MOODY'S RATINGS

CREDIT OPINION

19 June 2024

Update

Send Your Feedback

Al Rayan Bank PLC

Update following downgrade of deposit ratings, outlook stable

RATINGS

Al Rayan Bank PLC

Domicile	United Kingdom
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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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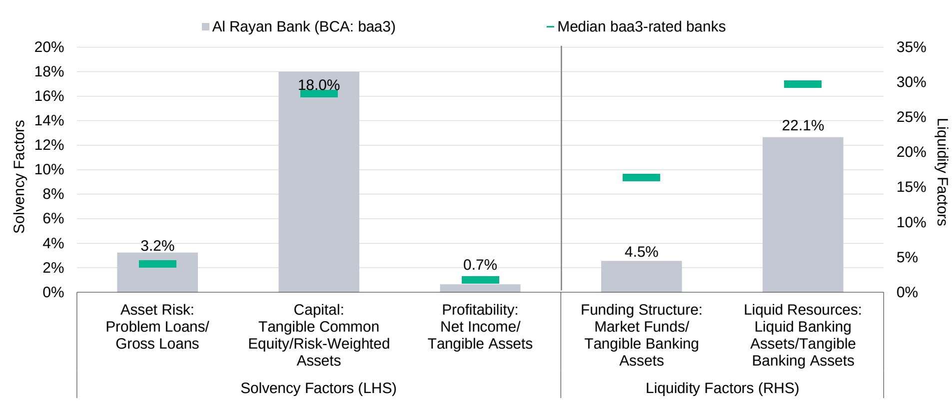
Summary

Al Rayan Bank PLC (ARB's) A2/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, A2 stable, baa3)[1], which result in no notches of uplift and leads to an Adjusted BCA of baa3, in line with the BCA; (3) the results of our Advanced Loss Given Failure (LGF) analysis, which results in one notch of uplift of the bank deposit rating; and (4) our expectation of a very high probability of support from Government of Qatar (Aa2 stable), resulting in a three notches of uplift for deposit ratings, which is to the same support assumption incorporated in MAR's ratings. ARB's Counterparty Risk Rating (CRRs) is A1/Prime-1 and its Counterparty Risk (CR) Assessment is Aa3(cr)/Prime-1(cr).

ARB's BCA of baa3 reflects the bank's strong capital, deposit based funding profile and improving profitability. These act as offsets to the bank's rising asset risk as reflected by a near tripling of its problem loan ratio in 2023, albeit to a still moderate 3.2% of gross loans, driven by its predominantly buy to let lending book in the context of a higher interest rate environment. The BCA also reflects the cost-sensitive nature and internet sourcing of the bank's deposit base, and the continuation of the strategic shift towards providing banking services to high net worth clients with links to the Gulf Cooperation Council (GCC) and property finance to a wider customer base, which started three years ago.

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 Ratings

Credit strengths

» Robust capitalisation, which supports solid loss absorption

» Adequate levels of high-quality liquidity resources

» Very high likelihood of support from Qatar

Credit challenges

» Managing a jump in non performing loans given higher concentration in Commercial Property Finance (CPF)

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

» Relatively high-cost deposit base

Outlook

The stable outlook on ARB's long-term deposit rating reflects the stable outlook on the issuer ratings of ARB's parent, MAR, and the stable outlook on Qatar's sovereign debt rating.

Factors that could lead to an upgrade

» An upgrade of ARB's long-term deposit ratings is unlikely given the downgrade. However, an upgrade of MAR's BCA or an upgrade of Qatar's rating could lead to upward pressure on ARB's long-term deposit ratings.

Factors that could lead to a downgrade

» ARB's BCA could be downgraded following a continued deterioration in the bank's asset risk, for example due to a continuation challenging macroeconomic environment, greater than expected loan growth in its new business segments leading to increased concentration and a decline in its liquidity. However, the very high likelihood of support from MAR and from the Government of Qatar could offset the impact of a lower BCA for ARB with additional notching on the bank's Adjusted BCA and long-term deposit ratings.

» A downgrade of MAR's BCA could also result in a downgrade of ARB's long-term deposit ratings.

Key indicators

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

	12-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (GBP Billion)	2.5	2.4	2.3	2.3	2.2	2.6[4]
Total Assets (USD Billion)	3.2	2.9	3.0	3.2	3.0	1.6[4]
Tangible Common Equity (GBP Billion)	0.2	0.2	0.2	0.1	0.1	7.7[4]
Tangible Common Equity (USD Billion)	0.2	0.2	0.2	0.2	0.2	6.7[4]
Problem Loans / Gross Loans (%)	3.2	1.0	0.4	0.3	0.2	1.0[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.0	16.4	16.0	13.9	14.4	15.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	31.4	11.4	5.1	3.2	2.7	10.8[5]
Net Interest Margin (%)	3.0	2.4	1.9	1.6	1.9	2.2[5]
PPI / Average RWA (%)	3.1	2.1	0.9	0.6	0.8	1.5[6]
Net Income / Tangible Assets (%)	0.9	0.7	0.4	0.2	0.3	0.5[5]
Cost / Income Ratio (%)	53.4	62.4	79.4	85.3	83.0	72.7[5]
Market Funds / Tangible Banking Assets (%)	4.5	6.1	4.4	7.9	9.8	6.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	22.1	19.3	16.5	23.9	25.3	21.4[5]
Gross Loans / Due to Customers (%)	88.3	92.6	95.2	89.3	89.8	91.0[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 Ratings 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 (Aa2 stable) (fourth largest overall), with total assets of $44 billion as of 31 March 2024, 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% (2023: 25%) stake in the bank from MAR in December 2016. QIA owns around 25% of ARB on a look-through basis. There is no letter of comfort in relation to the QIA investment.

Detailed credit considerations

Jump in NPLs and increasing concentration to commercial property and buy to let underpin rise in asset risk

Our assigned baa3 Asset Risk score reflects the moderate non-performing asset levels, but also takes into consideration the risks from its limited operating history and evolving business model.

ARB strategy has shifted and it will now focus on growing its commercial property business and providing banking services, predominantly deposits and Home Purchase Plan Premier (HPPP), to high net worth clients from GCC, while its retail home financing (HPP = home purchase plan) is currently in run-off. As of December 2023, ARB's total financing book was £1.9 billion, split 37% between retail financing, 47% in commercial property finance portfolio and 16% in Premier.The bank also has exposure to Gulf Cooperation Council (GCC) countries (ca. 13% of the total financing book).

The commercial property finance portfolio, which amounted to £903 million (47% of total financing assets as of year-end 2023), an increase from £789 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 £300 million as of year-end 2023 and will continue to be a key area of focus and growth for the bank.

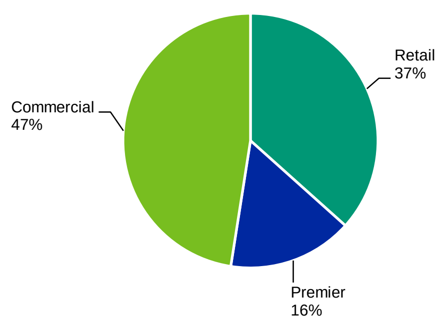
In terms of asset risk, non-performing financings jumped to 3.2% as of year-end 2023, three times higher than the 1.03% as of year-end 2022. This increase results mainly from an increase in commercial property finance, which problem loans almost quadrupled from

£ 8.6 million at year-end 2022 to £42.4 million at year-end 2023, but also from an increase in HPP stage 3 loans, increased by 75% YoY on the back of a decreasing loan book. CPF and HPP are primary residential with greater loan book concentration in buy-to-let (BTL) increasing base rates and inflationary pressures have put pressure on customers' and tenants' ability to repay.

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 80%.

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 positive for ARB, given that customers cannot take a second-line mortgage on the property, as they themselves are not the legal owners. As of year-end 2023, ARB's total retail financing book was £698 million, equating to 37% of total financing assets, a reduction from 42% as of year-end 2023 (£794 million). However, this will decrease in line with the run off plans.

Exhibit 3
ARB's financing assets' breakdown
As of year-end 2023



Source: ARB's Annual report

Capitalisation is higher as balance sheet shrinks and provides 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 £194 million common equity. ARB's TCE to risk-weighted assets was 17.99% in 2023 and TCE leverage [2] was 7.64% as of 31 December 2023. 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 2023, and reported a ratio of net income to tangible banking assets of 0.9%, up from 0.6% as of year-end 2022. ARB's net interest margin (NIM) surged from 2.4% at year-end 2022 to 3.0% at year-end 2023.

The bank's cost-to-income ratio was 53%, an improvement from 62% at year-end 2022, but 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. We expect ARB's profitability to stay at levels commensurate with its ba3 score as base rates are expected to gradually decline in H2 2024, while cost of funding is pressured by its persistently 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 2023, ARB's limited external market funding decreased to 4.5% of tangible banking assets (TBA) from 6.1% as of year-end 2022, which mainly consist of deposits from banks and financial institutions.

To support its funding profile, ARB offers very competitive retail profit rates on the best buy tables, attracting mainly retail deposits. Deposits from customers increased by 5% YoY to £2.15 billion at year-end 2023(year-end 2022: £2.05 billion). However, this increases the overall cost of funding, reduces margins and strains profitability, and exposes the bank to less-stable funding sources.

ARB is predominantly funded via retail and SME deposits. In 2023, By making its savings products accessible via aggregators in 2023, ARB experienced a significant transition in customer preference from instant access accounts to term deposits. Now, over two-thirds of its total deposits constitute secure longer-term funding. (2022: 57% of deposits were term deposits).

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, ARB 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 is 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 22.1% of Tangible Banking Assets as of year-end 2023 (19.3% in 2022). ARB maintains surplus liquidity well in excess of regulatory requirements, as evidenced by its LCR of 786% as at 31 December 2023.

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, its evolving business model and transition risk as its changes its strategic direction.

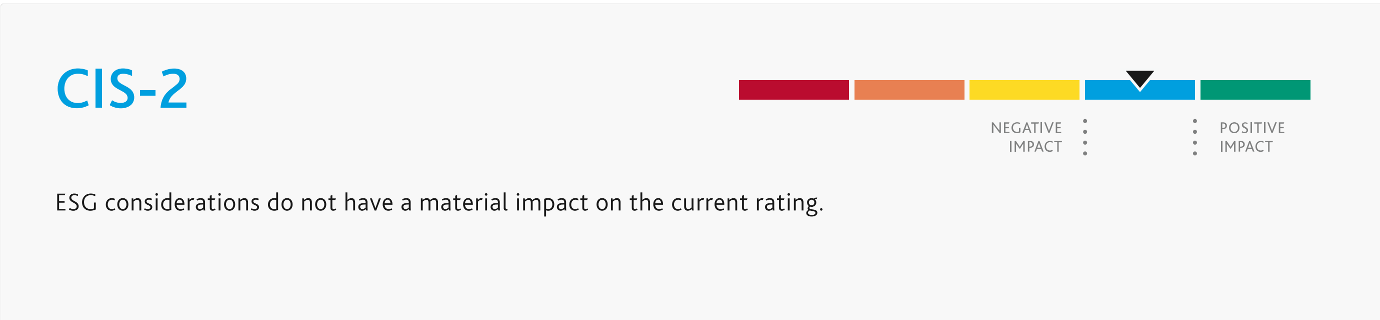
The rating is capped by close links between ARB and MAR

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 at the same level as the baa3 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 CIS-2

Exhibit 4
ESG credit impact score



Source: Moody's Ratings

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 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 Ratings

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 and its closure in 2022, risk management policies and procedures have improved to be more in line with industry best practices. The bank is also shifting its focus to private banking services to clients from GCC countries, running off its retail lending operations and focussing on commercial property finance. ARB is a subsidiary of Qatar's Masraf Al Rayan and the QIA owns around 25% 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 position ARB's Adjusted BCA at the parent's BCA of baa3, which results in no uplift to ARB's assigned BCA.

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, one notch above the Adjusted BCA of baa3.

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 three notches of uplift to the deposit ratings, in line with the support assumption incorporated in MAR's, a three 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.

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	3.2%	a3	↔	baa3	Loan growth	Single name concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	18.0%	aa2	↔	a3	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	0.7%	baa2	↔	ba3	Earnings quality	Expected trend
Combined Solvency Score		a2		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	4.5%	aa2	↔	baa3	Deposit quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	22.1%	baa1	↔	baa3	Expected trend	Access to committed facilities
Combined Liquidity Score		a1		baa3		
Financial Profile				baa3		
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				baa3 - ba2		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

Balance Sheet	in-scope (GBP Million)	% in-scope	at-failure (GBP Million)	% at-failure
Other liabilities	238	9.6%	389	15.6%
Deposits	2,149	86.3%	1,999	80.3%
Preferred deposits	1,934	77.7%	1,838	73.8%
Junior deposits	215	8.6%	161	6.5%
Dated subordinated bank debt	25	1.0%	25	1.0%
Preference shares (bank)	3	0.1%	3	0.1%
Equity	75	3.0%	75	3.0%
Total Tangible Banking Assets	2,490	100.0%	2,490	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	baa1
Counterparty Risk Assessment	10.6%	10.6%	10.6%	10.6%	3	3	3	3	0	a3 (cr)
Deposits	10.6%	4.1%	10.6%	4.1%	1	1	1	1	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	baa1	3	A1	A1
Counterparty Risk Assessment	3	0	a3 (cr)	3	Aa3(cr)	
Deposits	1	0	baa2	3	A2	A2

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

Ratings

Exhibit 7

Category	Moody's Rating
AL RAYAN BANK PLC	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
PARENT: MASRAF AL RAYAN (Q.P.S.C.)	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2
ST Issuer Rating	P-1

Source: Moody's Ratings

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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