MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 January 2019

Update

Rate this Research

RATINGS

Al Rayan Bank PLC

Domicile	United Kingdom
Long Term CRR	Aa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Aa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

The principal Methodology used to rate ARB is the Banks methodology published in July 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

Periodic interim update

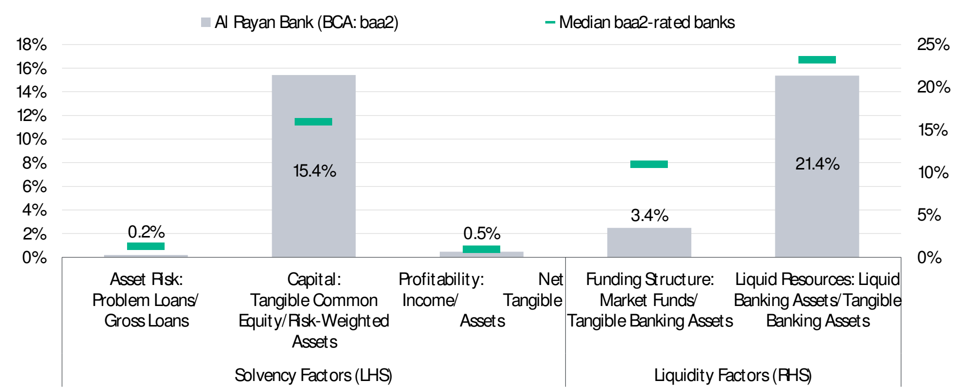
Summary

We assign to Al Rayan Bank PLC (ARB) a baa2 baseline credit assessment (BCA), an a2 adjusted BCA, Aa3 long-term deposit ratings, as well as a Counterparty Risk Ratings (CRR) of Aa2/Prime-1 and Counterparty Risk Assessment of Aa2/Prime-1. The bank's short-term deposit ratings are Prime-1.

ARB's baa2 BCA reflects the bank's: (1) sound asset risk 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) reliance on funding from Qatar Central Bank and Qatar Investment Authority and evolving wholesale funding structure.

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 stable, baa2)[1]; (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 August 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 benefiting from low non-performing assets levels
- » Robust capitalisation that supports further expected growth
- » Adequate levels of high quality liquidity resources

Credit challenges

- » Asset risk constrained by above-market asset growth and geographic and single name concentration
- » Limited operating history and evolving business model
- » Evolving funding profile and relatively high cost deposit base
- » Modest profitability constrained by high initial investment cost to grow the limited lending

Rating outlook

The outlook on the long-term deposit rating is stable, and is aligned with the stable outlook assigned to the ratings of ARB's immediate parent, Masraf.

Factors that could lead to an upgrade

- » An upgrade of the bank's BCA could be triggered by a more stable asset quality profile or improved profitability.
- » Additionally, alterations to ARB's liability structure may change the notches of uplift provided by our Advanced LGF analysis and lead to higher notching from the bank's Adjusted BCA, thereby improving the local-currency deposit rating by a notch.

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 risk or demonstration of a more aggressive risk appetite. A downgrade could also arise from significant deterioration in the bank's profitability, capitalisation and liquidity metrics.
- » A downgrade of ARB's deposit ratings could be driven by a reduction of the corporate and wholesale deposit base, and/or by a downgrade of Masraf's rating.
- » Downward pressure on the ratings could develop in the case of significant dependence on non-bailinable funding sources, which would result in higher loss given failure for depositors under our LGF analysis.

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 July 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

ARB is the first wholly Sharia-compliant retail bank based in United Kingdom (Aa2 stable) and a majority owned subsidiary of Masraf, the second largest Islamic bank in Qatar (Aa3, stable) (fourth overall) with total assets of USD 27 billion as of Q3 2018, 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 of Britain PLC. Qatar Holding (wholly owned by Qatar Investment Authority (QIA)) acquired a 30% stake in the bank from Masraf in Dec 2016 and owns approx. 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

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

The high growth strategy was implemented following the takeover and led to a compound annual growth rate of 41% between 2014 and 2017, now remaining highly unseasoned. ARB focuses on three business segments (see Exhibit 3).

1. The retail business is mostly composed of Sharia-compliant Home Purchase Plans (HPP) and Buy-to-Let Home Purchase Plan (BTL) 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 equating 47% of total financing assets.

2. The commercial property finance portfolio, which amounted to GBP478 million (34% of total financing assets 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 and represents 19% of total financing assets.

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 to 0.06% as of YE 2017 from 0.52% as of 2015 while maintaining a conservative approach to asset risk, their asset growth has been significant at 34% year-on-year during 2015-2017, albeit from a small base over the past two years.

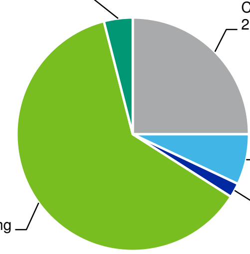
Reflective of the customer base, ARB's financing is concentrated in the south east of England, particularly London, for which HPP financing equates to 44% of overall UK's HPP financing in June 2017. In addition, ARB has large average ticket size financings of GBP1 million to primarily new London based GCC customers, increasing concentration risk further, as well as the large ticket sizes reduce the granularity of the overall financing book.

On a positive note, average finance-to-values (FTV) for BTL are modest at 53% and comfortably below the limit of 75%, while HPP are at 55%.

Exhibit 3

ARB's residential and commercial financing split

Payment type split at YE2017



Note: CPF: Commercial Property Financing
Source: Al Rayan Bank

Modest profitability constrained by high initial investment cost to grow the limited lending

We view ARB's profitability as weak and assign a ba1 Profitability score, in line with its Macro Adjusted score, reflecting 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.

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. The bank reported Return of Assets of 0.48% as of YE 2017, down from 0.66% at YE 2016, and 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 rental rates will increase and the cost of funding reduce, 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.

Robust capitalisation supports further expected growth

We view ARB's capital levels as solid and assign a1 Capital score one notch below the Macro Adjusted score of aa3, which reflects the likely reduction in the capital ratio going forward, due to the continued growth in financing.

ARB's Tier 1 capital is fully made up of common equity, since retained earnings are negative due to the losses incurred by Masraf to acquire the business. ARB's leverage ratio decreased from 8.1% at end of the year 2016 to 6.7% at end of the year 2017. ARB's Tangible Common Equity (TCE) over Risk Weighted Assets ratio remains solid at 15.4% and TCE leverage at 7.2% (31 December 2017). 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. In fact, ARB is exploring the opportunity to raise external Sharia-complaint hybrid capital in 2019, which will be a first by a bank in UK.

Evolving funding profile and relatively high cost deposit base

Overall ARB has a good liquidity profile supported by a sound funding profile and adequate level of liquid assets.

We assign a baa2 Funding Risk score, 3-notches downward adjusted from the Macro Adjusted score of aa2. Our adjustment reflects ARB's limited market access as well as evolving funding profile.

At the end of 2017, ARB had limited external market funding at 3.4% of Tangible Banking Assets (TBA). Additionally, ARB drew 3-month rolling contracts of $50 million and $75 million respectively from QIA and QCB. In order to support its funding profile, ARB offers very competitive retail profit rates, attracting mainly non-Muslim retail deposits (deposits grew more than 30% year on year) through attractive profit rates on the best buy tables. However, this increases the overall cost of funding, reducing margins and negatively impacting profitability.

Furthermore, 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 TFS funding in recent years led conventional high-street lenders to turn to the mortgage-backed bond market more sporadically. This 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. The end of TFS in 2018 and the need for UK banks to replace their borrowings under the scheme will increase the supply of RMBS and covered bonds as well as increasing competition for retail deposits. The refinancing of the existing Sukuk that matures in 2021 will depend on market conditions.

Adequate levels of high quality liquidity resources

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. 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 HQLA and cash on demand and short-term commodity Murabaha and Wakala[2]transactions equating 21% of TBA as of year-end 2017 down from 27% a year earlier.

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

ARB's operating environment is influenced largely by the UK; its Macro Profile is thus in line with the UK's Macro Profile 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, Masraf 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.

Support and structural 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.

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. In line with our support assumptions on deposits, neither the CR Assessment nor the CRR benefit from notching uplift due to government support.

Counterparty Risk Rating

The Counterparty Risk Ratings (CRRs) of ARB are positioned at Aa2/Prime-1.

The CRRs of ARB are Aa2 and Prime-1 and take into account the level of subordination to CRR liabilities in the bank's balance sheet, and assumes a nominal volume of such liabilities. Our advanced LGF approach provides three notches of uplift to the CRR above the adjusted BCA.

The CRR is higher than ARB's deposit rating, reflecting our view that secured counterparties to banks typically benefit from greater protections under insolvency laws and bank resolution regimes than do senior unsecured creditors, and that this benefit is likely to extend to the unsecured portion of such secured transactions in most bank resolution regimes. We believe that in many cases regulators will use their discretion to allow a bank in resolution to continue to honour its CRR liabilities or to transfer those liabilities to another party who will honour them, in part because of the greater complexity of bailing in obligations that fluctuate with market prices, and also because the regulator will typically seek to preserve much of the bank's operations as a going concern in order to maximize the value of the bank in resolution, stabilize the bank quickly, and avoid contagion within the banking system. CRR liabilities at banks subject to operational resolution regimes therefore benefit from the subordination provided by more junior liabilities, with the extent of the uplift of the CRR from the adjusted BCA depending on the amount of subordination.

Counterparty Risk Assessment

The CR Assessment of ARB is positioned at Aa2(cr)/Prime-1(cr).

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment of ARB is Aa2(cr)/Prime-1(cr) and positioned at three 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.

About Moody's Bank Scorecard

The principal methodology used in these ratings was Banks published in August 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	155	8.6%	318	17.6%
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%
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 Rating	20.3%	20.2%	20.3%	20.2%	3	3	3	3	0	aa2
Counterparty Risk Assessment	20.2%	20.2%	20.2%	20.2%	3	3	3	3	0	aa2 (cr)
Deposits	20.2%	3.0%	20.2%	3.0%	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 Rating	3	0	aa2	0	Aa2	Aa2
Counterparty Risk Assessment	3	0	aa2 (cr)	0	Aa2 (cr)	--
Deposits	2	0	aa3	0	Aa3	Aa3

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
The principal Methodology used to rate ARB is the Banks methodology published in July 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

Ratings

Exhibit 5

Category	Moody's Rating
AL RAYAN BANK PLC	
Outlook	Stable
Counterparty Risk Rating	Aa2/P-1
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
PARENT: MASRAF AL RAYAN (Q.P.S.C.)	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
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

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment

2 Commodity Murabaha is a contract for purchase and re-sale for cost plus profit, which provides cash or liquidity facility without having to take out a loan and pay interest. Wakala is an investment agency contract, which usually includes in its terms a fee for the expertise of the agent.

REPORT NUMBER 1157534

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Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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