom
Long Term Debt	Not Assigned
Long Term Deposit	Aa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

The principal Methodology used to rate ARB is the Banks methodology published in April 2018. In the case of ARB, when we state "debt" in the ratings, we are referring to "financing".

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Al Rayan Bank PLC

Semi-annual update

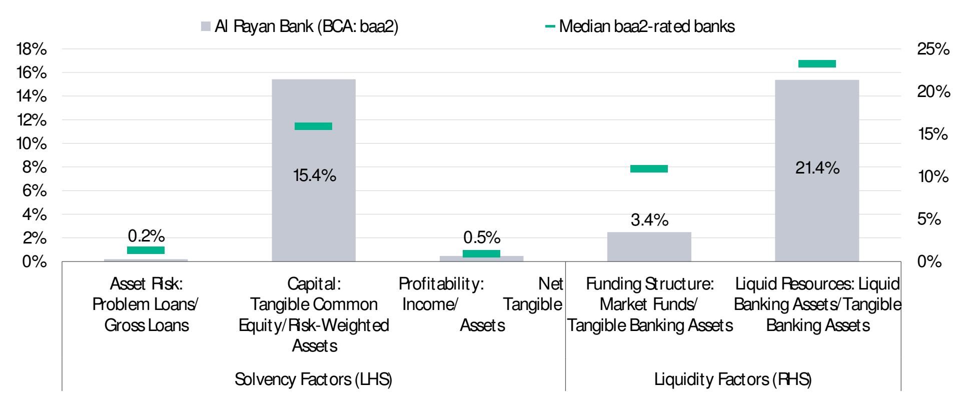
Summary

We assign a baa2 baseline credit assessment (BCA), an a2 adjusted BCA, Aa3 long-term deposit ratings, as well as a Counterparty Risk Assessment (CR Assessment) of Aa3(cr)/ Prime-1(cr) to Al Rayan Bank PLC (ARB). The bank's short-term deposit ratings are Prime-1.

ARB's baa2 BCA reflects the bank's: (1) sound asset quality profile in both its secured and unsecured portfolios; (2) our expectation that capitalisation; and (3) levels of liquid resources will remain robust. These strengths are balanced against ARB's: (1) rapid growth in financing, which could result in a deterioration in asset quality in a downturn; (2) limited operating history and evolving business model; (3) modest, albeit improving profitability; and (4) limited access to market funding and high reliance on funding from Qatar Central Bank and Qatar Investment Authority.

The long-term deposit ratings are underpinned by: (1) the bank's a2 adjusted BCA which reflects our view that ARB benefits from a very high probability of support from its parent Masraf Al Rayan (Masraf, A1 negative); (2) the results of our Advanced Loss Given Failure (LGF) analysis, reflecting our view that the bank's junior depositors would face very low loss-given-failure, leading to two notches of uplift from the adjusted BCA; and (3) a low expectation of government support.

Exhibit 1
Rating scorecard - key financial ratios



The principal Methodology used to rate ARB is the Banks methodology published in April 2018. In the case of ARB, when we state "loans" and "interest" in the exhibits, we are referring to "financing assets" and "income from Islamic financing transactions".
Source: Moody's Financial Metrics

Credit strengths

» Sound asset risk profile

» Robust capitalisation

» Sufficient liquid resources

Credit challenges

» Above-market asset growth

» Limited operating history and evolving business model

» High reliance on funding from QCB and QIA

» Modest profitability

Rating outlook

The outlook on the long-term deposit ratings is negative. The negative outlook is aligned with the negative outlook assigned to the ratings of ARB's immediate parent, Masraf. Masraf's negative outlook is driven by (i) our expectation that the downside risk of a prolongation of the dispute between Qatar and a group of peer countries could lead to some outflows of external funding, which would reduce the Masraf's liquidity buffers, while domestic funding sources remain tight due to current oil prices ; and (ii) the weakening capacity of the government of Qatar to provide support in case of need, as implied by the negative outlook on its Aa3 government bond rating.

Factors that could lead to an upgrade

» An upgrade of the bank's BCA could be triggered by the establishment of a stabilized asset quality profile as the financing book continues to grow. An upgrade to the BCA could also arise should profitability metrics improve.

Factors that could lead to a downgrade

» A downgrade of ARB's BCA could be driven by a material deterioration in the bank's asset quality or demonstration of a materially more aggressive risk appetite in its financing book. Negative pressure could also arise from significant deterioration in the bank's profitability metrics, capitalisation and liquidity metrics.

» A downgrade of ARB's deposit ratings could be driven by a downgrade of its immediate parent's rating.

Key indicators

Exhibit 2
Al Rayan Bank PLC (Consolidated Financials) [1]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	2013	CAGR/Avg.[3]
Total Assets (GBP billion)	1.8	1.4	1.0	0.6	-	40.7[4]
Total Assets (EUR billion)	2.0	1.7	1.4	0.8	-	34.6[4]
Total Assets (USD billion)	2.4	1.8	1.5	1.0	-	34.2[4]
Tangible Common Equity (GBP billion)	0.1	0.1	0.1	0.1	-	8.5[4]
Tangible Common Equity (EUR billion)	0.1	0.1	0.2	0.1	-	3.7[4]
Tangible Common Equity (USD billion)	0.2	0.1	0.2	0.2	-	3.5[4]
Problem Loans / Gross Loans (%)	0.1	0.0	0.5	-	-	0.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	15.4	17.7	23.1	34.7	-	22.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	0.6	0.2	4.9	-	-	1.9[5]
Net Interest Margin (%)	2.0	2.1	2.5	1.8	-	2.1[5]
PPI / Average RWA (%)	1.3	1.5	1.8	0.2	-	1.2[6]
Net Income / Tangible Assets (%)	0.5	0.7	1.0	0.2	-	0.6[5]
Cost / Income Ratio (%)	70.6	68.3	68.2	95.9	-	75.7[5]
Market Funds / Tangible Banking Assets (%)	3.4	5.8	15.5	4.9	-	7.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	21.4	27.0	26.2	29.9	-	26.1[5]
Gross Loans / Due to Customers (%)	88.2	124.7	145.2	131.5	-	122.4[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented
The principal Methodology used to rate ARB is the Banks methodology published in April 2018. In the case of ARB, when we state "loans" and "interest" in the exhibits, we are referring to "financing assets" and "income from Islamic financing transactions".
Source: Moody's Financial Metrics

Profile

Al Rayan Bank PLC (ARB) is the UK's first wholly Sharia-compliant retail bank and a majority owned subsidiary of Masraf Al Rayan (Masraf), which acquired the bank in 2014. Formerly called Islamic House of Britain PLC, it was established in 2002 and obtained a license in August 2004, as Islamic Bank Britain PLC. Qatar Holding (QIA) acquired a 30% stake in the bank from Masraf in Dec 2016 and owns c.38% of ARB on a look-through basis. There is no letter of comfort in relation to the QIA investment.

Detailed credit considerations

Sound asset risk profile, though above market asset growth with geographic and single name concentration

Established in 2004 as Islamic Bank of Britain, the first wholly Sharia-compliant UK bank, ARB was renamed in 2014 following their acquisition by Masraf Al Rayan, the second largest bank in Qatar. The growth strategy which was implemented following the takeover led to a compound annual growth rate of 41% between 2014 and 2017, with total assets amounting to GBP1,806 million at YE 2017 compared to GBP648 million at YE 2014. ARB focuses on three business segments.

1. The retail business is mostly composed of Home Purchase Plans (HPP) and Buy-to-Let Home Purchase Plan (BTLPP) products, which adhere to Sharia principles: contrary to traditional mortgage lenders, ARB retain ownership of the property, with customers paying a rent, circumventing the payment of interest by customers, which is forbidden under Sharia Law. We deem this feature as credit positive, given that customers cannot take a second lien mortgage on the property, as they themselves are not the legal owner. At YE 2017, ARB was serving over 3,800 customers through its retail channel, for a total book of GBP665 million. .

2. The commercial property finance portfolio, which amounted to GBP478 million at YE 2017 was spread over 120 clients, and covers large residential investment private rental sector (PRS) schemes, mixed used industrial warehouses, student property as well as prime offices. The client base is composed of both UK and GCC corporates and family offices.

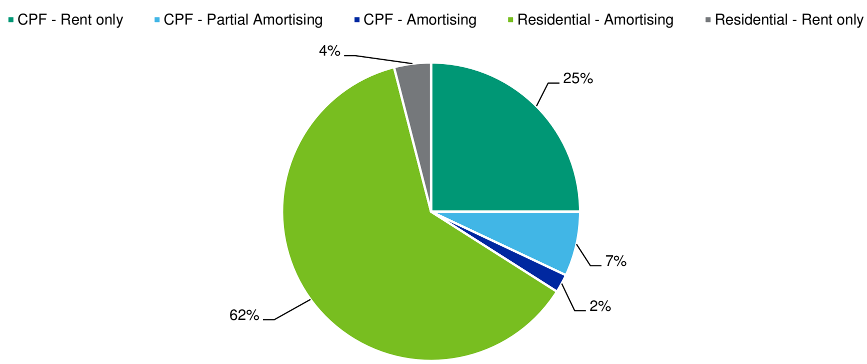
3. The GCC segment offers private banking services to GCC customers, including real estate finance and day-to-day banking services. The portfolio of GBP266 million at YE 2017 was spread between 268 high net-worth customers.

ARB has improved their asset risk track record since the financial crisis, by moving out of unsecured financing where they had incurred some losses, into secured financing. Whilst we recognise that since the shift into secured financing ARB has reduced non-performing financings while maintaining a conservative approach to asset risk, their asset growth has been significant, albeit from a small base over the past two years. Although reflective of the customer base, financing is concentrated in the south east of England, particularly London, for which HPP financing equates to 44% of overall HPP financing in June 2017. In addition, ARB has large average financings of GBP1 million outstanding to GCC customers accounting for 19% of the book, increasing concentration in London further, as well as reducing the granularity of the overall financing book.

Average Finance-to-values (FTV) are above peer stock FTV levels, though are in-line on a new financing basis. Buy-to-let (BTL) new financing FTVs are modest at 53% and comfortably below the limit of 75%.

Our assigned baa1 Asset Risk score is six notches below our macro adjusted score of aa1, reflecting the low non-perfoming assets levels, but also considers risks which may arise through the high growth rate of financing, single name concentration risks surrounding GCC customers, and geographic concentration risks.

Exhibit 3
ARB's residential and commercial financing split
Payment type split at YE2017



Source: Al Rayan Bank

Modest profitability

Profitability had been largely negative up until 2014, driven historically by losses made from financing, but also by the high cost base maintained by ARB. Cost-to-income has increased to 71%, but still remains above peers. This has been driven by costs such as opening a branch in Knightsbridge, a key area for GCC customers. Profitability is likely to increase going forward, as costs are reduced, rental rates increase and the cost of funding reduces, through a Sukuk issuance and a reduced reliance on more expensive retail deposits. ARB is also looking to move into higher margin SME financing, further aiding profitability.

Our assigned ba1 Profitability score, in line with its Macro Adjusted score, reflects the recency of ARB's losses due to high non-performing assets post the financial crisis, high cost base and funding costs, impacting profitability in more recent years.

Robust capitalisation supports further expected growth

ARB's tier 1 capital is predominantly made up of common equity, reflecting retained earnings from prior periods. Capitalisation remains solid at 15.4% (31 December 2017), though this is required to support the continued financing growth and expansion of the bank. ARB uses the standardised approach to risk weighting assets and have adequate capital to meet their growth plans, without the further need for a capital injection. However, if asset risk were to deteriorate through lower underwriting standards, or a deterioration in the UK macro environment, additional capital may be required or reduced financing growth would have to take place.

Our assigned a1 Capital score one notch below the Macro Adjusted score of aa3, reflects the likely reduction in the capital ratio going forward, due to the continued growth in financing.

High reliance on funding from QCB and QIA, with high levels of liquidity maintained

ARB has limited access to wholesale funding, given their requirement to comply to Sharia principles and not pay interest. Given this, it is highly reliant on the Qatar Investment Authority (QIA) and Qatar Central Bank (QCB) for funding, to which ARB has drawn 3-month rolling contracts of $50 million and $75 million respectively. Given the lack of market access, ARB offers very competitive retail profit rates, attracting mainly non-Muslim retail deposits through attractive profit rates on the best buy tables. However, this increases the overall cost of funding, reducing margins and negatively impacting profitability.

In February 2018, ARB issued the UK's first asset-backed Sukuk through a special-purpose vehicle, Tolkien Funding Sukuk No. 1. The issuance, GBP250 million securitization of Sharia-compliant HPP, opens new funding options for ARB given the limited activity in the asset-backed Sukuk market since the global financial crisis. Raising funding secured on HPP provides ARB with a cheap alternative to deposit funding. While other UK challenger banks have had access to the Bank of England's term funding scheme (TFS), ARB has not been able to tap the scheme because it is not sharia compliant.

The availability of such cheap central bank funding in recent years led traditional high street lenders to turn to the mortgage-backed bond market more sporadically. This has led to a decline of prime residential mortgage-backed securities (RMBS), which made the ARB deal all the more appealing to traditional UK securitisation investors.

We view liquidity as a strength for the bank, with above average liquid banking assets to tangible banking assets maintained compared with peers. Liquidity is largely made up of cash on demand and short-term commodity Murabaha and Wakala transactions.

Our assigned baa2 Funding Risk score reflects ARB's limited market access and reliance on funding from the QIA and WCB, as well as higher cost retail deposit funding. Our assigned baa1 Liquid Resources score, in line with the Macro Adjusted score, reflects the adequate level of liquidity held to meet short term requirements.

ARB's BCA Is supported By the UK's Strong + macro profile

ARB's operating environment is influenced largely by the UK (Aa2 stable); its Macro Profile is thus in line with the UK at Strong +. Banks operating in the UK benefit from operating in a wealthy and developed country, with a very high degree of economic, institutional and government financial strength, as well as very low susceptibility to event risk. The main risks to the system now stem from the economic uncertainty resulting from the UK's decision to leave the European Union (EU) and the high level of indebtedness of UK households, which are thus sensitive to changes in interest rates.

We expect that the vote in favour of the UK leaving the EU and the subsequent triggering of Article 50 of the Lisbon Treaty will result in heightened uncertainty over the UK's future trade relationship with the EU. This uncertainty is expected to result in lower economic growth, reduced demand for credit, a modest increase in unemployment, downward pressure on property prices and potentially higher and more volatile wholesale funding costs, albeit these have not materialised to date. These drivers will pressure revenues, asset quality and profitability metrics for all banks in the system.

ARB intends to utilise the UK's current ability to passport into mainland Europe, offering banking services for GCC clients based in Paris. However, given current Brexit negotiations, ARB may need to open a full subsidiary in mainland Europe to offer these services, as passporting may not be possible past the March 2019 deadline, the scheduled conclusion of Brexit negotiations.

Qualitative adjustments

ARB's financial profile score of baa1, is subject to a negative one-notch downward qualitative adjustment for Corporate Behaviour given the bank's relatively limited operating history, nascent business model and evolving business model.

The scorecard's calculated BCA range is baa1-baa3. Our BCA of baa2 is positioned in the mid-point of the range offered by our scorecard.

Support and structural considerations

Affiliate support

Given the strategic importance of ARB to its parent Masraf, allowing GCC customers to have access to private banking services in the UK, we expect the probability of support from Masraf to be very high. The parent has representation on ARB's board and is active in the development of its forward looking strategy. We use the parent's supported rating of A1, as the basis for deriving support to ARB. This is based on the expectation that ARB would be supported in case of need, due to the interconnectedness of the bank with its parent, its operating under the same brand name, the 38% ownership (on a look-through basis) by Qatar Holding and relatively modest size. As a result we assign three notches of support to the BCA of baa2, to arrive at an adjusted BCA of a2.

Notching considerations

Loss Given Failure And Additional Notching

We apply our Advanced LGF analysis to ARB because it is domiciled in the UK, which we consider has an operational resolution regime, following the implementation of the EU Bank Recovery and Resolution Directive (BRRD). Our standard assumptions, which are applied to ARB, assume: residual tangible common equity at failure of 3% of TBA, losses post-failure of 8% of TBA, junior wholesale deposits of 26% of the bank's total deposit book, a 25% run-off in junior wholesale deposits, a 5% run-off in preferred deposits, and a 25% probability of deposits being preferred to senior unsecured funding.

Under these assumptions, ARB's deposits are likely to face very low loss-given-failure, due to the loss absorption provided by the volume of deposits themselves. This results in a PRA for ARB's deposits of aa3, two notches above the a2 Adjusted BCA.

The CR Assessment is positioned at Aa3(cr)/Prime-1(cr), in line with the country ceiling of Qatar. The CR Assessment is two notches above the Adjusted BCA of a2, based on the cushion against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments, i.e. bail-in-able funding and deposits. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss. Therefore, we focus purely on subordination and take no account of the volume of the instrument class.

Government Support

We do not assign additional Government Support to ARB, given we already use the supported rating of ARB's parent Masraf in our consideration of affiliate support. Our assigned deposit rating is therefore in line with the PRA.

About Moody's Bank Scorecard

The principal methodology used in these ratings was Banks published in April 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

- Our Bank Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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 methodology and scorecard factors

Exhibit 4

Al Rayan Bank PLC

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.2%	aa1	←→	baa1	Loan growth	Single name concentration
Capital						
TCE / RWA	15.4%	aa3	←→	a1	Stress capital resilience	Expected trend
Profitability						
Net Income / Tangible Assets	0.5%	ba1	←→	ba1	Earnings quality	
Combined Solvency Score		a1		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	3.4%	aa2	←→	baa2	Lack of market access	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	21.4%	baa1	←→	baa1	Expected trend	
Combined Liquidity Score		a1		baa2		
Financial Profile				baa1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa2		
Affiliate Support notching				--		
Adjusted BCA				a2		

Balance Sheet	**in-scope (GBP million)**	**% in-scope**	**at-failure (GBP million)**	**% at-failure**
Other liabilities	145	8.0%	308	17.0%
Deposits	1,597	88.4%	1,434	79.4%
Preferred deposits	1,182	65.4%	1,123	62.2%
Junior Deposits	415	23.0%	311	17.2%
Junior subordinated bank debt	10	0.6%	10	0.6%
Equity	54	3.0%	54	3.0%
Total Tangible Banking Assets	1,806	100%	1,806	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Assessment	20.8%	20.8%	20.8%	20.8%	3	3	3	3	0	aa2 (cr)
Deposits	20.8%	3.6%	20.8%	3.6%	2	2	2	2	0	aa3

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	aa2 (cr)	0	Aa3 (cr)	--
Deposits	2	0	aa3	0	Aa3	Aa3

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Source: Moody's Financial Metrics

Ratings

Exhibit 5

Category	Moody's Rating
AL RAYAN BANK PLC	
Outlook	Negative
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
PARENT: MASRAF AL RAYAN (Q.S.C.)	
Outlook	Negative
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
ST Issuer Rating	P-1

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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