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CREDIT OPINION

20 April 2023

Update

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RATINGS

Al Rayan Bank PLC

Domicile	United Kingdom
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

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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Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Al Rayan Bank PLC

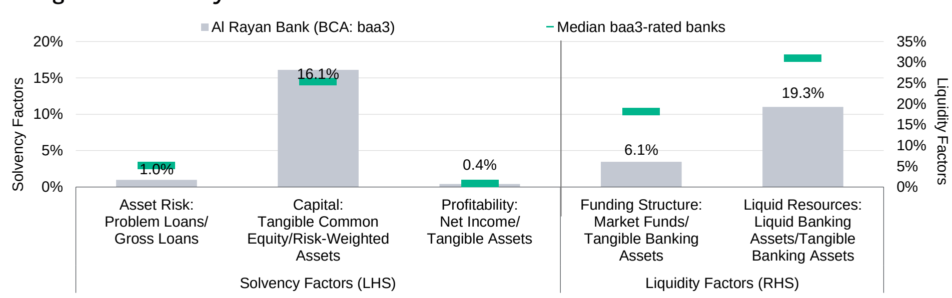
Update following deposit ratings affirmation, outlook negative and BCA downgrade to baa3

Summary

Al Rayan Bank PLC (ARB's) A1/Prime-1 bank deposit ratings reflect (1) the bank's Baseline Credit Assessment (BCA) of baa3; (2) our assumption of a very high probability of support for ARB's senior creditors from the bank's parent bank, Masraf Al Rayan (Q.P.S.C.) (MAR, A1 negative, baa2)[1], which result in one notch of uplift and leads to an Adjusted BCA of baa2, one notch above the BCA; (3) the results of our Advanced Loss Given Failure (LGF) analysis, which results in no additional uplift of the bank deposit rating due to low level of bail-in able junior deposits due to ARB's reliance on primarily retail funding sources; and (4) our expectation of a very high probability of support from Government of Qatar (Aa3 stable), resulting in a four notches of uplift for deposit ratings, which is to the same support assumption incorporated in MAR's ratings. We assume a low probability of support from the Government of United Kingdom (Aa3 stable) because of ARB's very small role domestically. ARB's Counterparty Risk Rating (CRRs) is Aa3/Prime-1 and its Counterparty Risk (CR) Assessment is Aa3(cr)/Prime-1(cr).

ARB's BCA of baa3 reflects Moody`s revised view of the bank's funding profile, which hasn't materially changed in the last few years, and the rating agency's view that ARB's credit risk is low and supported by good capital and improving profitability. ARB's BCA also reflects the execution risk related to the bank's evolving business model, with a recent strategic shift towards providing banking services to high net worth clients with links to the Gulf Cooperation Council (GCC) as well as commercial property finance to a wider customer base, and away from serving customers' home finance needs in the UK.

Exhibit 1
Rating Scorecard - Key financial ratios



Note: When we state "Loans", "Interest" and "debt" in the exhibits, we are referring to "Financing assets", "Income from Islamic financing transactions" and "Funding".
Source: Moody's Investors Service

Credit strengths

» Low level of non-performing financing book

» Robust capitalisation, which supports solid loss absorption

» Adequate levels of high-quality liquidity resources

» Very high likelihood of support from Qatar

Credit challenges

» Limited operating history and evolving strategic shift away from retail banking business model

» Relatively high-cost deposit base

Outlook

The negative outlook on ARB`s deposit ratings reflects the negative outlook assigned to its parent bank, Masraf Al Rayan`s (Q.P.S.C.) (MAR, A1 negative, baa2), issuer and deposit ratings, which are the result of its weakening asset risk and profitability.

Factors that could lead to an upgrade

» An upgrade of ARB's long-term deposit ratings is unlikely given the negative outlook on ARB's and MAR's long-term ratings. However, Moody's could stabilise the rating outlook if asset quality and profitability pressures reverse at MAR without material impact on its capital.

Factors that could lead to a downgrade

» A downgrade of ARB's deposit ratings could be driven by a downgrade of MAR's BCA, or a lower probability of government support.

» A downgrade of ARB's BCA could also be driven by a material deterioration in its solvency and liquidity, but the very high likelihood of support from MAR and from the Government of Qatar could offset the impact of a lower BCA on the bank's Adjusted BCA and ratings.

Key indicators

Exhibit 2

Al Rayan Bank PLC (Consolidated Financials) [1]

	12-22[2]	12-21[2]	12-20[2]	12-19[2]	12-18[2]	CAGR/Avg.[3]
Total Assets (GBP Billion)	2.4	2.3	2.3	2.2	2.0	5.1[4]
Total Assets (USD Billion)	2.9	3.0	3.2	3.0	2.5	3.6[4]
Tangible Common Equity (GBP Billion)	0.2	0.2	0.1	0.1	0.1	5.9[4]
Tangible Common Equity (USD Billion)	0.2	0.2	0.2	0.2	0.2	4.4[4]
Problem Loans / Gross Loans (%)	1.0	0.4	0.3	0.2	0.1	0.4[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.1	16.0	13.9	14.4	14.4	15.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	11.4	5.1	3.2	2.7	1.7	4.8[5]
Net Interest Margin (%)	2.4	1.9	1.6	1.9	2.0	2.0[5]
PPI / Average RWA (%)	2.1	0.9	0.6	0.8	0.7	1.0[6]
Net Income / Tangible Assets (%)	0.7	0.4	0.2	0.3	0.3	0.4[5]
Cost / Income Ratio (%)	62.4	79.4	85.3	83.0	83.5	78.7[5]
Market Funds / Tangible Banking Assets (%)	6.1	4.4	7.9	9.8	12.4	8.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	19.3	16.5	23.9	25.3	16.0	20.2[5]
Gross Loans / Due to Customers (%)	92.6	95.2	89.3	89.8	105.6	94.5[5]

[-] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [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 because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

Al Rayan Bank PLC (ARB) is the first wholly Sharia-compliant retail bank based in the United Kingdom (Aa3 stable) serving more than 90,000 personal, business and premier customers. It is a majority-owned subsidiary of Masraf Al Rayan (Q.P.S.C) (MAR), the second-largest Islamic bank in Qatar (Aa3 stable) (fourth largest overall), with total assets of $46 billion as of the year-end 2022, which acquired the bank in 2014. Formerly called Islamic House of Britain PLC, it was established in 2002 and obtained a licence 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 MAR in December 2016. After 5% was sold back to MAR in 2021, QIA still owns 25% of the bank today. Qatar government via QIA and its other entities owns around 58% of ARB on a look-through basis. There is no letter of comfort in relation to the QIA investment.

Recent Developments

In April 2023, Moody's changed the outlook on the long-term issuer and backed senior unsecured ratings of ARB's parent MAR to negative from stable in order to capture the weakening trends in bank's asset quality and profitability.

Detailed credit considerations

Low level of NPLs but overall risk profile constrained by its evolving business model

Our assigned baa1 Asset Risk score reflects the low non-performing asset levels, but also takes into consideration the risks from its limited operating history and evolving business model. The bank also has exposure to Gulf Cooperation Council (GCC) countries (ca. 15% of the total financing book).

Under its previous high-growth strategy, loans grew at a compound annual growth rate of 46% between 2014 and 2017, which fell to 16% in 2018. However, growth since moderated and in 2021 and 2022, the financing book growth was more moderate at 1.5% following ARB's decision to reign in its growth and focus on investment and upgrades to its processes and controls to address the challenges it was facing.

ARB strategy has shifted and it will now focus on growing its commercial property business and providing banking services, predominantly deposits and mortgages, to high net worth clients from GCC. As of December 2022, ARB's total financing book was £1.9 billion, split 42% between retail financing, 42% in commercial property finance portfolio and 16% in Premier.

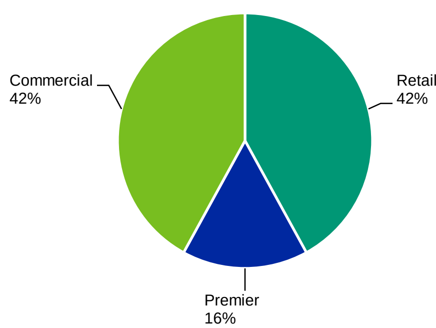
The retail business is mostly composed of Home Purchase Plans (HPPs) and Buy-to-Let Home Purchase Plan products (BTL-HPP), which adhere to Sharia principles. Unlike traditional mortgage lenders, ARB retains ownership of the property, with customers paying a rent, rather than the payment of interest by customers, which is forbidden under Sharia (Islamic law). We deem this feature as credit positive, given that customers cannot take a second-line mortgage on the property, as they themselves are not the legal owners. As of year-end 2022, ARB's total retail financing book was £794 million, equating to 42% of total financing assets.

The commercial property finance portfolio, which amounted to £792 million (42% of total financing assets as of year-end 2022), and covers large residential investment private rental sector schemes, mixed use retail park, student property, as well as prime offices. The client base is composed of both UK and GCC corporates and family offices.

The Premier segment offers private banking services to GCC customers, including real estate finance and day-to-day banking services. The portfolio reached £305 million as of year-end 2022 and will continue to be a key area of focus and growth for the bank.

The non-performing financings were low at 1.0% as of year-end 2022 and ARB continues to maintain a conservative approach to asset risk. Reflective of the customer base, ARB's financing is concentrated in the south east of England, particularly London. In addition, ARB has large average ticket size financings of £1 million to primarily new London-based GCC customers, exposing the bank to higher-than-average single-name concentration risk. The average finance-to-value ratio for BTL-HPP and HPP are comfortably below the limit of 75%.

Exhibit 3
ARB's financing assets' breakup
As of year-end 2022



Source: ARB's Annual report

Robust capitalisation supports solid loss absorption

We view ARB's capital levels as solid and assign an a3 Capital score. ARB's tangible common equity (TCE) capital is composed by £171 million common equity. ARB's TCE to risk-weighted assets was 16.1% in 2022 and TCE leverage[2] was 7.0% as of 31 December 2022. ARB uses the standardised approach to calculate risk weighted assets and has adequate capital to meet its growth plans, without the further need for a capital injection. However, if asset risk was 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 raised £3 million external Sharia-compliant high-trigger AT1 capital in July 2019, the first by a bank in the UK, that boosts its Tier 1 ratio by 30bps.

Improving profitability, high cost to income ratio and funding costs

We view ARB's profitability as improving and assign a ba3 Profitability score that reflects the bank's improving profitability, cost to income ratio and relatively higher funding costs.

The bank's profitability had been largely negative until 2014, historically driven by losses made from financing and the high cost base maintained by ARB. However, in line with the rising rate environment and a shift towards its CPF portfolio which is more floating rate, the bank has seen an increase in its net income in 2022, and reported a ratio of net income to tangible banking assets of 0.7%, up from 0.4% as of year-end 2021. The bank`s cost-to-income ratio was 62%, remaining above that of its peers. The underlying cost to income ratio has been historically high due to a mixture of the low interest rate environment in recent years and higher regulatory and compliance costs. ARB's profitability will likely improve and stay at levels commensurate with its ba3 score as rental rates increase while cost of funding is pressured by its more expensive retail deposits.

Deposit based funding profile at a relatively high-cost base

We assign a baa3 market funds score to reflect ARB's material reliance on internet sourced deposits which we view as likely to be less stable given its cost-sensitive nature and its evolving funding profile. As of year-end 2022, ARB's limited external market funding increased to 6.1% of tangible banking assets (TBA) from 4.4% as of year-end 2021.

To support its funding profile, ARB offers very competitive retail profit rates on the best buy tables, attracting mainly retail deposits. However, this increases the overall cost of funding, reduces margins and strains profitability, and exposes the bank to less-stable funding sources. In addition, the bank also carries a level of deposits above the £85,000 maximum under the UK`s deposit guarantee scheme.

As indicated in the bank's Liquidity Coverage Ratio (LCR) disclosure, ARB is predominantly funded via retail and SME deposits. Nevertheless, ARB has a higher proportion (broadly unchanged in recent years) of retail and SME deposits classified as less stable, and non-operational deposits, both of which are less sticky in nature, compared with the average traditional UK retail commercial banks.

In December 2020, the BoE announced that in 2021, it will establish a Sharia compliant non-interest-based deposit facility for UK-based Islamic banks and will improve their liquidity management capabilities. In December 2021 the Bank participated in the Bank of England Alternative Liquidity Facility (ALF) which has been set up to facilitate access for Sharia compliant banks in the UK to High Quality Liquid Assets (HQLA) denominated in GBP.

Adequate levels of high-quality liquidity resources

Our assigned Liquid Resources score of baa3 Our overall assessment of ARB's liquidity profile reflects the adequate level of liquidity held by ARB to meet its short-term requirements. The bank's liquidity is largely made up of HQLA [3] from the Bank of England ALF and cash on demand and short-term commodity Murabaha and Wakala[4] transactions equating to 19.3% of Tangible Banking Assets as of year-end 2022 (16.5% in 2021). ARB maintains surplus liquidity well in excess of regulatory requirements, as evidenced by its LCR of 458% as at 31 December 2022.

ARB's BCA is supported by the UK's Strong+ Macro Profile

ARB's operating environment is influenced largely by the UK; the bank's Macro Profile is thus in line with the UK's Macro Profile of Strong+.

Qualitative adjustments

ARB's Financial Profile score of baa2 is subject to a negative one-notch downward qualitative adjustment for Corporate Behaviour, given the bank's relatively limited operating history, and its evolving business model.

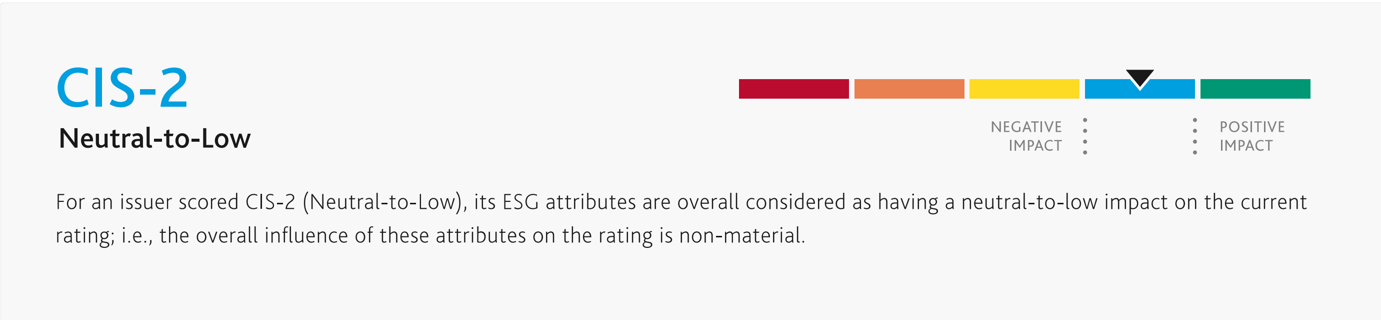
The rating is capped by close links between ARB and MAR

When a bank is owned by another entity, the probability of default of the bank is unlikely to be significantly lower than that of its parent, and the BCA of a bank is, therefore, typically constrained by the rating of its owner. This is because credit issues at one part of a group can be transmitted to another. We believe that ARB's credit profile could be weakened by a deterioration in its parent's creditworthiness. The shared branding and overlapping customer base between the two entities expose the bank to reputational risk, potentially leading to adverse credit events, such as deposit outflow at the bank, in the event of severe credit problems at MAR. ARB's BCA is currently positioned one notch below the baa2 BCA of MAR. if ARB`s financial profile were to improve MAR's BCA would be a constraint on ARB's BCA, due to the above mentioned interlinkages.

ESG considerations

Al Rayan Bank PLC's ESG Credit Impact Score is Neutral-to-Low CIS-2

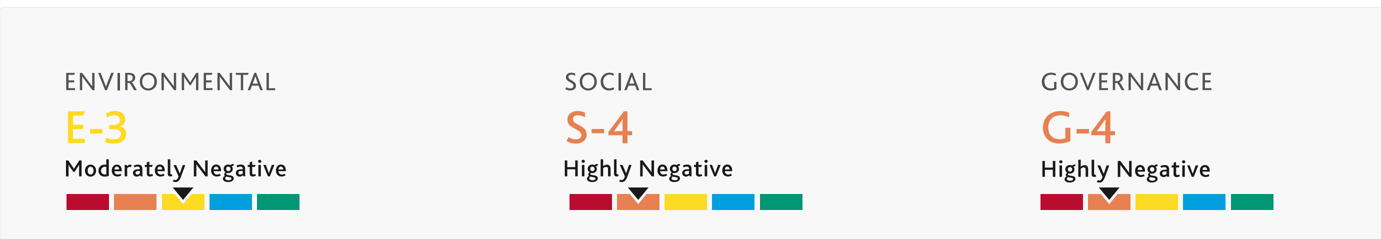
Exhibit 4
ESG Credit Impact Score



Source: Moody's Investors Service

Al Rayan Bank (ARB)'s ESG Credit Impact Score is neutral-to-low (**CIS-2**) The score reflects the fact that ARB's rating is constrained by its parent's rating, which neutralises the impact of ESG risk exposures. ARB's high governance risks stem from the bank's evolving business model and recent track record. Environmental and social factors have a limited credit impact on the rating to date.

Exhibit 5
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

ARB faces moderate environmental risks primarily because of its portfolio exposure to commercial property financing. In line with peers, commercial property financing elevates the bank's exposure to carbon transition risk, as compared to the majority of the bank's loan book which is geared towards residential property financing, which Moody's regards as having limited exposure to carbon transition risks.

Social

ARB faces high industrywide social risks related to customer relations and associated regulatory risk, litigation exposure and high compliance standards, as well as data security and customer privacy. These risks are mitigated by the bank's developed policies and procedures and its sound IT framework.

Governance

ARB faces high governance risks reflecting the bank's evolving business model and recent track record. Following the regulatory investigation of ARB by the FCA in 2019 , risk management policies and procedures have improved to be more in line with industry best practices and the bank is also shifting its focus to private banking services to clients from GCC countries. ARB is a subsidiary of Qatar's Masraf Al Rayan and the Qatari government owns directly and indirectly, around 58% of ARB on a look-through basis. Because the bank is effectively controlled by Masraf Al Rayan through its 75% shareholding, we have aligned the subsidiary's board structure, policies and procedures score with that of its parent, given the bank's strategic importance and public affiliation with the group, the parent's oversight of its subsidiary board and the regulated nature of both entities.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Affiliate support

Given the strategic importance of ARB to its parent MAR, which allows GCC customers to have access to private banking services in the UK, we expect the probability of support from MAR 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 BCA of baa2 as the basis for deriving support to ARB. We give one notch of uplift to ARB's assigned BCA of baa3 which results in an Adjusted BCA of baa2.

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. 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 10% of the bank's total deposit book, instead of the standard 26% assumption, 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.

We use the 10% junior wholesale deposits assumption to reflect the more retail and small-middle enterprise deposit funding. Under these assumptions, ARB's deposits are likely to face a moderate loss given failure because of the loss absorption provided by the volume of deposits themselves. This results in a Preliminary Rating Assessment (PRA) for ARB's deposits of baa2, in line with the Adjusted BCA.

Government support

Our assumption of very high government support reflects (1) MAR's evolving role as a flagship Islamic bank in Qatar with ARB as its largest overseas subsidiary; (2) ARB's direct and indirect ownership by the Qatari government and related institutions; and (3) the strong track record of the Qatari government preemptively supporting its banks in the past. This results in a four notches of uplift to the deposit ratings, in line with the support assumption incorporated in MAR's, a two notch uplift to the Counterparty Risk (CR) Assessment and a three notch uplift to the Counterparty Risk Ratings (CRRs).

We have a low expectation of support from the Government of the United Kingdom because of ARB's very small role domestically.

Counterparty Risk (CR) Assessment and Counterparty Risk Ratings (CRRs)

ARB's CR Assessment is Aa3(cr)/Prime-1(cr)

The CR Assessment of ARB, per our Advanced LGF approach, is three notches above the Adjusted BCA of baa2, based on the buffer against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments, such as bail-in-able funding and deposits. The CR Assessment benefits from two additional notches of uplift because of government support, in line with our assumptions of a very high probability of support from the Qatar government in the event of failure.

ARB's CRRs are Aa3/Prime-1

Our Advanced LGF approach provides two notches of uplift to the CRRs above the Adjusted BCA which takes into account the level of subordination to CRR liabilities in the bank's balance sheet, and assume a nominal volume of such liabilities. The CRRs benefit from three additional notches of uplift because of government support, in line with our assumptions of a very high probability of support from the Qatar government in the event of failure.

About Moody's Bank Scorecard

Our Bank Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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 6

Al Rayan Bank PLC

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

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.0%	aa3	↔	baa1	Loan growth	Single name concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16.1%	aa2	↔	a3	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	0.4%	ba1	↔	ba3	Earnings quality	Expected trend
Combined Solvency Score		a1		baa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	6.1%	aa3	↔	baa3	Deposit quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	19.3%	baa2	↔	baa3	Expected trend	Access to committed facilities
Combined Liquidity Score		a2		baa3		
Financial Profile				baa2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				-		
BCA Scorecard-indicated Outcome - Range				baa2 - ba1		
Assigned BCA				baa3		
Affiliate Support notching				1		
Adjusted BCA				baa2		

Balance Sheet	in-scope (GBP Million)	% in-scope	at-failure (GBP Million)	% at-failure
Other liabilities	253	10.6%	396	16.5%
Deposits	2,044	85.3%	1,901	79.3%
Preferred deposits	1,840	76.7%	1,748	72.9%
Junior deposits	204	8.5%	153	6.4%
Dated subordinated bank debt	25	1.0%	25	1.0%
Preference shares (bank)	3	0.1%	3	0.1%
Equity	72	3.0%	72	3.0%
Total Tangible Banking Assets	2,397	100.0%	2,397	100.0%

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	10.6%	10.6%	10.6%	10.6%	2	2	2	2	0	a3
Counterparty Risk Assessment	10.6%	10.6%	10.6%	10.6%	3	3	3	3	0	a2 (cr)
Deposits	10.6%	4.2%	10.6%	4.2%	1	1	1	0	0	baa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	2	0	a3	3	Aa3	Aa3
Counterparty Risk Assessment	3	0	a2 (cr)	2	Aa3(cr)	
Deposits	0	0	baa2	4	A1	A1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
AL RAYAN BANK PLC	
Outlook	Negative
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
PARENT: MASRAF AL RAYAN (Q.P.S.C.)	
Outlook	Negative
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 BCA.

2 defined as 'Tangible Common Equity / (Total Assets - Derivatives)'

3 High Quality Liquid Assets

4 Commodity Murabaha is a contract for purchase and resale 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.

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