Rating Action: Moody's concludes review on 14 UK banks' ratings; assigns CR Assessments to 17 UK banks

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Actions conclude methodology-related reviews and revision of government support considerations

London, 05 June 2015 -- Moody's Investors Service has today concluded its rating reviews on 14 banks in the UK (Aa1 stable). These reviews were initiated on 17 March 2015 following the publication of Moody's revised bank methodology (see "Rating Methodology: Banks," 16 March 2015, available at moodys.com) and reflect revisions in the rating agency's government support assumptions for these banks.

Moody's rating actions on UK banks reflect the following considerations: (1) the "Very Strong -" Macro Profile of the UK; (2) differences across UK banks' core financial ratios; (3) the protection offered to senior creditors by substantial volumes and subordination of bail-in-able securities, as captured by Moody's Advanced Loss Given Failure (LGF) liability analysis; and (4) the reduced likelihood of government support for some of these institutions.

The 14 banks included in this rating action are:

--- Bank of Ireland UK, Clydesdale, Coventry Building Society, ICICI Bank UK
--- Investec Bank plc, Leeds Building Society, Lloyds Banking Group
--- Nationwide Building Society, Nottingham Building Society, Principality Building Society
--- Santander UK, Skipton Building Society, West Bromwich Building Society
--- Yorkshire Building Society

In earlier rating actions, Moody's concluded its reviews of the three UK global investment banks, Barclays plc, HSBC Holdings plc and Royal Bank of Scotland Group plc, and, separately, its review of Close Brothers Limited and Ulster Bank Limited.

The rating actions on the UK banks and rated affiliates that Moody's has taken today are:

- 10 baseline credit assessments (BCAs) affirmed, three upgraded, and two placed on review for upgrade
- 11 adjusted BCAs affirmed, two upgraded, one placed on review for upgrade and one downgraded
- Seven long-term bank deposit ratings upgraded, three upgraded and left on review for upgrade, three upgraded with positive outlook, three have positive outlooks and one confirmed.
- Six short-term bank deposit ratings affirmed, five upgraded and three unchanged
- Five bank issuer/senior unsecured debt ratings upgraded, a further three upgraded with positive outlook, three unchanged with positive outlook, and one on review for upgrade.

Further, of the three banking groups with rated holding company senior unsecured debt, one rating was upgraded, one rating was downgraded and one rating remains on review for upgrade.

Moody's has also assigned Counterparty Risk (CR) Assessments to the banks themselves or to the bank subsidiaries of these 14 UK banks, in line with its revised bank methodology.

Moody's has assigned stable outlooks to the long-term deposit ratings of eight of the affected banks, and positive outlooks to six, with one outlook remaining on review for upgrade. Moody's has assigned stable outlooks to the bank issuer/senior unsecured debt ratings of two of the affected banks, and positive outlooks to five, with one outlook remaining on review for upgrade.

Moody's has withdrawn the outlooks on all junior instrument ratings for its own business reasons. Please refer to
Moody’s Investors Service’s Policy for Withdrawal of Credit Ratings, available on its website, www.moodys.com. Outlooks, which provide an opinion on the likely rating direction over the medium term, are now assigned only to long-term deposit and senior unsecured debt ratings.

Please click on the following link to access a full list of affected credit ratings. This list is an integral part of this press release and identifies each affected issuer


RATING RATIONALE

The revised methodology includes a number of elements that Moody’s has developed to help more accurately predict bank failures and determine how each creditor class is likely to be treated when a bank fails and enters resolution. These new elements capture insights gained from the crisis and the fundamental shift in the banking industry and its regulation.

In light of the new banking methodology, Moody’s rating actions generally reflect the following considerations:

(1) THE "VERY STRONG -" MACRO PROFILE OF THE UK

The UK banks 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 stem from the high level of UK household indebtedness, making borrowers sensitive to changes in interest rates. UK banks are largely funded by deposits and banks' funding structures have remained relatively stable in the past few years, with slight increases in capital and internal funds as well as declines in short-term funding. The UK banking sector is relatively concentrated, but competition from the shadow banking market somewhat challenges the price-setting dominance of large banks.

(2) DIFFERENCES ACROSS UK BANKS’ CORE FINANCIAL RATIOS

The banks’ BCAs, which range from a3 to b2, reflect differences across the UK banking system's core financial ratios, including aggregate problem loan ratios, capital buffers, profitability metrics and liquidity metrics. The BCAs also reflect differences in product mix and sector and single-name concentrations (see below for the analytical considerations for individual banks covered in this press release.)

(3) PROTECTION OFFERED TO DEPOSITORS COMPARED TO SENIOR AND OTHER CREDITORS, AS CAPTURED BY MOODY’S ADVANCED LGF LIABILITY ANALYSIS

Because of the UK’s operational resolution regime, Moody’s applies its Advanced LGF analysis to UK banks’ liability structures under its revised methodology. This analysis results in a loss-given-failure ranging from "moderate" to “extremely low” for these UK banks’ long-term deposits, in light of depositor preference and a range of levels of deposit funding, as well as the protection offered by the amount of debt subordinated to deposits within these banking groups. This has led to deposit rating upgrades for some but not all of the UK banks covered in this press release.

UK banks’ senior debt ratings, where applicable, were also largely upgraded because of their respective volumes and amounts of subordinated securities, reflecting a “low” to “very low” expected loss given failure in the event of resolution.

UK entities’ subordinated debt ratings were largely unchanged for operating entities, reflecting a high expected loss given failure in the event of resolution. The subordinated debt ratings of some bank holding companies were upgraded by one notch as expected loss is now captured by the LGF analysis and does not require a notch for structural subordination.

For more information on Moody’s LGF analysis, please see Moody’s "Banking -- Global How Resolution Frameworks Drive Our Creditor Hierarchies" at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1003760 (in addition to the methodology itself).

(4) DECLINE IN THE LIKELIHOOD OF GOVERNMENT SUPPORT

Moody’s has also lowered its expectations about the degree of support that a government might provide to a bank in Europe. The main trigger for this reassessment is the introduction of the Bank Recovery and Resolution Directive (BRRD) in the European Union (in January 2015), which is currently being transposed in each European
jurisdiction. This has resulted in a reduction in government support uplift included in long-term debt and deposit ratings for UK bank operating companies, to one notch for those UK banks considered systemically important banks. For UK bank holding companies, our reduced support assumptions result in a low level of support. The impact of this is, wholly, or in some cases more than, offset by the recognition of loss-given-failure as described above.

ASSIGNMENT OF COUNTERPARTY RISK ASSESSMENTS

As part of today’s action, Moody’s has assigned CR Assessments to 17 UK banks and their branches. 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 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 (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Moody’s CR Assessments for banks subject to a going-concern operational resolution regime, which includes all UK banks, start with the banks’ adjusted BCA and uses an advanced LGF approach that takes into account the level of subordination to counterparty obligations in the bank’s liability structure as well as an assumption of government support.

As a result, of the 17 CR Assessments assigned to the banking groups and their subsidiaries, the CR Assessment for 12 entities is three notches higher than the respective adjusted BCA with five entities four notches higher, reflecting Moody’s view that authorities are likely to structure a resolution in order to honour the operating obligations the CR Assessment refers to in order to preserve a bank’s critical functions and reduce potential for contagion, which thereby benefit from the loss absorbency offered by bail-in-able debt and deposits.

SPECIFIC ANALYTICAL FACTORS FOR THE 14 BANKS

- Bank of Ireland (UK) Plc

Moody’s affirmed Bank of Ireland UK’s BCA at ba2, incorporating (1) its strong funding position supported by a broad deposit base sourced largely through its relationship with the Post Office; (2) its high level of integration into its parent, Bank of Ireland (BOI, Baa2/Baa2 stable; ba2); (3) improving profitability levels, which will provide shock absorbers against downside risks; (4) the downside risk linked to the relatively high average loan-to-value (LTV) ratios compared to other UK banks; and (5) the poor asset quality of the bank’s declining legacy commercial loans book.

The long-term deposit rating was confirmed at Ba2 and the short-term deposit rating was affirmed at Not Prime. This results from (1) Bank of Ireland UK’s adjusted BCA of ba2; (2) the application of Moody’s Advanced LGF analysis; and (3) low probability of government support for Bank of Ireland UK, resulting in no uplift from the adjusted BCA. The outlook on the long-term ratings is stable.

The BCA could move up if the bank establishes a longer track record of independence from its parent with a stable asset and capital structure, along with sustainable profitability metrics and continuing improvements in asset quality.

The BCA could be lowered if BOI UK’s capitalisation was to materially decline - either through higher than expected losses or through dividend payments to its parent. A material increase in the bank’s risk profile could also lead to negative rating pressure. Given the level of integration with BOI, a downgrade of the parent could also have negative rating implications.

A positive change in the bank’s BCA would likely lead to an upgrade of the long-term deposit rating. A downward movement in Bank of Ireland UK’s BCA would likely result in downgrades to its deposit rating.

Moody’s assigned a Baa2(cr)/Prime-2(cr) CR Assessment to Bank of Ireland (UK) Plc, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- Clydesdale Bank plc

The review for upgrade of Clydesdale Bank’s (Clydesdale) standalone BCA of ba1 reflects Moody’s view that Clydesdale and its debt-holders will benefit from National Australia Bank’s (NAB, Aa2/Aa2 stable; a1) proposed GBP1.7 billion conduct charge indemnity in favour of Clydesdale, to be initiated alongside the proposed
demerger/IPO of the National Australia Group Europe (NAGE; unrated). NAGE is Clydesdale's holding company and the conduct contingent liability is required by the UK Prudential Regulation Authority (PRA) as a condition for regulatory approval of the de-merger/IPO. The de-merger/IPO will allow a greater focus on NAB's core, strategic markets in Australia (Aaa stable) and New Zealand (Aaa stable). Moody's also downgraded Clydesdale's adjusted BCA by one notch to baa3, to reflect the rating agency's view that NAB's announcement of the de-merger/IPO of NAGE implies a lower likelihood of affiliate support.

Moody's upgrade of Clydesdale deposit rating to Baa1 from Baa2 and the downgrade of its subordinated debt to Ba1 from Baa3 reflects the bank's adjusted BCA of baa3 and the application of the Advanced LGF analysis, which, given the bank's significant volumes of junior deposits, results in a two-notch uplift from the adjusted BCA for the deposit ratings.

Moody's assigned a A3(cr)/Prime-2(cr) CR Assessment to Clydesdale, three notches above the adjusted BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

Clydesdale's standalone BCA reflects Moody's view that the bank faces longer-term structural challenges from its weakened franchise and past risk-management/control weaknesses. The BCA captures the bank's efforts to strengthen its risk-management and control framework and implement a cost-reduction program. However, Moody's says that these measures will take some time to be effective. Until they are implemented, Clydesdale faces short-term pressure due to (1) a business loan portfolio whose asset quality is subject to deterioration; and (2) low profitability, which reduces the bank's financial flexibility.

If the disposal and provision of the conduct cost-contingent indemnity by NAB are successful, Clydesdale's BCA might be upgraded. However, challenges to this remain due to (1) the diminished franchise strength; (2) execution risks associated with the present strategy and restructuring related to the demerger/IPO; and (3) asset-quality pressures within the business loan portfolio.

A positive change in the bank's BCA would unlikely affect the long-term ratings because of the potential netting effect of receding affiliate support. Further, negative pressure on Clydesdale's BCA is unlikely, but could stem from a significant decline in capital ratios or a deterioration in asset quality. A downward movement in Clydesdale's BCA would likely result in downgrades to all its ratings.

- Coventry Building Society (Coventry)

Moody's affirmation of Coventry's a3 BCA reflects the Society's good multi-regional franchise, solid profitability and cost efficiency, and strong asset quality. Furthermore, the standalone BCA also reflects the Society's relatively lower level of net interest margin, its conservative risk profile and focus on low loan-to-value prime residential mortgage lending.

The Society's long-term debt and deposit ratings were upgraded to A2 from A3 and its short-term rating was upgraded to Prime-1 from Prime-2. This results from (1) Coventry's adjusted BCA of a3; (2) the application of Moody's Advanced LGF analysis, leading to a one-notch uplift from the adjusted BCA, due to the moderate loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves; and (3) no government support. The outlook on the long-term ratings is positive, incorporating the society's improving credit fundamentals and conservative risk profile, supported by its track record of consistently solid asset-quality metrics.

The Society's BCA could be upgraded if its credit fundamentals continue to improve while its asset risk profile is maintained. A positive change in the building society's BCA would likely affect all ratings. Coventry's deposit and senior debt ratings could also be upgraded if the building society were to issue significant amounts of long-term debt and more subordinated debt.

Coventry's BCA could come under downward pressure in the event of a notable economic slowdown in the UK, resulting in deterioration in asset quality and significant decline in profitability or through a shift away from its historically conservative underwriting standards. A downward movement in Coventry's BCA would likely result in downgrades to all ratings.

Moody's assigned a Aa3(cr)/Prime-1(cr) CR Assessment to Coventry, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- ICICI Bank UK plc (ICICI UK)

The affirmation of ICICI UK's ba2 BCA and baa3 adjusted BCA reflects the bank's niche strategic position as
provider of financial services in Europe to the corporate clients of the parent (ICICI Bank Ltd, Baa3/Baa3 Positive, baa3). The BCA is, however, constrained by volatility in earnings and concentration risks in the bank’s corporate lending portfolio. The adjusted BCA reflects the agency’s view of a very high probability of support from its parent company.

The bank’s long-term debt and deposit ratings were upgraded to A3 from Baa3 and its short-term rating was upgraded to Prime-2 from Prime-3. This results from (1) the bank’s adjusted BCA of baa3; (2) the application of Moody’s Advanced LGF analysis, leading to a three-notch uplift from the adjusted BCA, due to the large loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves; and (3) no government support. The outlook on the long-term ratings is positive, in line with the outlook on the parent’s ratings.

Further sustained improvements in the bank’s UK corporate and retail franchise, including more meaningful diversification, could lead to upward pressure on the BCA. An established track-record of maintaining a core retail deposit base and minimization of the impact of one-off events on its profitability would also contribute to this trend. A positive change in ICICI UK’s adjusted BCA would likely affect all ratings. ICICI UK’s deposit and senior debt ratings could also be upgraded if the bank were to issue significant amounts of senior and/or subordinated long-term debt.

Negative pressure on the BCA would likely be driven by (1) pressure on the liquidity position or high volatility in the deposit base given its price-sensitivity; and (2) deterioration in asset quality in the corporate loan book, given that the largest exposures can significantly erode its profitability and capital. A reduction in Moody’s assessment of potential parental support and/or a downgrade of the parent’s BCA would also negatively affect the supported ratings of ICICI UK. A negative change in ICICI UK’s adjusted BCA would likely affect all ratings.

Moody’s assigned a A3(cr)/Prime-2(cr) CR Assessment to ICICI UK, three notches above the adjusted BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- Investec Bank plc and its rated affiliates

Moody’s affirmed Investec Bank plc’s (IBP) BCA at baa3, which reflects the bank’s present transition and de-risking strategy of containing legacy risks on the balance sheet (primarily stemming from non-performing commercial real-estate (CRE) exposures). The BCA also reflects Moody’s expectation for a relatively limited risk appetite in its new lending and a shift in the bank’s sources of income towards lower risk and more stable revenue streams, primarily in the wealth-management segment. Additionally, IBP’s ratings incorporate (1) the bank’s sound capitalisation and low nominal leverage compared with those of its peers; (2) strong liquidity buffers; and (3) the overall positive evolution of its funding profile away from past reliance on wholesale funding.

IBP’s long-term deposit ratings were upgraded to A3 from Baa3 and its short-term rating was upgraded to Prime-2 from Prime-3. This results from (1) IBP’s adjusted BCA of baa3; (2) the application of Moody’s advanced LGF analysis; and (3) no government support, resulting in a three-notch uplift from the baa3 adjusted BCA. The outlook on the long-term ratings is stable.

Positive pressure on the BCA is unlikely to materialise in the near term given the relatively recent stabilisation of the outlook in April 2014. Pressure towards a positive outlook could arise from a combination of the following factors: a sustained increase in the proportion of stable earnings sources which diversify the bank’s exposure to the UK property market; significant and sustained improvement in IBP’s profitability and efficiency ratios; material shift in its lending profile towards more diverse and lower risk credits; as well as an increase in the proportion of stickier longer-term customer deposits. A positive change in IBP’s BCA would likely affect all ratings.

Investec Bank plc’s BCA would experience negative pressure from (i) a deviation from IBP’s current strategy of reducing risk (for example by redeploying capital freed up into growing the already sizeable portfolio of investments, including low rated and unrated securitisations, or the portfolio of investment and trading properties) and diversifying its revenue base towards lower risk businesses; (ii) a significant increase in the bank’s current as reported gross defaults as a percent of core loans and advances of 5.54% (as of 31 March 2015, unaudited preliminary results) or (iii) a deterioration from the present adequate capital and strong liquidity position. A downward movement in IBP’s BCA would likely result in downgrades to all ratings.

Moody’s assigned a A3(cr)/Prime-2(cr) CR Assessment to IBP, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

The long-term issuer and senior unsecured ratings of Investec plc, IBP’s parent, were upgraded to Baa3 from Ba1,
with a stable outlook. Investec plc's short-term ratings were also upgraded to Prime-3 from Not Prime.

- Leeds Building Society (Leeds)

Moody’s affirmed Leeds’ BCA at a3, incorporating the Society’s adequate capacity for loss absorption that are supported by solid profitability metrics, a resilient net interest margin, and a sound funding structure. The rating also reflects the relatively high level of non-performing loans compared with its peers, mainly arising from its legacy Irish and also its sub-prime and self-cert lending portfolios, and its continued exposure to the buy-to-let and CRE markets, both of which carry higher risks than owner-occupier residential mortgage lending.

Moody’s upgrade of Leeds' long-term deposit and senior unsecured ratings to A2 from A3 reflects: (1) Leeds’ adjusted BCA of a3; (2) the application of Moody’s Advanced LGF analysis, resulting in a one notch of uplift from the a3 adjusted BCA; and (3) low government support resulting in no ratings uplift. The outlook on the long-term deposits and senior unsecured ratings is stable.

The BCA could move up following a sustainable decline in its non-performing loan ratio and further improvements in the Society’s capital levels. A positive change in the Society’s BCA would likely affect all ratings.

The BCA could be lowered if Leeds’ asset quality and profitability metrics show a significant deterioration. A downward movement in Leeds’ BCA would likely result in downgrades to all ratings.

Moody’s assigned a Aa3(cr)/Prime-1(cr) CR Assessment to Leeds, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- Lloyds Bank plc (Lloyds)

Moody’s affirmed Lloyds’ BCA at baa1, which reflects (1) its solid capitalisation; (2) improved asset quality metrics; (3) reduced use of short-term wholesale funding; and (4) sound liquidity management. It also incorporates the Lloyds’ historically low profitability metrics driven by the ongoing legacy conduct remediation costs incurred by the bank.

Lloyds’s long-term debt and deposit ratings were confirmed at A1 and its short-term rating was affirmed at Prime-1. This results from (1) Lloyds’s standalone adjusted BCA of baa1; (2) the application of Moody’s advanced Loss Given Failure (LGF) analysis, resulting in a two notch uplift from the baa1 adjusted BCA; and (3) a one-notch uplift for government support, reflecting a moderate probability of support. The outlook on the long-term ratings has been changed to positive reflecting the positive trend in terms of asset quality, capital and, to a lesser extent, profitability.

The BCA could move up if Lloyds is able to (1) reduce the impact of conduct remediation on its profitability and return to stable net income; (2) complete the ongoing deleveraging of its run-off portfolio, further limiting downside risk and (3) maintains solid capital and leverage metrics following an expected increase in dividend payments.

Lloyds’ BCA could be lowered following a material deterioration in the UK’s operating environment, including a significant deterioration in the housing market; (2) a material reversal in the trend relating to the use of wholesale funding (especially short-term); and (3) sizeable, unexpected conduct remediation charges. A downward movement in Lloyds’ BCA would likely result in downgrades to all ratings.

Moody’s assigned an Aa3(cr)/Prime-1(cr) CR Assessment to Lloyds, four notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations as well as a moderate probability of government support.

- Nationwide Building Society (Nationwide)

Moody’s affirmed Nationwide Building Society’s BCA at a3, which reflects (1) its role as the largest building society in the UK; (2) stable retail funding; (3) predominance of prime lending with good asset quality and improved capital and leverage ratios; (4) improved profitability; and (5) strong liquidity metrics.

Nationwide's long-term debt and deposit ratings were upgraded to A1 from A2 and its short-term rating was affirmed at Prime-1. This results from (1) Nationwide's standalone BCA of a3; (2) the application of Moody's advanced Loss Given Failure (LGF) analysis, resulting in a one-notch uplift from the a3 adjusted BCA; and (3) a one-notch uplift for government support (unchanged), reflecting a moderate probability of support. The outlook on the long-term ratings is stable.
Upward ratings pressure is limited because of Nationwide’s limited geographic and business diversification. We acknowledge upward rating pressure arising from the building society’s demonstrated ability to raise capital externally through the issuance of CCDS as well as build capital organically due to the strong recovery in earnings generation capacity and positive trend in reducing legacy CRE exposure. A positive change in Nationwide’s BCA would likely affect all ratings.

Downward pressure on Nationwide’s BCA could develop from increased risk taking through above average loan book growth in over-heating markets such as real-estate in London and South East England as it would increase the likelihood of deterioration in asset quality and capital. While such a scenario is inconsistent with Nationwide’s publicly stated strategy, downward movement in Nationwide’s BCA would likely result in downgrades to all ratings.

Moody’s assigned an Aa2(cr)/Prime-1(cr) CR Assessment to Nationwide, four notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations as well as a moderate probability of government support.

- Nottingham Building Society (Nottingham)

The rating agency upgraded Nottingham’s BCA to baa1 from baa2 reflecting: (1) the introduction of the revised rating methodology; (2) a material improvement in profitability and strengthening of the Society’s solvency profile through internal capital generation; and (3) solid asset-quality metrics, which places Nottingham as among the best positioned in the building societies’ sector.

Moody’s upgrade of the Society’s long-term deposit rating to Baa1 from Baa2 reflects: (1) the upgrade of Nottingham’s adjusted BCA to baa1; (2) the application of Moody’s Advanced LGF analysis, which results in no uplift from the adjusted BCA; and (3) no government support. The outlook is stable.

A continued and sustainable improvement in profitability and cost-to-income ratios, while maintaining asset quality, would be viewed positively and could put positive rating pressure on Nottingham’s BCA. Nottingham’s deposit rating could also be upgraded if the building society were to issue significant amounts of debt. An upward movement in Nottingham’s BCA would likely result in an upgrade of the long-term deposit rating.

Nottingham’s BCA could come under downward pressure in the event of a notable economic slowdown in the UK resulting in deterioration in asset quality beyond our stress scenarios and a significant decline in profitability and operating efficiency relative to the sector as a whole. A downward movement in Nottingham’s BCA would likely result in a downgrade of the long-term deposit rating.

Moody’s assigned a A1(cr)/Prime-1(cr) CR Assessment to Nottingham, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- Principality Building Society (Principality)

Moody’s affirmed Principality’s BCA at baa3, incorporating the Society’s solid regional franchise, improving profitability and strong overall asset quality. The standalone BCA also takes into account material earnings and geographical concentration and exposure to second-charge mortgages and commercial portfolios that are relatively risky and more sensitive to a downturn in the economy, compared with the more plain-vanilla retail mortgages segment.

The long-term deposit and senior debt ratings were affirmed at Baa3 and the short-term deposit rating was affirmed at Prime-3. This results from (1) Principality’s adjusted BCA of baa3; (2) the application of Moody’s Advanced LGF analysis, resulting in no uplift from the adjusted BCA; and (3) low government support and hence no further ratings uplift. The outlook on the long-term ratings is positive, reflecting the favourable market conditions, improving operating environment and the anticipation that Principality will continue to deliver sustainable profitability and efficiency while maintaining satisfactory capital levels and sound liquidity and continue to improve its asset-quality metrics.

Upward BCA rating pressure could arise from (1) further deleveraging of their riskier exposures while maintaining positive performance in the commercial and second charge portfolios; (2) sustainable improvement in profitability supported by a decrease in cost of risk; and (3) additional material strengthening in the society’s solvency profile. Principality’s deposit and senior unsecured debt ratings could also be upgraded if the building society were to issue significant amounts of debt. An upward movement in Principality’s BCA would likely result in an upgrade of all ratings.

Downward pressure on Principality’s BCA could stem from: (1) unanticipated asset quality erosion in the loan
portfolio; (2) deterioration in the capital position owing to excessive growth; and (3) material weakening of the society’s franchise. A downward movement in Principality’s BCA would likely result in a downgrade of the long-term deposit and senior unsecured ratings.

Moody’s assigned a A3(cr)/Prime-2(cr) CR Assessment to Principality, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

- Santander UK plc (San UK)

The review for upgrade on San UK’s BCA reflects the improvements in the solvency profile of the bank. The review will focus on the following key drivers: (1) the improvement in the leverage ratio following the issuance of high trigger Additional Tier 1 note; (2) the trend in asset quality metrics; and (3) the bank’s ability to increase profitability in a sustainable way.

Moody’s upgraded San UK’s long term deposit rating to A1 from A2 and placed it on review for upgrade together with the senior unsecured debt rating of (P)A2, in line with the review status of the BCA. The upgrade of the deposit rating reflects (1) the bank’s adjusted BCA of baa1; (2) the application of the Advanced LGF analysis, which, given the bank’s significant volumes of senior debt and junior deposits, results in a two-notch uplift from the adjusted BCA; and (3) government support uplift of one notch reflecting a “moderate” probability of support.

Positive pressure on the BCA could develop if San UK: (1) improves its leverage ratio; (2) increases profitability; (3) maintains a sound funding profile by further increasing the amount of its prime banking and savings customers; and (4) maintains its strong asset quality despite growth in its SME lending portfolio. A positive change in San UK’s BCA would likely affect all ratings. San UK’s deposit and senior debt ratings could also be upgraded if the bank were to issue significant amounts of long-term debt and more subordinated debt.

Given the review for upgrade, a downgrade is unlikely at the moment. However, negative pressure on the BCA would likely be driven by: (1) significant deterioration of San UK’s loan-book asset quality; (2) material deterioration in profitability, reducing the bank’s loss-absorption capacity; and (3) deterioration in the bank’s funding and liquidity position, including a further reduction in the quantity or quality of its liquidity buffer. A downward movement in San UK’s BCA would likely result in downgrades of all ratings.

Moody’s assigned a Aa3(cr)/Prime-1(cr) CR Assessment to San UK, four notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations as well as a moderate probability of government support. The CR Assessment has been placed on review for upgrade.

- Skipton Building Society (Skipton)

The upgrade of Skipton’s BCA to baa2 from baa3 was driven by: (1) the Society’s significant reduction in organisational complexity; (2) significant improvements in the asset quality of the mortgage and savings division; and (3) Moody’s expectation that increasing competition will pressure profitability, but will remain at adequate levels.

Moody’s upgraded the Society’s long-term deposit and senior debt ratings to Baa2 from Baa3 and upgraded the short-term rating to Prime-2 from Prime-3. The changes are driven by: (1) Skipton’s adjusted BCA of baa2; (2) the application of Moody’s Advanced LGF analysis; and (3) no uplift from government support uplift, leading to no uplift from the BCA for the long-term deposit rating. However, due to Moody’s expectation of potential changes in the liability structure in the short term, the outlook on the Baa2 deposit rating remains on review for upgrade. The deposit rating would likely go up if the bank issues long term debt within the review period.

The BCA could move up if Skipton is able to 1) achieve further improvements in asset quality; 2) maintain sound profitability metrics despite competitive pressure; 3) abstain from making further investments in subsidiaries not aligned with their core mortgage and savings business; while maintaining 4) solid capital levels. A positive change in the bank’s BCA would likely affect all ratings. Skipton’s senior unsecured debt and deposits ratings could also be upgraded if the company were to issue significant amounts of long-term debt.

Skipton’s BCA could be lowered following (1) any material deterioration in asset quality and profitability (2) difficulties at one of Skipton’s major subsidiaries, especially Connells, leading to a drain on resources (either financial or managerial) away from the core lending franchise. A downward movement in Skipton’s BCA would likely result in downgrades to all ratings.

Moody’s assigned a A2(cr)/Prime-1(cr) CR Assessment to Skipton, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.
West Bromwich Building Society (West Brom)

Moody’s affirmed West Brom’s BCA at b2. The standalone BCA reflects the society’s weak profitability and efficiency levels, its high level of non-performing loans, mainly arising from its CRE portfolio and its continued exposure to the higher-risk buy-to-let market. The BCA also takes into account the society’s improving capital levels, low reliance on wholesale funding and its adequate liquidity buffers.

The society’s long-term debt and deposit ratings were upgraded to B1 from B2. This results from (1) West Brom’s adjusted BCA of b2; (2) the application of Moody’s Advanced LGF analysis, leading to a one-notch uplift from the BCA, due to the moderate loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves; and (3) no government support. The outlook on the long-term ratings is stable.

Despite the improving operating environment upward pressure on West Brom’s BCA is unlikely. Nevertheless, a significant increase in profitability, improvement in efficiency levels and achievement of a sustainable business model would be viewed positively. A positive change in the building society’s BCA would likely affect all ratings. West Brom’s deposit and senior debt ratings could also be upgraded if the building society were to issue significant amounts of senior and or subordinated long-term debt.

The current standalone rating incorporates some degree of volatility in overall financial fundamentals. However, West Brom’s BCA’s rating could come under downward pressure in the event of a notable economic slowdown in the UK resulting in significant asset quality deterioration, impacting the society’s capital levels. A downward movement in West Brom’s BCA would likely result in downgrades to all ratings.

Moody’s assigned a Ba2(cr)/Not Prime(cr) CR Assessment to West Brom, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

Yorkshire Building Society (Yorkshire)

The affirmation of Yorkshire’s BCA at baa1 was driven by: (1) the society’s improvement in asset-quality metrics and shrinkage of legacy portfolios; and (2) solid and stable fundamentals in profitability, funding and solvency.

Moody’s upgrade of the Society’s long-term deposit rating to A3 from Baa1 and affirmation of the senior debt rating at Baa1 and of the short-term rating at Prime-2 are the results of: (1) Yorkshire’s adjusted BCA of baa1; (2) the application of Moody’s Advanced LGF analysis, leading to a one-notch uplift from the BCA for the long-term deposit rating, due to the moderate loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits themselves, and no LGF uplift for senior debt ratings; and (3) low government support and hence no further ratings uplift. The outlook is positive on all ratings, reflecting the Society’s improving credit fundamentals and risk profile.

Upward BCA rating pressure could arise from a continued improvement of its financial performance, significant further de-risking coupled with improvement in risk composition and arrears. Yorkshire’s deposit and senior unsecured debt ratings could also be upgraded if the building society were to issue significant amounts of debt. An upward movement in Yorkshire’s BCA would likely result in an upgrade of all ratings.

Significant deterioration in asset quality or a negative shift in assumptions underlying forward looking loss analysis would be factors for determining whether a downward adjustment in the standalone assessment is appropriate. More generally a weakening in the UK operating environment impacting loss-absorption capacity (earnings and capital) along with deterioration in retail funding to levels that are out of line with those of peers could lead to downward pressure on Yorkshire’ BCA. A downward movement in Yorkshire ‘s BCA would likely result in a downgrade of all ratings.

Moody’s assigned a A1(cr)/Prime-1(cr) CR Assessment to Yorkshire, three notches above the BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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