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INVESTORS SERVICE

CREDIT OPINION
22 May 2020

Update

Rate this Research

RATINGS

Barclays Bank UK PLC

Domicile	London, United Kingdom
Long Term CRR	Aa2
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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Barclays Bank UK PLC

Update post full year results

Summary

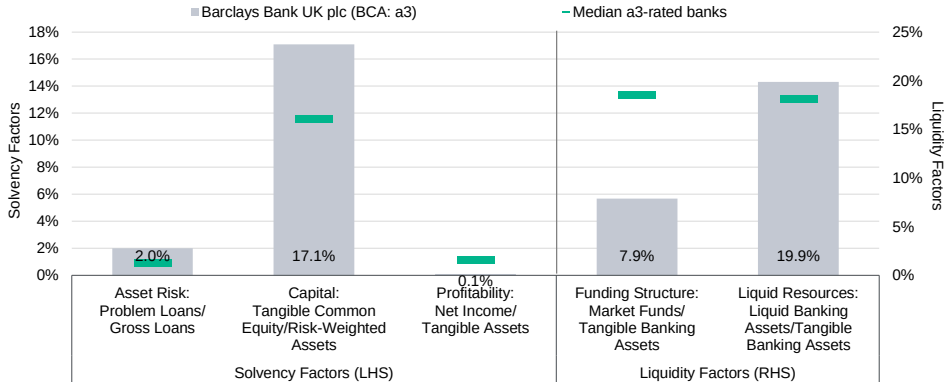
Barclays Bank UK PLC (BBUK) is a domestic systemically important bank based in the United Kingdom (Aa2 negative). BBUK is the ring-fenced bank of Barclays PLC (LT senior unsecured Baa3 positive).

BBUK's long- and short-term deposit ratings are A1/Prime-1, and its long- and short-term Counterparty Risk Rating (CRR) are Aa2/Prime-1.

BBUK's A1 long-term deposit rating considers the bank's a3 standalone BCA and incorporates a one-notch uplift resulting from our advanced Loss Given Failure (LGF) analysis and one notch of government support, reflecting our assessment of a moderate probability of support from the UK government, if needed.

The banks' a3 Baseline Credit Assessment (BCA) reflects: (1) moderate asset risk; (2) robust capitalisation; (3) historically stable and predictable earnings from strong retail and small business banking franchises, challenged in 2020 by the negative macroeconomic impacts of the coronavirus crisis; (4) good levels of liquidity; and (5) limited reliance on confidence-sensitive wholesale funding.

Exhibit 1
Rating Scorecard - Key financial ratios as at 31 December 2019



Source: Moody's Investors Service

Credit strengths

» Robust capitalisation

» Limited exposure to confidence-sensitive wholesale funding and good liquidity levels

Credit challenges

» Moderate asset risk; however, material exposures to unsecured retail lending will lead to higher cost of risk in the current downturn

» Historically stable and predictable earnings from strong retail and small business banking franchises will be challenged in 2020 by the negative macroeconomic impact of coronavirus

Rating outlook

The outlook for the deposit ratings of BBUK is negative. The outlook reflects our view that the UK's economic and fiscal strength are likely to be weaker going forward, and more susceptible to shocks than what we previously assumed, and UK public institutions have weakened, as they have struggled to cope with the magnitude of policy challenges that they currently face, including those that relate to fiscal policy. The outbreak of coronavirus and the related macroeconomic impacts will exacerbate existing pressures on UK banks' revenues, asset quality and overall profitability.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The banking sector has been one of the sectors affected by the shock given the expected impact on asset quality and profitability. Although the initial shock from the coronavirus has been similar across countries, economic outcomes will differ because of different capacities to withstand the shock. The overall risks to our baseline forecasts[1] for all countries are skewed to the downside.

Factors that could lead to an upgrade

BBUK's BCA could be upgraded if the prospects for the UK's operating environment either stabilise or improve and/or there is a considerable increase in profitability and liquidity. A higher BCA could lead to a rating upgrade. An upgrade of BBUK's long-term deposit rating could also result from a higher stock of bail-in-able liabilities that would provide higher protection for the bank's junior depositors, beyond what we currently expect.

Factors that could lead to a downgrade

BBUK's BCA could be downgraded if there is a further deterioration of the UK operating environment, in case of a deterioration in asset quality and weaker profitability or lower capitalisation or a deterioration in the bank's liquidity profile. A downgrade of the BCA would likely lead to a rating downgrade. The rating could also be downgraded due to a reduction in the stock of bail-in-able liabilities that would reduce the degree of protection for junior depositors.

Profile

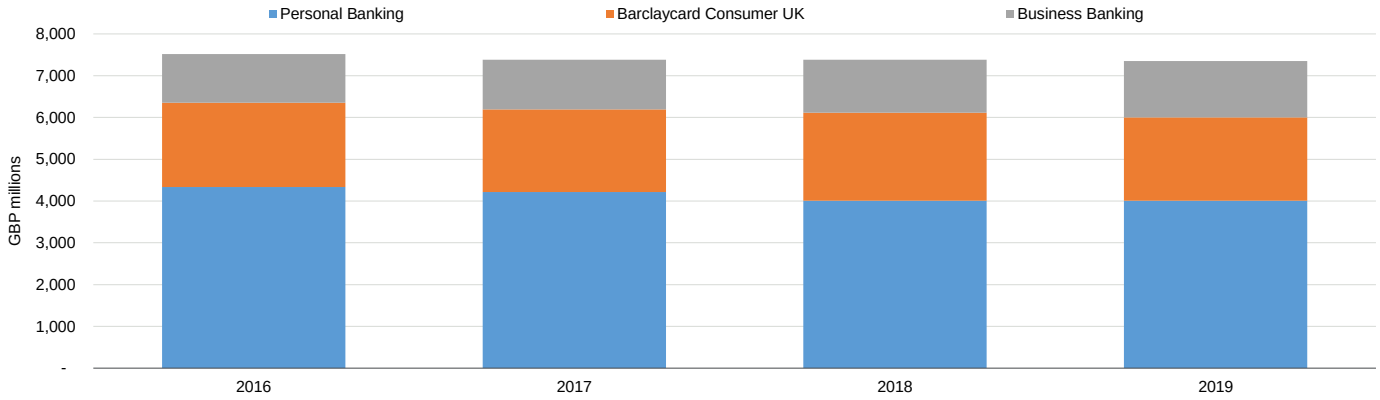
BBUK is the ring-fenced bank of the Barclays group, accounting for around 20% of the group's total assets, following the transfer of the group's retail and business banking operations from Barclays Bank on 1 April 2018. BBUK is one of the market leaders in the UK, with strong franchises in retail (including credit cards) and small business banking.

BBUK houses the group's core UK retail and small business banking operations, which we consider as a key credit strength. BBUK's operations are spread across three main segments: (1) Personal Banking (55% of revenues in 2019 Barclays UK's segmental results, (2) Barclaycard Consumer UK (27%) and (3) Business Banking (18%) (see Exhibit 1).

BBUK operates exclusively in the UK and, as such, the bank's Strong+ Macro Profile is in line with that of the UK.

Exhibit 2

Barclays UK: revenues breakdown by business segment



* In Q218, Wealth was reclassified from Wealth, Entrepreneurs & Business Banking (now named Business Banking) to Personal Banking. Comparatives have been restated.
Source: Company data

Detailed credit considerations

Robust capitalisation

Our assigned score of aa3 for Capital reflects the bank's good regulatory capitalisation and leverage positions. BBUK reported a common equity tier 1 (CET1) ratio of 13.5% at end-2019 and a CRR leverage ratio of 4.8% at the same date. We expect the bank's regulatory capitalization to modestly weaken due to the negative impact of the coronavirus-led economic environment, translating into lower capital generation through earnings and higher risk-weighted assets.

Historically stable and predictable earnings from strong retail and small business banking franchises will be challenged in 2020 by the negative macroeconomic impact of coronavirus

Our ba1 assigned score for Profitability reflects our expectation of a deterioration in the bank's profitability over the next 12-18 months, due to a sharp increase in credit impairments and lower revenue related to the coronavirus-led weaker economic environment; we anticipate profitability will partially recover in 2021, provided economies rebound, as the coronavirus pandemic fades.

In 2019, BBUK reported £156 million net attributable income, depressed by £1.6 billion provisions for litigation and conduct. Total revenues were £7.3 billion (£4 billion from Personal Banking; £2 billion from Barclaycard Consumer UK and £1.4 billion from Business Banking) reflecting growth in mortgage lending and in customer deposits. Operating expenses excluding conduct and litigation costs were £4.4 billion. Credit impairment charges were £709 million.

The group is affected by Brexit, having a large presence in the UK. Our ratings incorporate the expectation of a "soft Brexit" (the exit of the UK from the EU with a negotiated agreement). We view that a "hard Brexit" (were no agreement to be reached by the end of December) will result in a weaker growth outlook for the UK. The coronavirus crisis will likely result in an even weaker operating environment with lower economic growth and higher unemployment, resulting in lower revenue and higher credit costs, which will translate into lower profitability than we previously expected.

Limited exposure on confidence sensitive wholesale funding and good liquidity levels

BBUK had a large retail and small business banking deposit book of £206 billion at end-2019, in excess of loans (we calculate a gross loan-to-deposit ratio of 97% as of the same date). The firm has limited reliance on wholesale funding, which is represented by bail-in-able liabilities issued to its parent company and required by regulation. Moreover, Barclays has drawn from the Bank of England's Term Funding Scheme, which could be replaced with borrowings under the new Term Funding Scheme (TFSME) or alternatively with deposits or secured funding. Access to borrowings under the TFSME provides capacity to further diversify BBUK's funding mix and support its net interest margin in the current very low interest rate environment. Our Funding Structure score of a1 is driven by our assessment of the bank's limited refinancing risk.

BBUK has a good liquidity profile, supported by its large high quality liquid asset pool of £41 billion at end-2019. The bank's ample liquidity is also evidenced by a strong liquidity coverage ratio of 144%, as at the same reporting date. We assign a baa2 score to Liquidity Resources, reflecting our assessment of the bank's liquidity profile.

Moderate asset risk, however, exposures to unsecured retail lending represents a tail risk

BBUK had a stage 3 problem loan ratio of 1.8% as at end 2019, which is in line with peers and below the average for the UK banking system. Stage 2 problem loans are higher than most peers, reflecting the significant portion of unsecured consumer credit book of £24 billion, at end-2019, which includes its UK cards and UK personal loans portfolio.

We view BBUK's mortgage underwriting standards as conservative: at end-2019, the bank's £144 billion UK mortgage book had an average balance weighted loan-to-value ratio of 51%, lower than that of its peers.

We assign a score of baa1 to asset risk.

Environmental, social and governance considerations

The global banking sector has been classified as "Low" risk in our environmental (E) risk heatmap[2] and as "Moderate" risk in our social(S) risk heatmap[3].

Environmental risks exposure is low for BBUK, in line with our general view for the banking sector. BBUK has no exposure to the high-carbon emission sectors, which are prone to environmental risks.

Social risk is moderate for BBUK, including considerations in relation to the coronavirus outbreak, given the substantial implications for public health and safety and deteriorating global economic outlook, creating a severe and extensive credit shock across many sectors, regions and markets. The firm, like other UK banks, is subject to regular investigations by the UK Financial Conduct Authority (FCA) on customer protection and fair treatment. Since the financial crisis, Barclays group has made around £11 billion in provisions for conduct related to Payment Protection Insurance (PPI). Investigations and related fines imposed by supervisors represent significant reputational risk for banks.

Governance[4] is highly relevant to BBUK, as it is to all banks. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. The bank's risk governance infrastructure is adequate and has not shown any shortfall in recent years. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss given failure and additional notching

We apply our advanced LGF analysis to BBUK because the bank is incorporated in the UK, which we consider to be an operational resolution regime. For this analysis, we assume residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits and a 5% run-off in preferred deposits. We also assume that junior deposits represent 10% of total deposits, given that the bank's operations are predominantly retail and SME. We assign a 25% probability to deposits being preferred to senior unsecured debt.

The implementation of UK ring-fencing has led us to perform separate advanced LGF analysis for Barclays (the holding company), Barclays Bank (the non ring-fenced-bank; LT senior unsecured A2 stable, bca baa3) and BBUK.

We assume that UK holding company senior obligations benefit from the subordination of both holding and bank-subordinated instruments. However, we believe that UK holding company senior unsecured debt is economically junior to bank senior unsecured debt, based on our forward-looking view that EU holding company senior unsecured debt, although legally pari passu to bank debt, will eventually fund bank senior unsecured debt, which is contractually, structurally or statutorily subordinated to operating company external senior debt.

Our advanced LGF analysis indicates a low loss given failure for deposits, resulting in a one-notch uplift to the relevant ratings from the firm's adjusted BCA of a3.

Government support

We assess a moderate probability of government support for BBUK' depositors, resulting in a further one-notch uplift incorporated in the relevant A1 ratings.

About Moody's Bank Scorecard

Our 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 3
Barclays Bank UK 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		2.0%	a2	←→	baa1	Sector concentration	Geographical concentration
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		17.1%	aa2	←→	aa3	Stress capital resilience	Expected trend
Profitability							
Net Income / Tangible Assets		0.1%	b3	↑↑	ba1	Earnings quality	Expected trend
Combined Solvency Score			a3		a3		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		7.9%	a1	←→	a1		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		19.9%	baa2	←→	baa2	Quality of liquid assets	
Combined Liquidity Score			a3		a3		
Financial Profile					a3		
Qualitative Adjustments					Adjustment		
Business Diversification					0		
Opacity and Complexity					0		
Corporate Behavior					0		
Total Qualitative Adjustments					0		
Sovereign or Affiliate constraint					Aa2		
BCA Scorecard-indicated Outcome - Range					a2 - baa1		
Assigned BCA					a3		
Affiliate Support notching					-		
Adjusted BCA					a3		

Balance Sheet is not applicable.

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	-	-	-	-	-	-	-	3	0	aa3
Counterparty Risk Assessment	-	-	-	-	-	-	-	3	0	aa3 (cr)
Deposits	-	-	-	-	-	-	-	1	0	a2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	aa3	1	Aa2	Aa2
Counterparty Risk Assessment	3	0	aa3 (cr)	1	Aa2(cr)	
Deposits	1	0	a2	1	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 4

Category	Moody's Rating
BARCLAYS BANK UK PLC	
Outlook	Negative
Counterparty Risk Rating	Aa2/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Commercial Paper	P-1

Source: Moody's Investors Service

Endnotes

1 Our latest macroeconomic forecasts are included in Global Macro Outlook 2020-21: Global recession is deepening rapidly as restrictions exact high economic cost, published on 28 April 2020

2 Environmental risks can be defined as environmental hazards encompassing the impacts of air pollution, soil/water pollution, water shortages and natural and man-made hazards (physical risks). Additionally, regulatory or policy risks, like the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts, that could impair the evaluation of assets are an important factor. Certain banks could face a higher risk from concentrated lending to individual sectors or operations exposed to the aforementioned risks.

3 Social risk considerations represent a broad spectrum, including customer relations, human capital, demographic and societal trends, health and safety and responsible production. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology costs, ageing population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue bases. Pressure on profitability can be particularly severe for small banks that have limited options to mitigate declines in net interest income, their main revenue source. By contrast, large institutions equipped with resources to invest in new businesses or technology will be somewhat able to overcome these challenges.

4 Corporate governance is a well-established key driver for banks and related risks are typically included in our evaluation of the banks' financial profile. Corporate governance is a well-established key driver for banks and related risks are typically included in our evaluation of the banks' financial profile may be captured in individual adjustments to the BCA. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. When credit quality deteriorates due to poor governance, such as break-down in controls resulting in financial misconduct, it can take a long time to recover. Governance risks are also largely internal rather than externally driven.

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