Global Credit Research
Announcement
16 NOV 2007

Moody's Investors Service

Announcement: Barclays Bank PLC

Moody's Comments on Write downs at Barclays Capital

London, 16 November 2007 -- Moody's commented on the GBP1.7bn charges and write downs (excluding the offsetting effect of GBP400m fair valuation on its own debt) within Barclays Capital over the period July -- October 2007 announced yesterday by Barclays PLC. The rating agency said that the announcement has led to no change in the ratings of the bank. The outlook for the bank's debt and deposit ratings (Senior at Aa1) remains stable, while the outlook for Barclays' B+ Bank Financial Strength Rating (BFSR) remains negative.

Given the ongoing dislocation in the financial markets, Moody's will continue to monitor the impact of market conditions on Barclays Bank PLC, including its exposures to structured products. Barclays reported net exposures of structured products at the end of October 2007 totalling GBP11.3bn, with a relatively small proportion of the more volatile mezzanine super senior CDOs. But an important consideration with regards to the possibility of further write downs, will be the efficacy of hedges the bank has in place and the sufficiency of the marks taken relative to gross and net exposures.

However, Moody's considers that the strong earnings capabilities and solid capitalisation of Barclays mean that this current write down can be absorbed without negatively impacting the credit rating of the bank. In conducting its own stress tests, Moody's has concluded that the bank would be able to absorb further write downs roughly equal to the size of those announced to date without experiencing further negative pressure on its rating.

Barclays Bank plc is headquartered in London, United Kingdom, and had total assets of GBP 1,158 billion at 30 June 2007.

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March 12, 2008

Amid Strong 2007 Results, Credit Concerns Loom For U.K. Banks, Says Report

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LONDON (Standard & Poor's) March 12, 2008--At first glance, U.K. banks appear to have emerged relatively unscathed to date from the global banking crisis, Standard & Poor's Ratings Services notes in a report, titled "Strong 2007 Performance Masks Growing Rating Concerns For U.K. Banks," published on March 11, 2008.

Reported pretax profits for the five major U.K. banking groups were a respectable £38.6 billion in 2007, fractionally up on 2006, which in turn was about double 2002 levels. Nevertheless, Standard & Poor's has become more cautious about the industry's prospects for 2008. "This reflects the greater uncertainty regarding the future contribution of the capital markets activities of the major banks, the impact of the harsher liquidity and funding environment on smaller lenders, and the weaker U.K. economic outlook," said Standard & Poor's credit analyst Nigel Greenwood.

Some financial institutions have already felt the chill: Both Barclays PLC and The Royal Bank of Scotland Group PLC (RBSG) now have negative outlooks, mortgage lenders Alliance & Leicester PLC and Bradford & Bingley PLC have been placed on CreditWatch with negative implications, and, of course, Northern Rock PLC has recently been nationalized.

The most striking feature of the major U.K. banks' reported earnings was the impact of credit market-related markdowns. These totalled about £7 billion if gains on fair valuing their own debt are excluded and ABN AMRO Bank N.V.-rel

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ated write-downs for RBSG are included. These markdowns were clearly material, but were insufficient on their own to affect ratings, and were not outsized in a global context. Further write-downs on structured investments, leveraged finance, and monoline exposures are possible, and could still loom large as a ratings factor.

Our ratings focus for the major U.K. banks in 2008 is switching toward:

-- Earnings prospects for their capital markets activities;

-- Resilience of their property and construction exposures (both commercial and residential);

-- Our expectation that corporate defaults will rise toward the long-term average; and

-- Continued income pressures faced by U.K. consumers.

Long-term ratings on the major U.K. banks have essentially been stable at the 'AA' level for a number of years. During the good times we were constrained from raising these ratings reflecting our approach of rating through the cycle. It also takes into account our cautious view on the evolution of the U.K. economy, the rise in household debt, and that, with the exception of HSBC, U.K. banks tend to manage capitalization more tightly than most large global peers. "As a result, there is a degree of slack in the current ratings to absorb both the recent impact of credit market-related events and the prospect of a broader softening in revenue growth and higher loan impairments," added Mr. Greenwood. Clearly, if the benefits of their diverse business profile prove insufficient to offset the effects of the weaker operating environment, the ratings could be lowered.

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The report is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-9823 or sending an e-mail to research_request@standardandpoors.com. Ratings information can also be found on Standard & Poor's public Web site at www.standardandpoors.com; select Ratings in the left navigation bar, then Credit Ratings Search. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office Hotline (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4017. Members of the media may also contact the European Press Office by sending an e-mail to media_europe@standardandpoors.com.

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March 11, 2008

Strong 2007 Performance Masks Growing Rating Concerns For U.K. Banks

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Strong 2007 Performance Masks Growing Rating Concerns For U.K. Banks

At first glance, U.K. banks appear to have emerged relatively unscathed to date from the global banking crisis. Reported pretax profits for the five major U.K. banking groups were a respectable £38.6 billion in 2007 (see table 1), fractionally up on 2006, which in turn was about double 2002 levels. Nevertheless, Standard & Poor's Ratings Services has become more cautious about the industry's prospects for 2008. This reflects the greater uncertainty regarding the future contribution of the capital markets activities of the major banks, the impact of the harsher liquidity and funding environment on smaller lenders, and the weaker U.K. economic outlook. Some financial institutions have already felt the chill: Both Barclays PLC and The Royal Bank of Scotland Group PLC (RBSG) now have negative outlooks, mortgage lenders Alliance & Leicester PLC and Bradford & Bingley PLC have been placed on CreditWatch with negative implications, and, of course, Northern Rock PLC has recently been nationalized.

Table 1

Headline 2007 Results For The Five Largest U.K. Financial Institutions*

(Mil. £)

	Ratings	Reported 2007 pretax profit	Pretax profit growth (2007 versus 2006) (%)	Pretax profit H2 2007 versus H1 2007 (%)	Core earnings/average RWAs (%)
Barclays PLC	AA/Negative/A-1+	7,076	(1)	(38)	1.5
HBOS PLC	AA/Stable/A-1+	5,474	(4)	(8)	1.3
HSBC Holdings PLC¶	AA/Stable/A-1+	12,106	10	(41)	1.9
Lloyds TSB Group PLC	AA/Stable/A-1+	4,000	(6)	1	1.7
Royal Bank of Scotland Group PLC§	AA/Negative/A-1+	9,900	8	1	1.7

Ratings shown are for the main operating banks and are Standard & Poor's at March 11, 2008. *Data are based on prelims except for HSBC Holdings PLC, which is based on audited final results. ¶HSBC Holdings PLC results have been converted from reported U.S. dollar numbers. §Data for Royal Bank of Scotland Group PLC is fully consolidated and includes those ABN AMRO businesses that are not reserved for Royal Bank of Scotland Group PLC. The impact on 2007 earnings was minimal. We define core earnings as a bank's consolidated net income (before allocation to minority interests) adjusted to arrive at what we deem to be sustainable earnings. Core earnings provide an indication of the bank's ability to self-finance its growth, as well as absorb unexpected shocks. Our assessment of a bank's future performance is focused on core earnings. RWAs--Risk-weighted assets.

The most striking feature of the major U.K. banks' reported earnings was the impact of credit market-related markdowns. These totalled about £7 billion if gains on fair valuing their own debt are excluded and ABN AMRO Bank N.V.-related write-downs for RBSG are included (see table 2). These markdowns were clearly material, but were insufficient on their own to affect ratings, and were not outsized in a global context. Further write-downs on structured investments, leveraged finance, and monoline exposures are possible, and could still loom large as a ratings factor.

Our ratings focus for the major U.K. banks in 2008 is switching toward:

- Earnings prospects for their capital markets activities;
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- Continued income pressures faced by U.K. consumers.

U.K. financial institutions reported strong domestic asset quality in 2007, but if tighter credit conditions start to affect the broader economy materially, credit-quality deterioration could accelerate, and property values could also decline more sharply than they have to date.

Table 2

Reported 2007 Credit Market-Related Writedowns

	Total	ABS CDO super senior markdowns	Other subprime and CMBS markdowns	Leveraged finance markdowns	Other trading portfolio markdowns
(Mil. £)					
Barclays PLC	(2,293)	(1,412)	(823)	(58)	N.A.
HSBC Holdings PLC	(889)	N.A.	(493)	(97)	(299)
HBOS PLC	(227)	N.A.	N.A.	N.A.	(227)
Lloyds TSB Group PLC	(280)	(114)	N.A.	N.A.	(166)
Royal Bank of Scotland Group PLC	(1,895)	(659)	(456)	(285)	(495)

Data excludes gains on fair valuing its own debt. Royal Bank of Scotland Group PLC data excludes ABN AMRO related write-downs (a reduction of £978 million in the carrying value of financial instruments acquired). Data for HSBC Holdings PLC excludes loan loss impairments in its U.S. consumer finance business. ABS--Asset-backed securities. CDO--Collaterized debt obligations. CMBS--Commercial mortgage-backed securities. N.A.--Not available.

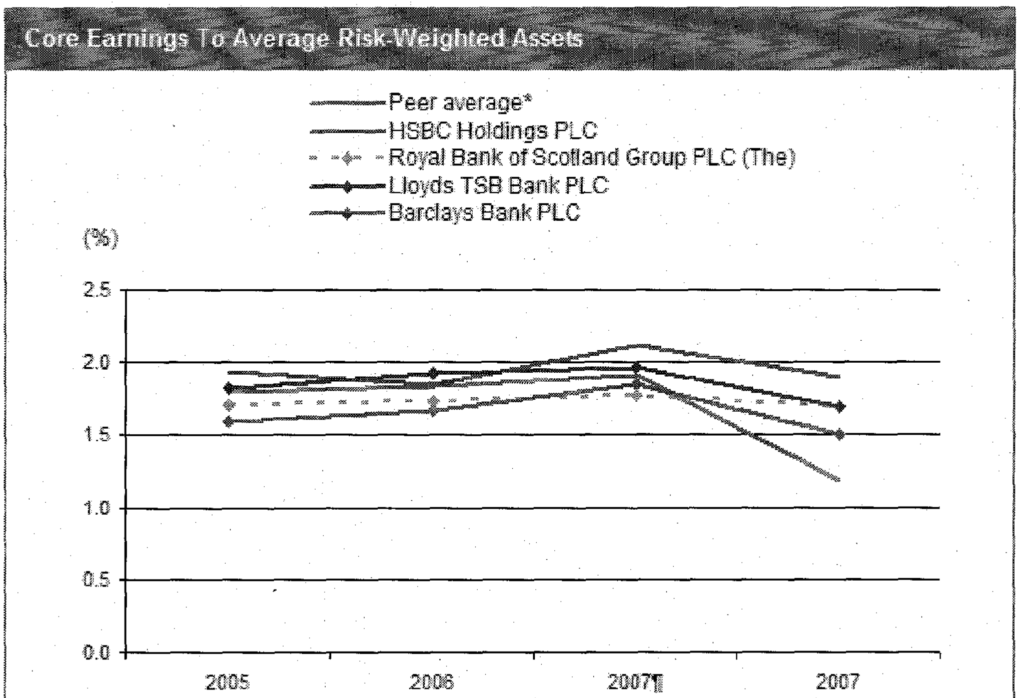
The sound overall earnings performance in 2007 reflects the very diverse business profile of the major U.K. banks. Their appetite to expand away from the U.K. (particularly in the case of Barclays, HSBC Holdings PLC, and RBSG) and increase the role for nonretail business lines is a key feature of their evolution over the past several years. In part, this shows the limited scope for domestic market consolidation, and their modest degree of confidence in the relative growth and returns of the U.K. retail market. This trend was starkly illustrated by the 2007 battle for ABN AMRO Bank N.V. ownership, which was ultimately acquired by a consortium led by RBSG, beating a rival bid from Barclays.

Long-term ratings on the major U.K. banks have essentially been stable at the 'AA' level for a number of years. During the good times we were constrained from raising these ratings reflecting our approach of rating through the cycle. It also takes into account our cautious view on the evolution of the U.K. economy, the rise in household debt, and that, with the exception of HSBC, U.K. banks tend to manage capitalization more tightly than most large global peers. As a result, there is a degree of slack in the current ratings to absorb both the recent impact of credit market-related events and the prospect of a broader softening in revenue growth and higher loan impairments. Clearly, if the benefits of their diverse business profile prove insufficient to offset the effects of the weaker operating environment, the ratings could be lowered.

Key Performance Indicators, Trends, And Expectations

The solid ratios of core earnings to average risk-weighted assets in 2007, and perhaps more importantly a consistently healthy track record, demonstrate the strong profitability of the major U.K. banks. Chart 1 highlights recent performance relative to a range of global peers and the degree to which some of those peers deteriorated in the latter part of 2007. Meanwhile, strong business diversity continues to support the ratings.

Chart 1



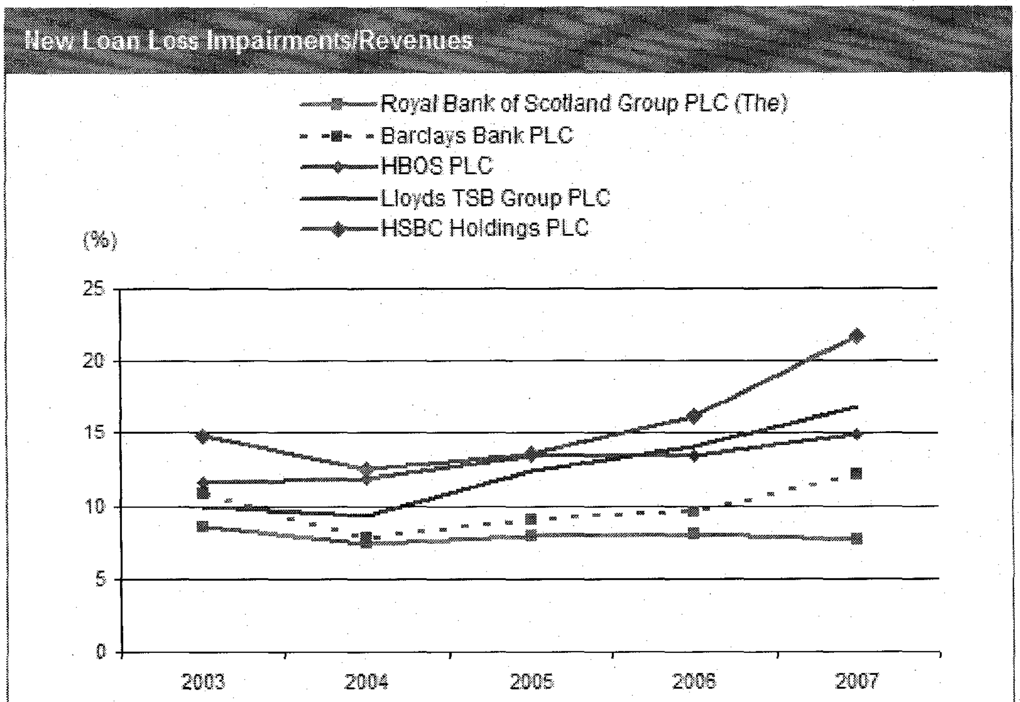
*Average is for Nordea Bank AB, ABN AMRO Bank N.V., ING Bank N.V., Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank Nederland), BNP Paribas, Societe Generale, Fortis Inc., Danske Bank A/S, National Australia Bank Ltd., Royal Bank of Canada, Bank of Ameica Corp., Citigroup Inc., Wachovia Bank. NA, Banco Santander S.A., Deutsche Bank AG, and UBS AG. ¶First-half of 2007. Source: Standard & Poor's.

Earnings are underpinned by sound net interest margins, a high degree of noninterest income with a fairly modest relative reliance on market-sensitive income, and a track record of good efficiency. These factors remained true in 2007, and we believe that they will put U.K. banks in good stead through the more difficult operating environment.

The speed and degree of asset-quality deterioration could be crucial

A feature of U.K. bank results over the past several years has been the historically low impact of loan loss impairments on earnings. The shift in 2007 was mainly as a result of the impact of credit market related write-downs on revenues and impairment charges (see chart 2).

Chart 2



Royal Bank of Scotland Group PLC 2007 data excludes ABN AMRO Bank N.V. Data for 2003-2004 is based on U.K. GAAP and are not fully comparable. Source: Standard & Poor's.

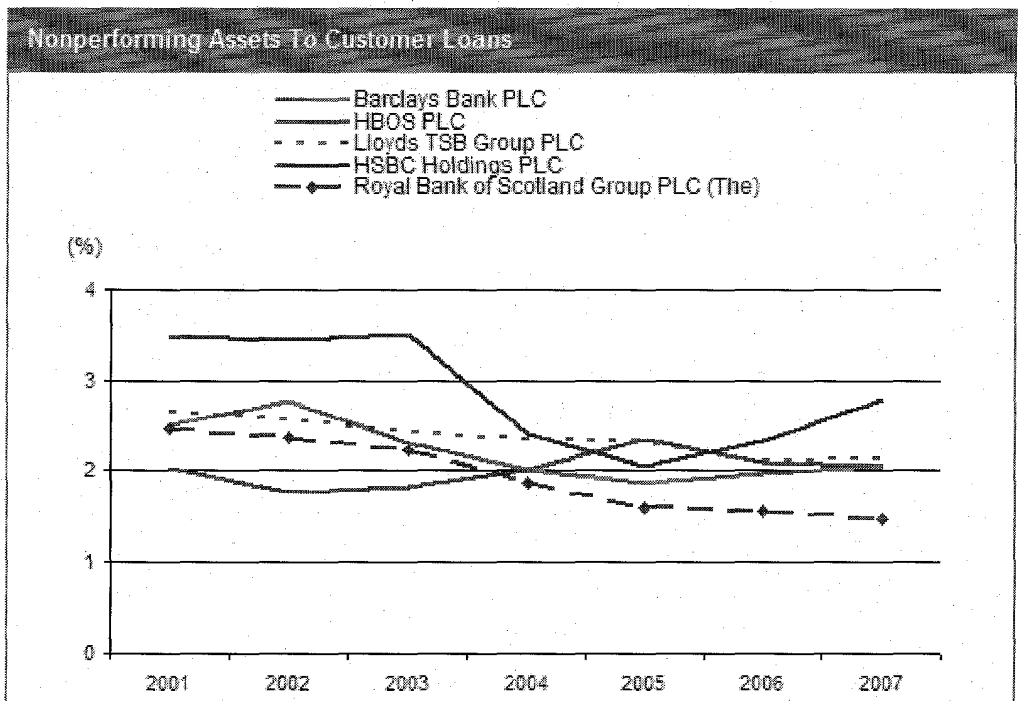
The higher level of impairments at HSBC reflects the difficulties suffered by its U.S. consumer finance business as a result of the severe deterioration in the U.S. housing market. HSBC stated that North American loan impairment charges and other credit risk provisions hit a high $12.2 billion in 2007 ($6.8 billion in 2006 and $4.9 billion in 2005) or more than two-thirds of the total for the group. These figures indicate both the speed and degree to which impairments can rise.

U.K. banks last experienced this effect in the early 1990s when domestic credit quality deteriorated sharply. To put the current low impairment charges into context, taking 1991-1993 as the stress period, the average ratio of new loan loss provisions to revenues (under U.K. GAAP) was about 25% (based on a peer group of Barclays, Bank of Scotland PLC, Lloyds Bank PLC, Midland Bank (now rebranded and part of HSBC), National Westminster Bank PLC, and RBSG). While we are not expecting a return to a similarly severe operating environment in the U.K., such a sharp deterioration in asset quality could clearly impact the ratings.

On the other hand, the performance of HSBC in 2007 is quite revealing. Their U.S. loan loss impairments were at a stressful level in 2007, yet the diversity of its earnings still led to a record overall performance. Therefore, it is worth highlighting the greater degree of revenue diversity of the major U.K. banks today versus the early 1990s.

Asset quality measured by nonperforming loans to average customer loans also remains close to historical lows (see chart 3). These figures contrast to an average ratio of about 7.5% between 1991 and 1993.

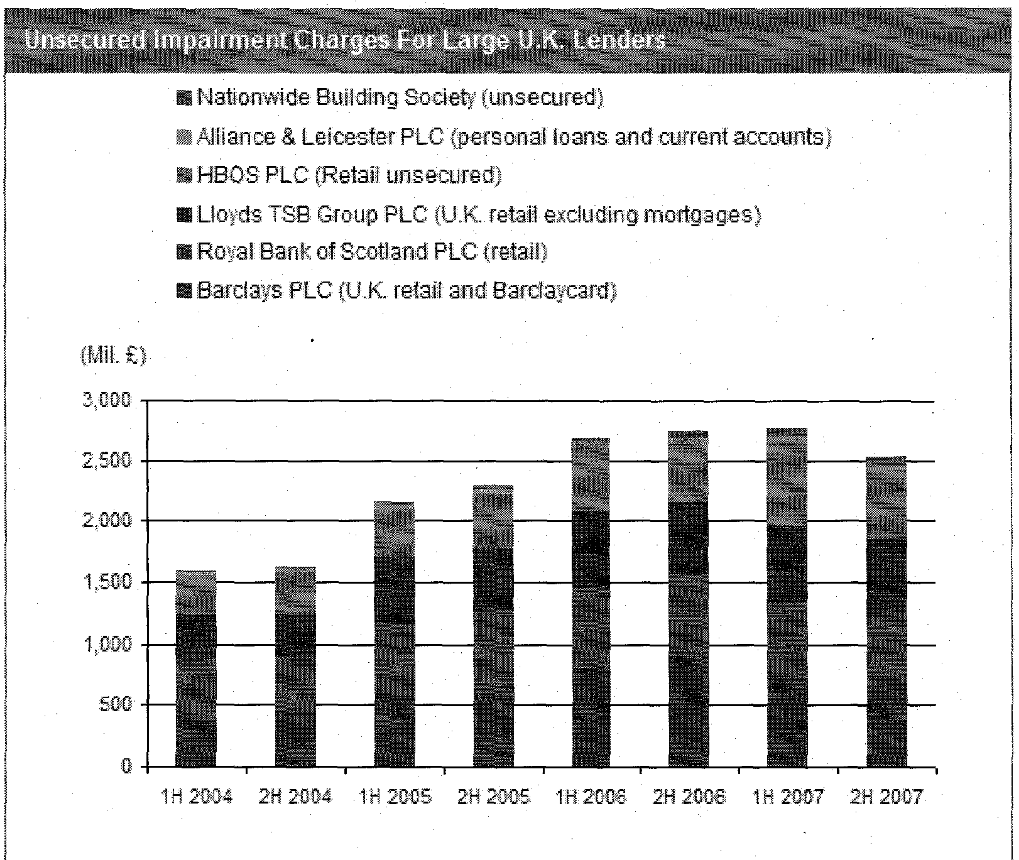
Chart 3



Royal Bank of Scotland Group PLC 2007 data excludes ABN AMRO Bank N.V. Data for 2003-2004 is based on U.K. GAAP and are not fully comparable. Source: Standard & Poor's.

Standard & Poor's also takes some comfort from U.K. banks having already experienced some stress over the past three years and have found this experience manageable. This stress followed the deterioration in U.K. unsecured credit quality due to higher levels of household debt, changes in insolvency legislation, and an increased willingness of consumers to take on debt (see chart 4). Related impairments rose sharply in 2005 and further still in 2006. Encouragingly, indications by the banks that this issue would start to moderate were borne out in the latter half of 2007. This timing was quite fortuitous given the credit problems elsewhere. Over the past three years, U.K. banks have adopted a more conservative approach to consumer credit, which should leave them a little better positioned if the U.K. economy does slip into recession.

Chart 4



Source: Company accounts.

To date, impairments on lending secured on property are not material. Losses remain negligible on residential mortgages, but we note that mortgage debt represents about 85% of total household debt (or £1.2 trillion). There are differences between the U.S. mortgage experience and that of the U.K. (for example, U.K. rate rises were less severe, house price inflation was more resilient to date, the subprime market was proportionately smaller, relaxation in lending standards was less marked, and key supply and demand fundamentals were pertinent to the U.K.). On closer inspection, however, the differences should not be exaggerated. Mortgage arrears and properties in possession are rising from cyclical lows. Losses relating to commercial real estate are also small, but U.K. banks do have large property and construction exposures, and these loan books have grown quickly in recent years. Cash flows to service debt remain healthy, but recent declines in commercial property valuations have been marked.

Segmental Reporting Highlights Benefits Of Diversification

Ratings on the major U.K. banks benefit from the diversified nature of their earnings. Although divisional reporting is not directly comparable, it provides a useful indication of overall performance drivers (see table 3). The obvious areas of weakness in 2007 came from capital markets activities (after a strong first half), but this was partly compensated by surprisingly resilient U.K. performance (both corporate and retail banking). Standard & Poor's notes, however, that the outlook for most business segments could be weak, with the exception of Asian banking, which only applies in a material sense to HSBC, and that expected weaknesses in capital markets and U.K. banking could prove lingering.

Table 3

Segmental Reporting Of Earnings (As Reported)

(Mil. £)	*2007	2006	(% change)
Barclays PLC			
U.K. Banking	2,653	2,546	4
o/w U.K. Retail Banking	1,282	1,181	9
o/w Barclays Commercial Bank	1,371	1,365	0
Barclaycard	540	458	18
International Retail and Commercial Banking	935	1,216	(23)
o/w International Retail and Commercial Banking--ex Absa	246	518	(53)
o/w International Retail and Commercial Banking--Absa	689	698	(1)
Barclays Capital	2,335	2,216	5
Barclays Global Investors	734	714	3
Barclays Wealth	307	245	25
Head office functions and other operations	(428)	(259)	65
Profit before tax	7,076	7,136	(1)
HBOS PLC			
Retail	2,049	2,364	(13)
Corporate	2,320	1,776	31
Insurance and Investment	644	581	11
International	757	617	23
Treasury and Asset Management	275	350	(21)
Group items	(337)	(241)	40
Drive	-	90	N.M.
Group underlying profit before tax	5,708	5,537	3
HSBC Holdings PLC¶ ($)			
Personal Financial Services	5,900	9,457	(38)
Commercial Banking	7,145	5,997	19
Global Banking and Markets	6,121	5,806	5
Private Banking	1,511	1,214	24
Other	3,535	(388)	N.M.
Profit before tax	24,212	22,086	10
Lloyds TSB Group PLC			
U.K. Retail Banking	1,732	1,549	12
Insurance and Investments	1,035	1,034	0
Wholesale and International Banking	1,822	1,640	11
Central group items	(382)	(324)	18
Insurance gross up§	(207)	349	N.M.

Table 3

Segmental Reporting Of Earnings (As Reported)(cont.)			
Profit before tax	4,000	4,248	(6)
The Royal Bank of Scotland Group PLC			
Corporate Markets	5,648	5,541	2
o/w Global Banking & Markets	3,687	3,779	(2)
o/w UK Corporate Banking	1,961	1,762	11
Retail Markets	2,883	2,568	12
o/w Retail	2,470	2,250	10
o/w Wealth Management	413	318	30
Ulster Bank	513	421	22
Citizens	1,323	1,582	(16)
RBS Insurance	683	749	(9)
ABN AMRO	128	-	N.M.
Central Items	(896)	(1,447)	(38)
Group operating profit**	10,282	9,414	9

*Based on preliminary data except for HSBC Holdings PLC, which is based on audited final results. ¶HSBC Holdings PLC results are expressed in U.S. dollars. §Attributable to the policyholders of the group's long-term assurance funds. **Profit before amortization of purchased intangible assets and integration costs. N.M.--Not meaningful.

Last year was very much one of two halves for capital markets activities. These activities are most prominent for Barclays and RBSG (and in the latter case will increase further in importance as a result of its acquisition of ABN AMRO's global wholesale business). Barclays Capital's pretax profit fell to £675 million in the second half of 2007, down 59% from £1.6 billion in the first half. Operating profit at RBSG's Global Banking and Markets division was down 30% to £1,517 million from £2,170 million in the first half. Standard & Poor's notes that both of these businesses demonstrate good diversity by income and geography. Some of the potential uncertainties for these and other banks include the outlook for their structured products businesses and investment portfolios; pressures for cost flexibility and restructuring; sluggish conditions in the leveraged finance market; and the potential for higher litigation charges. In addition, we also expect reduced income from principal investments, which provided a useful boost to 2007 earnings. Markdowns on credit market assets were lower than at many overseas investment banks; this may be justified, but we do expect further markdowns in 2008.

U.K. retail and commercial banking earnings proved quite resilient in 2007. All of the major banks, with the exception of HBOS PLC, recorded useful growth. (HSBC, for whom the U.K. represents just less than one-quarter of group profits stated that profit before tax in the U.K. rose by 21% in 2007). The resilient performance was driven by satisfactory income growth, good cost control, and reduced consumer credit loan loss impairments. Strong growth in retail deposits was also a feature. Weaker results in HBOS' Retail Division reflected a rise in impairments on unsecured loans, but also a slight fall in net interest income as a result of mortgage margin compression and the impact of its greater relative reliance upon wholesale funding. We expect income growth to be challenged by the marked reduction in mortgage loan growth--although banks have been widening mortgage spreads--while corporate lending will be affected by lower commercial property-related transactions. As discussed earlier, there is the potential for loan loss impairments to deteriorate quickly.

Wealth management was a strong performer in 2007, much as it had been in 2006. However, its relative contribution to earnings is and will remain fairly modest. Significant overseas investment by several of the banks indicates that they see wealth management as one of the growth drivers, but weak investment market conditions may temper some of this sales growth versus plan. General insurance earnings were lower in 2007, largely as a result of claims related to the severe floods in the U.K. during the middle of the year.

Accounting Issues

The accounting classification of financial assets determines how, where, and when the write-downs are reported in the banks' financial statements. For example, the figures stated above mainly relate to write-downs against revenue on financial assets that are fair valued through the income statement (see table 2). The write-downs represent a point-in-time valuation at year-end. It seems quite possible that the reduction in valuation of asset-backed securities, collateralized debt obligation, subprime assets, and the deterioration in monolines' financial standing since the year-end will result in further write-downs in 2008.

Additionally, some banks recorded significant write-downs directly through equity on available-for-sale (AFS) assets. Reported fair-value losses (gross of tax) on AFS assets amounted to £727 million for HBOS, £638 million for HSBC, and £590 million for Lloyds TSB, respectively (data are not available for Barclays and RBSG). If current market conditions continue, some of these losses may ultimately be deemed impaired and will be transferred to the income statement and reported as impairment. Banks are comfortable that there is no reason to consider them impaired at end-2007. For equity instruments, a significant or prolonged decline in fair value of an investment below its cost would provide evidence of impairment. For AFS debt instruments, impairment will potentially be influenced less by current fair values, with a greater emphasis on the recovery of value through future cash flows. This may be particularly important in cases where the current fair values are significantly weakened by issues other than credit, such as liquidity and spreads.

The exposures that have resulted in the write-downs are summarized in table 4. The majority of these exposures are fair valued either through profit or loss, or directly in equity. These exposures are predominantly illiquid and hard-to-value assets, and are typically fair valued with significant unobservable inputs. The percentage of trading assets of U.K. banks that were fair valued using significant unobservable inputs were 9.9% for HBOS, 4.6% for Barclays, 3.8% for RBSG, and 3.1% for HSBC (data are not available for Lloyds TSB).

As a result of widening spreads in the current market conditions, major U.K. banks that opted for the fair-value option of their own debt, reported significant gains in their income statements. The gains amounted to £1.5 billion for HSBC, £658 million for Barclays, and £275 million for RBSG. In contrast, HBOS and Lloyds TSB Group PLC do not fair value their own debt. As an aside, the widening spreads on 'AA' rated corporate bonds also had a notable effect on the valuation of defined-benefit pension schemes of the major U.K. banks. This resulted in significant actuarial gains in their 2007 financial statements, which boosted their shareholders' funds. This benefit would be greater for the banks that have not adopted the corridor method of pension accounting.

Table 4

Subprime And Other Exposures At Year-End 2007

(Mil. £)

	Net ABS CDO exposure	Other U.S. subprime	Alt-A	Monoline insurers	CMBS, commercial mortgages	Leveraged finance
Barclays PLC	4,671	5,037	4,916	1,335	12,399	7,368
HBOS PLC	329	105	7,097	551	3300	N.A.

Table 4

Subprime And Other Exposures At Year-End 2007(cont.)						
HSBC Holdings PLC	279	3,674	N.M.*	602	N.A.	4,432
Lloyds TSB Group PLC	130	N.A.	619	155	1,355	N.A.
Royal Bank of Scotland Group PLC	3,834	1,292	2,233	2,547	8,808	8,698

*HSBC's exposure to Alt-A is through its direct lending in the U.S. and amounts to less than £150 million. Royal Bank of Scotland Group PLC includes consolidated figures of ABN AMRO at year end. ABS--Asset-backed securities. CDOs--Collaterized debt obligations. CMBS--Commercial mortgage-backed securities. N.A.--Not available. N.M.--Not meaningful.

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December 19, 2007

Bank Industry Risk Analysis: U.K. Banks Are Charting More Turbulent Waters

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Bank Industry Risk Analysis: U.K. Banks Are Charting More Turbulent Waters

Major Rating Factors

Strengths:

- A solid track record of strong profitability, underpinned by good efficiency
- Solid and consistent banking market shares
- Generally strong risk management
- Diversity of revenues, both by business line and geographically

Weaknesses:

- Highly indebted household sector under increased affordability pressures, leading to rising retail impairment charges
- Adverse funding conditions
- Cyclically weaker prospects for the economy and the mortgage market
- Relatively weak capitalization
- Reputational damage to the sector from the bailout of Northern Rock PLC
- Increased regulatory scrutiny of retail banking

Executive Summary

Following years of profitable growth, the U.K. banking sector has faced an exceptionally demanding market environment in the second half of 2007. While funding conditions are expected to improve in 2008, the year will bring additional challenges. Standard & Poor's Ratings Services' stable outlooks on most of our U.K. bank ratings reflect our expectation that the industry will show a high resilience overall and will continue to be supported by broadly favorable economic conditions. These expectations are, however, dependent on the magnitude and duration of current market dislocation. If market conditions deteriorate further or if economic prospects weaken materially, U.K. bank ratings could be exposed to broader downward pressures.

U.K. banks have gone into this difficult period relatively well placed. Standard & Poor's considers the U.K. banking system to be one of the strongest in the world. It operates within solid economic, accounting, and legal frameworks, all of which are supportive of its fundamental strength. In addition, profitability has been strong and while some of the larger banks in particular are now having to cope with unexpected balance sheet expansion--due to longer warehousing of risk and funding off balance sheet commitments--the impact appears manageable.

Asset quality for U.K. banks continues to be strong, which reflects the combination of a benign credit environment in recent years and improvements in risk management. However, U.K. household indebtedness is high by any standard, and there is clear evidence that the credit cycle has turned. To date, financial stress has been felt hardest in the most vulnerable segments and credit quality remains almost universally sound outside of the unsecured lending portfolios. However, household finances continue to be squeezed and many mortgage borrowers will also experience a degree of payment shock, even though base rates appear to have peaked. We continue to expect any deterioration in asset quality to be moderate in the absence of a severe weakening in the macroeconomic environment. However, if tighter credit conditions start to materially affect the broader economy, leading to a significant rise in unemployment, credit-quality deterioration could be much more rapid and property values could also be expected to decline sharply.

Profitability for U.K. banks is expected to remain satisfactory; the highest rated being underpinned by their diversity both by business line and geography, coupled with consistent efficiency measures. While retail banking is not going to become a low profitability business, it will typically become a less profitable one in 2008 due to significantly weaker revenue growth prospects and the ongoing constraints from the current funding conditions. The associated margin impact should be offset to a significant degree by margin expansion on lending. Higher loan loss provisions, albeit from a low base, are also expected to impact profitability further.

Despite strong profitability, U.K. banks' capitalization has remained quite weak in the past few years as a result of share buybacks and acquisitions. Standard & Poor's preferred measures of capital strength have diverged from regulatory ratios, and U.K. banks now compare unfavorably in this respect with those of many other banking systems. Nevertheless, the comfortable profit margins of most U.K. banks provide good capacity to withstand all but the most extreme loss rates without eroding capital.

Outlooks on U.K. banks are predominantly stable, reflecting Standard & Poor's view that the banks are typically well positioned to cope with current market conditions and a more widespread economic downturn, while maintaining sound financial performance. However, some banks will be more vulnerable to earnings pressures or to deteriorating asset quality. Downgrades may occur if banks do not meet Standard & Poor's expectations of earnings resilience and risk management capabilities. Positive ratings actions are less likely and would need to be based on clear evidence of banks' superior ability to withstand any cyclical downturn, combined with demonstrated improvements in their business mix and franchise, as well as superior risk management.

Economic Risk

Macroeconomic background

With nominal GDP of £1.3 trillion (see table 1), the U.K. is one of the largest economies in the world. It has relatively high average wealth, as demonstrated by per capita GDP of about $45,000, which is in line with its European 'AAA'-rated peers. It has a well-developed and diversified economy, underpinned by flexible and competitive markets, proven ability to attract inward investment, and a relatively strong resilience to external shocks. Historically, it has experienced periods of economic volatility, but the establishment of a credible monetary policy via the now-independent Bank of England (BoE) has promoted greater stability.

Table 1

U.K. Economic And Financial Indicators

	2009f	2008f	2007f	2006	2005	2004	2003
GDP nominal (bil. £)	1,494	1,433	1,375	1,302	1,234	1,184	1,118
GDP per capita ($)	47,683	46,857	45,177	39,831	37,304	36,267	30,709
Real GDP (% change)	2.2	2.1	3.1	2.8	1.8	3.3	2.8
Trade balance (bil.$)	(6.0)	(5.9)	(5.8)	(5.9)	(5.6)	(5.1)	(4.3)
General government balance (% of GDP)	(2.7)	(2.8)	(2.8)	(2.7)	(3.3)	(3.4)	(3.5)
General government debt (% of GDP)	46.3	45.5	44.5	43.9	42.8	39.4	39.3
CPI inflation (average % change)	2.0	2.1	2.4	2.3	2.0	1.3	1.4

Table 1

U.K. Economic And Financial Indicators(cont.)							
Unemployment (% of workforce)	5.1	5.2	5.3	5.4	4.7	4.8	5.00
Domestic credit to private sector and NFPEs (% of GDP)	213.9	201.8	187.1	174.9	162.8	153.7	146.3
Monetary aggregate growth (%)	11.8	11.2	10.4	12.7	12.7	9.1	7.2

Source: Standard & Poor's Sovereign Database. f--Forecast. NPFEs--Nonfinancial public enterprises.

Strong and sustained economic growth to slow

The U.K.'s relative economic performance has undergone a remarkable period of expansion in recent years, as demonstrated by 61 successive quarters of increases in output to the third quarter of 2007. After average GDP growth of 2.5% over 2001-2004, the economy slowed to 1.8% in 2005 before rebounding to 2.8% in 2006, thanks to a recovery in consumer demand and a still expansive fiscal policy. Growth has remained close to 3% in 2007, but is expected to fall back to about 2.0% in 2008 and 2009 in the light of the acute deterioration in market conditions in the second half of 2007 and the wealth effects related to the significant slowdown in the housing market.

Consumer spending has been the mainstay of economic growth, supported by real wage increases, continuing low unemployment and, to a limited extent, releases of capital in the form of home equity withdrawal. However, household finances have been steadily stretched over the past few years by higher debt servicing costs--a product of borrowing on higher income multiples and the tightening cycle of interest rates. December's 25 basis point (bp) rate cut should help some mortgage borrowers, although how much of this will be passed on is unclear as banks are seeking to expand margins. However, many other borrowers will suffer a degree of payment shock as their low, fixed-rate deals start to reset. Consumers' ability to spend is likely to be further impinged by rising energy and food prices in 2008, although this is not to say that the U.K. consumer is about to fall out of love with shopping. Standard & Poor's expects consumer demand to increase by 1.8% in 2008, compared with 2.8% in 2007. However, there is downside risk to this projection. If the credit squeeze is prolonged and it infects the wider economy, the knock-on effects for first consumer confidence and then employment could be expected to lead to a sharper slowdown. (For more information, see "European Economic Forecast: Downside Risks Dampen The Outlook For Growth In Europe," published on Oct. 2, 2007, on RatingsDirect.)

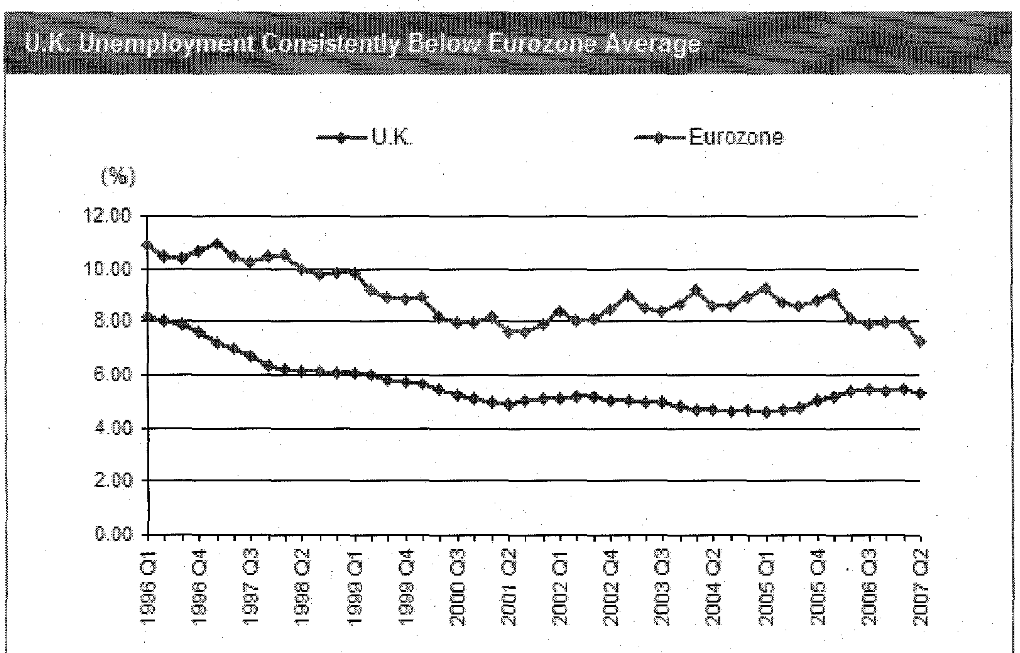
In the public sector, the government's expansionary fiscal policy continues to support near-term growth, particularly in employment. The U.K. has recorded the highest increase in government spending as a proportion of GDP in the OECD since 2000, with government debt set to reach 44.5% of GDP in 2007--although this is still some way below the Eurozone average. Government spending is expected to level off, with the current-account deficit remaining just less than 3% of GDP in the medium term.

In the corporate sector, investment activity has continued its steady revival following a weak period in 2003-2004. Increased investment has largely been focused on improving productivity and reducing energy consumption to support cost competitiveness. The corporate sector remains relatively profitable due to a combination of higher interest income and increased property income receipts. Corporate sector debt remains high, however, despite the sector surplus of recent years, and the commercial property market has started to soften.

Unemployment relatively low and stable

The U.K.'s labor market is one of the most flexible in Western Europe, and continues to expand as a result of strong migrant labor inflows from the newer EU member states. Even so, robust job growth in recent years has led to a tighter labor market and above inflation rises in wages. However, while unemployment remains well below the average for the Eurozone at 5.3% and there is no immediate prospect of a material deterioration, there are prospective signs of weakening due to slower economic growth, weaker corporate earnings prospects, and a gradual refocusing on public sector efficiency (see chart 1).

Chart 1



Source: European Central Bank.

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Monetary Policy Committee being pulled in opposite directions

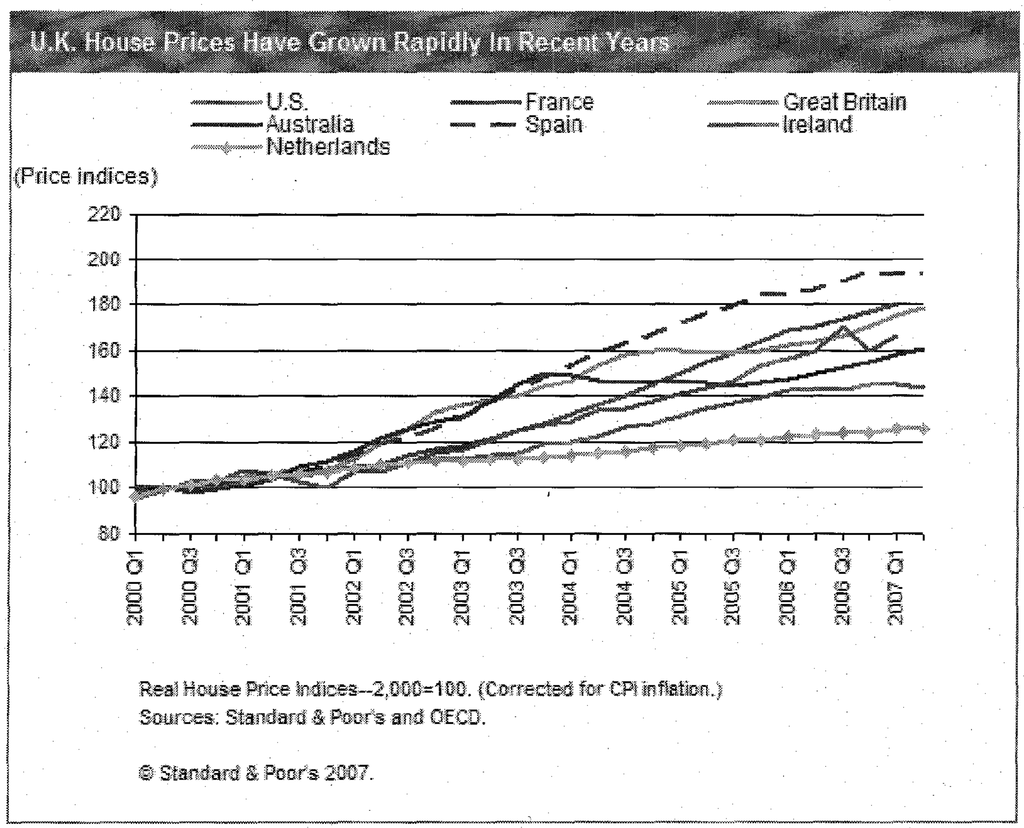
Since 1997, sole responsibility for inflation and interest rate policy has been with the Monetary Policy Committee (MPC) of the BoE, which targets 12-month consumer price (CPI) growth of 2.0%. While rising base rates have led to a fall in CPI from its recent peak of 3.1% in April 2007 to 2.1% in October, inflationary pressures from higher energy and food prices remain.

The BoE has established a credible record for price control and inflation targeting in the past decade, but must now weigh up the conflicting pressures of still evident inflationary pressures and a credit crisis that, if left unchecked, could lead to a much more rapid slowdown in the economy. This is arguably leading to one of the toughest periods of decision-making for the MPC since it was set up. While clearly still concerned about inflationary pressures, the MPC voted for a 25 bp cut on Dec. 6, 2007, reducing the BoE's base rate to 5.5%. Standard & Poor's expects the rate to be cut by a further 50 bps through the first half of 2008.

House price growth has peaked

Since 1995, the U.K. housing market has seen some of the fastest price growth of all developed economies (see chart 2). Following a relative slowdown in house price inflation in 2005, prices rose again in 2006 and early 2007, with the annual rate of house price inflation touching 10%. This follows a long-established trend of house prices rising faster than incomes, leading to lower affordability and, when combined with the interest rate rises, rising debt service costs. Indeed, mortgage lenders' accommodating stance--through longer repayment periods, higher income multiples, and the development of products for less creditworthy borrowers--has been a supporting pillar of the continued demand. Further stimulus has come from the buy-to-let (BTL) market, which has picked up the slack as first-time buyers have increasingly been priced out of the market and instead continued to rent. BTL accounted for 10% of outstanding balances at end-June 2007, from 3% five years ago.

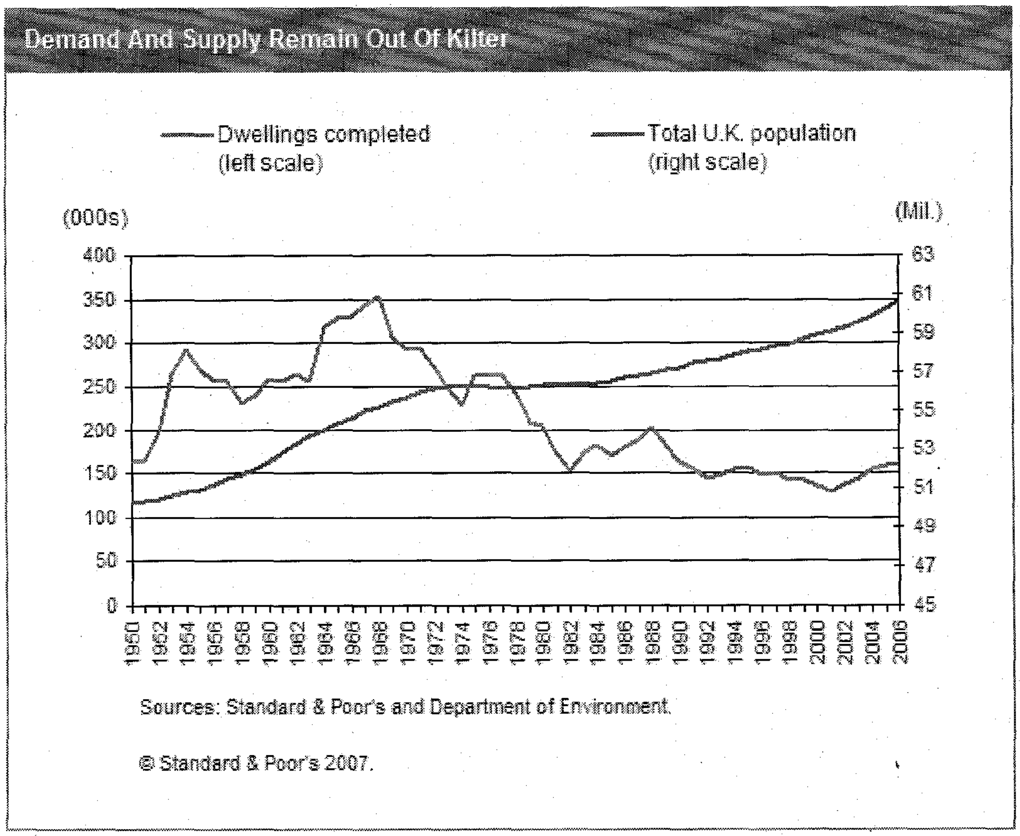
Chart 2



Since mid 2007, the market appears to have turned and sales activity has eased considerably--new mortgage approvals in September were 30% down year on year and property values have started falling on some measures. This appears to be reflective of affordability constraints taking an even tighter grip and, latterly, a fall in consumer confidence and the supply of credit.

Standard & Poor's expects annual house price inflation to continue to diminish fairly rapidly in the coming months, but that the market will experience a soft landing overall. Further modest reductions in interest rates will provide support to house prices, as will the long-term fundamental imbalance that persists in many areas of the country between the supply of new houses and the demand for housing (see chart 3). In addition, the BTL market, which has primarily relied for yield on returns from capital growth, is now receiving some greater support from rising rents in many areas.

Chart 3



Nevertheless, there is significant downside risk to that prediction if credit supply is further constrained, the economy slows more markedly than we anticipate or confidence evaporates. For now, sellers are sitting on their hands, but a significant rise in unemployment would further reduce demand and, additionally, could prompt a glut of supply at depressed prices if arrears lead to a material rise in repossessions. This would be exacerbated if property investors start to cash in their chips--about 30% of properties are not owner occupied. This is not our central forecast, however.

Generally low systemic risk

Overall, the U.K.'s systemic risk is relatively low, given its strong political system and economic maturity. The following structural vulnerabilities exist, however:

- Low savings ratio. Household savings have deteriorated steadily in the past decade as the consumer spending boom took hold. In the second quarter of 2007, the savings ratio fell to a 40-year low of 2.0%. While weaker economic prospects and slower wage growth can be expected to curtail household spending, the savings ratio is likely to remain below its long-term average of 7.0% in the medium term.
- High U.K. household sector indebtedness in relation to income. Although in general, household balance sheets look reasonably strong, there are signs of stress among a minority of households, with personal insolvencies rising sharply, particularly among nonhomeowners. Household finances are expected to be squeezed further in 2008, but debt levels would only become a cause for systemic concern in the event of a severe economic downturn.

- Exchange-rate volatility. The openness of the U.K.'s economy and its role as a trading nation make it vulnerable to changes in its exchange rate. Increased economic predictability has led to greater exchange-rate stability, but it remains sensitive to the changing relative fortunes of the U.S. and the Eurozone. The weak dollar is making U.K. exports increasingly uncompetitive.
- Twin deficits. The U.K. has run a trade deficit of about 3% of GDP since mid 2005. This raises some sustainability issues, partially offset by the country's substantial "invisible earnings," achieved in part via London's role as an international financial center. The regular fiscal deficit of about 3% of GDP against a backdrop of strong economic growth implies a structural deterioration in public finances. However, while it would mark a break with current policy, the moderate stock of government debt (44% of GDP) does afford the government some latitude to provide additional fiscal stimulus in the event of a sustained economic downturn.

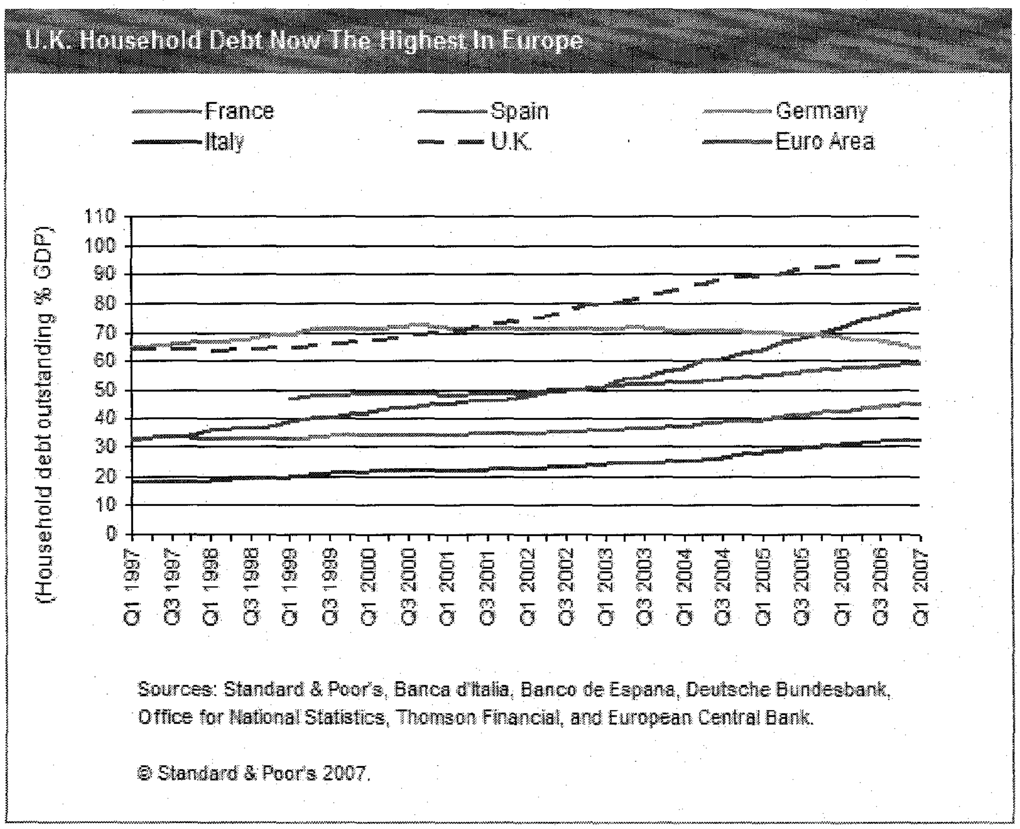
We continue to expect any deterioration to be moderate, in the absence of a severe weakening in the macroeconomic environment. However, if tighter credit conditions start to materially impact the broader economy, leading to a significant rise in unemployment, credit-quality deterioration could be much more rapid.

Household consumer debt has risen sharply

The rapid accumulation of debt and exposure of a large proportion of U.K. households to changes in borrowing rates suggest that the personal sector is more vulnerable to an economic shock than in many other countries. In addition, the development of the BTL and the subprime lending markets in recent years has increased uncertainty about asset quality in the event of a downturn.

U.K. consumer debt has risen sharply in the past decade as households responded to the low cost of borrowing, strong earnings growth, rising house prices, and greater job security. This trend is evidenced by the deteriorating savings ratio, which mirrors that in the U.S. The result is that household debt in the U.K. now stands at 97% of GDP, making it the highest in Europe (see chart 4). Although household wealth has also risen sharply over the period, this is attributable principally to the rising value of a large and relatively illiquid asset--housing. Although the value of housing stock exceeds that of mortgage debt by more than 3x, the U.K. household sector is in a net borrowing position, which means that total debt exceeds total savings.

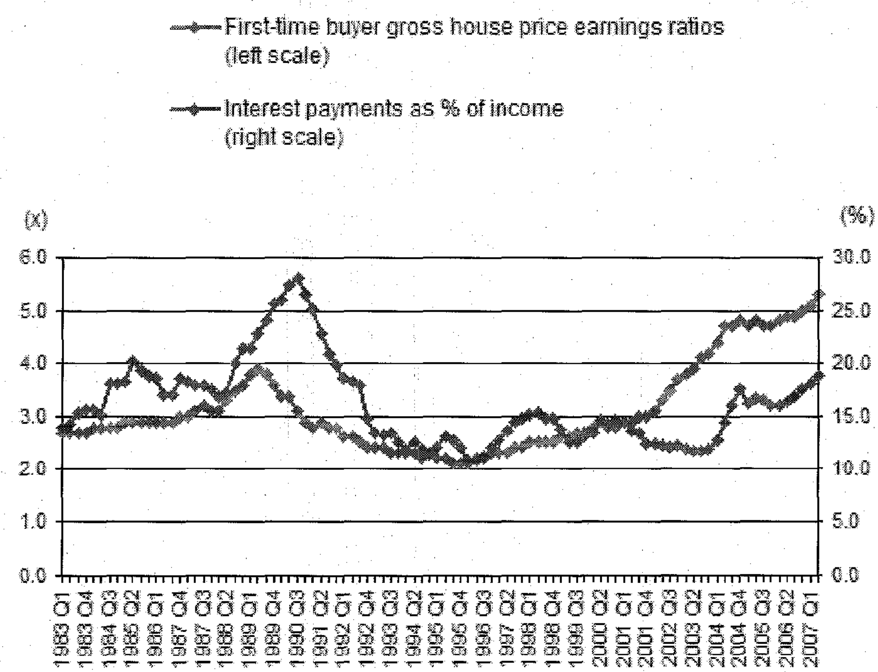
Chart 4



However, despite the rises in interest rates and the quantum of debt, debt-servicing costs have remained moderate by historical standards, suggesting that increased debt for the population at large has been manageable (see chart 5). Indeed, U.K. bank mortgage arrears, while rising, remain low by historical standards.

Chart 5

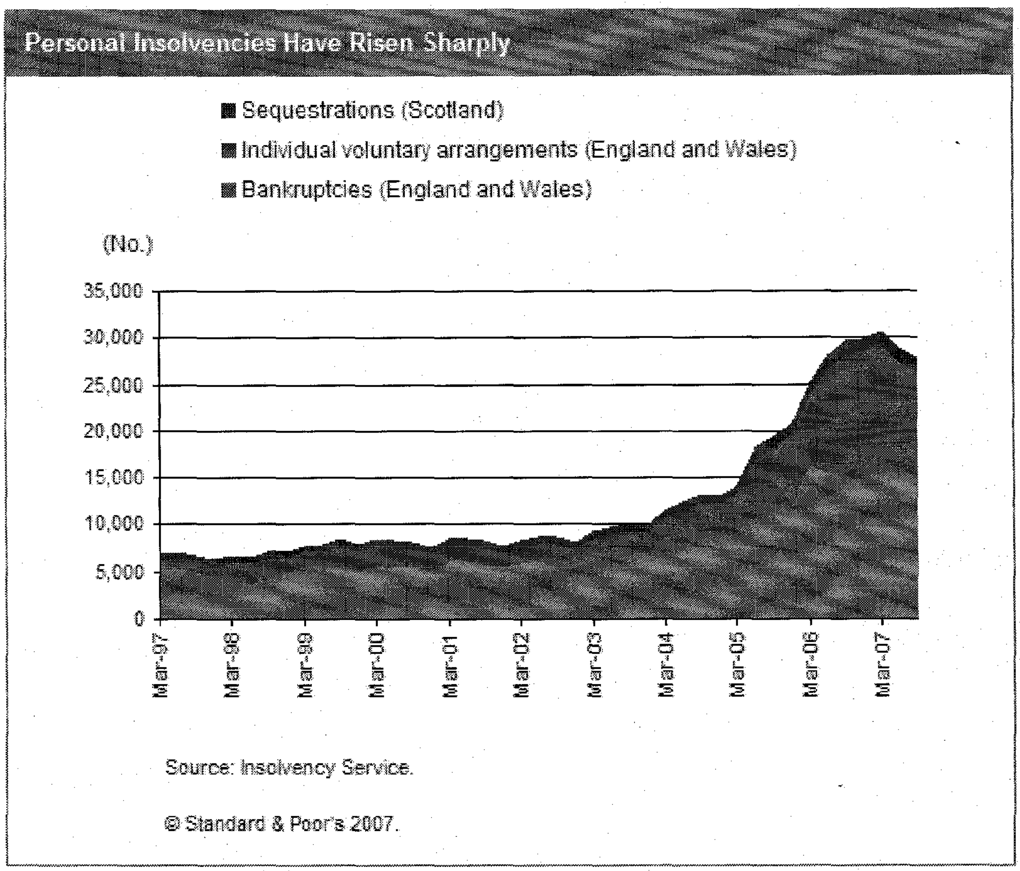
Average Debt Servicing Costs At Their Highest Since 1991



Sources: Standard & Poor's, Royal Institute of Chartered Surveyors, and Council of Mortgage Lenders.

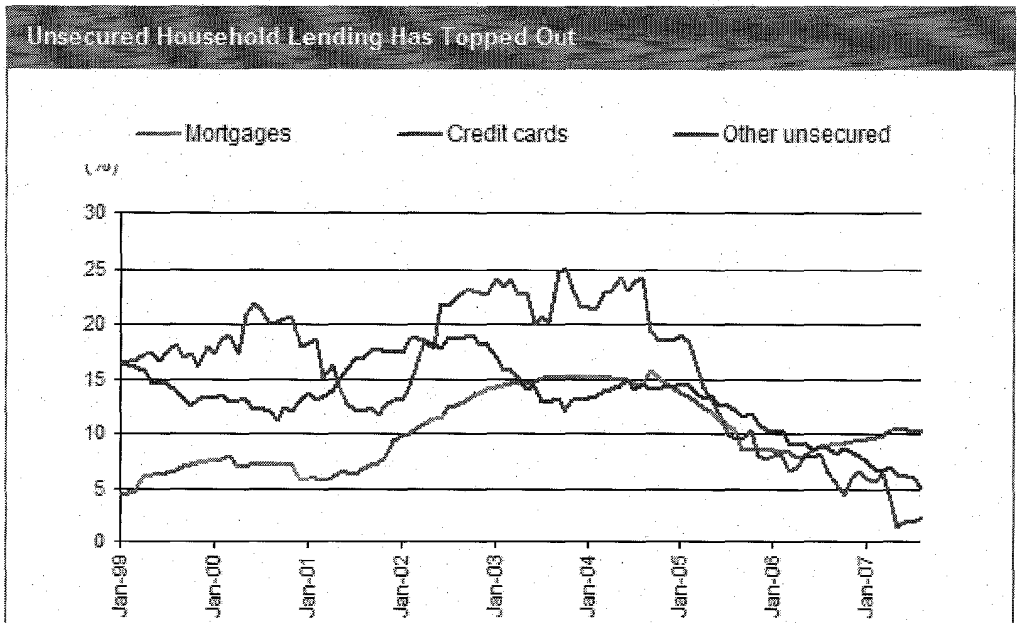
However, while "average" households have been able to continue to service their debts, there is considerable variance around this mean. For the past few years, a rising number of the most highly leveraged borrowers have been struggling with repayments, indicated by the increase in personal insolvencies, which doubled between March 2005 and March 2007. While this is in part the impact that rising interest rates have had on affordability, the trend can also be attributed to other factors. These include new legislation allowing individuals to declare themselves insolvent with fewer repercussions--known as Individual Voluntary Arrangements (IVAs)--the willingness of some lenders to throw credit at consumers in previous years, greater cultural acceptance of insolvency, and the rapid growth of the subprime market, which has enabled those with weak credit histories to still get mortgage finance, albeit at more punitive rates (see chart 6).

Chart 6



This trend is also apparent from banks' own data, which started to show a significant increase in the charge-off rate on unsecured lending from 2005. For instance, Barclaycard, the consumer lending arm of Barclays PLC and the largest credit card issuer in the U.K., saw impairment charges jump 38% in 2005 and a further 36% in 2006, before reducing in 2007. In response, most banks were quick to tighten scorecards, reprice their offerings, cut back unused credit facilities, and enhance their credit collection procedures. Unsecured lending has continued to grow, but at a much slower pace (see chart 7). While individual insolvencies have continued to rise, a trend that Standard & Poor's expects to continue, the pre-emptive actions and the small relative size of unsecured consumer lending as a proportion of most institutions' total lending and profits will mean that these credit losses should not impinge unduly on bank earnings.

Chart 7

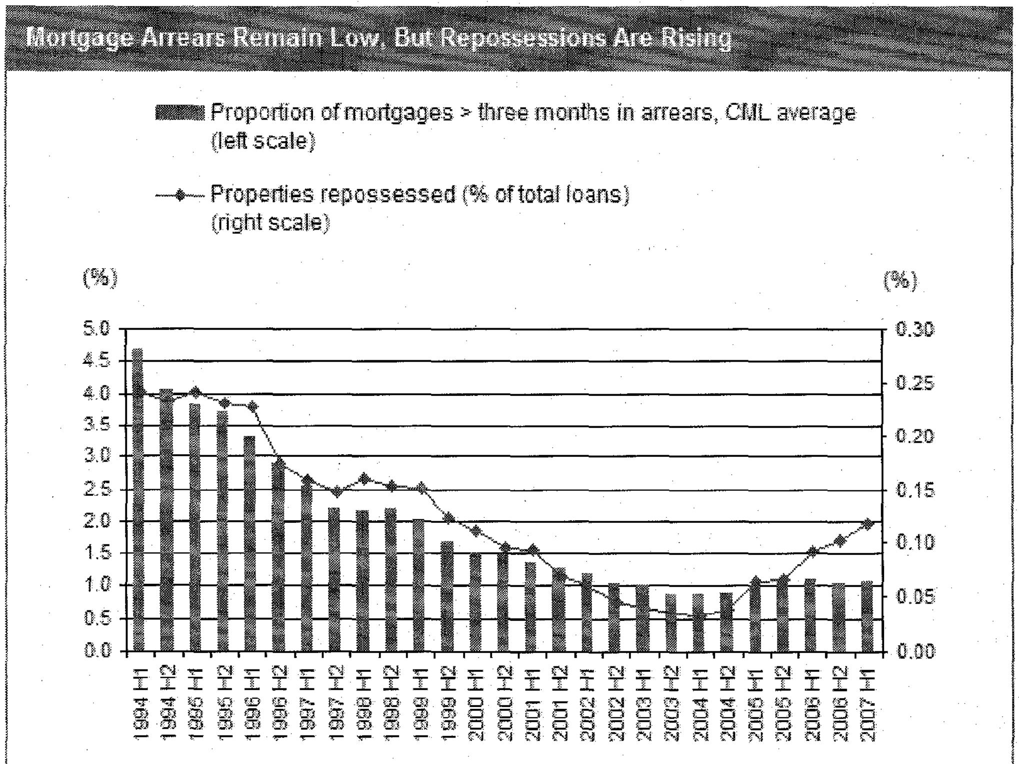


Annual growth in major U.K. banks' lending to U.K. households. Major U.K. banks are defined as: HSBC PLC, Abbey National PLC, Lloyds TSB PLC, Nationwide PLC, Northern Rock PLC, Barclays PLC, HBOS PLC, The Royal Bank of Scotland PLC, Alliance & Leicester PLC, and Bradford & Bingley PLC. Source: Bank of England.

The third quarter of 2007 saw a marked slowdown in the growth in personal insolvencies. However, the reduction in IVAs appears at odds with the underlying pressures on household finances, the continuing rise in bankruptcy orders, and reports from the Citizens Advice Bureau that it dealt with a record 1.7 million debt problems during the past 12 months, an increase of 20% on the previous year. Rather than signaling an improvement in the situation, it appears more likely that the reduction is mainly attributable to the dispute between the IVA practitioners and the banks, who accuse the former of charging too much. This could be resulting in a stockpiling of IVA cases, which will work their way through the system over the coming year.

To date, the adverse experience in the consumer credit market has not been echoed in mortgage lending, which accounts for more than 80% of outstanding consumer debt. Although mortgage arrears have started to creep up since 2005, the overall picture remains relatively benign, with only 1.06% of all mortgage loans more than three months in arrears, slightly higher than the 20-year low reached in mid 2004 (see chart 8). Repossessions have followed a similar path, but are now on a more pronounced upward trend. This is indicative of the softening property market--until recently rising property prices made forced sales a more attractive option for both banks and borrowers.

Chart 8



CML--Council of Mortgage Lenders. Source: Standard & Poor's and Council of Mortgage Lenders.

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For overall U.K. household credit quality, an unlikely, but wholly plausible scenario would involve a combination of significantly increased interest rates at the same time as a sharp rise in unemployment and a sharp fall in house prices. This combination of circumstances would represent a profound shock for the household sector, given its leverage, with significant second-order effects on the broader economy. It would also lead to a material rise in arrears and credit losses on mortgage books. Most lenders stress test their lending portfolios based on such a scenario, which essentially follows the pattern of the recession in the early 1990s.

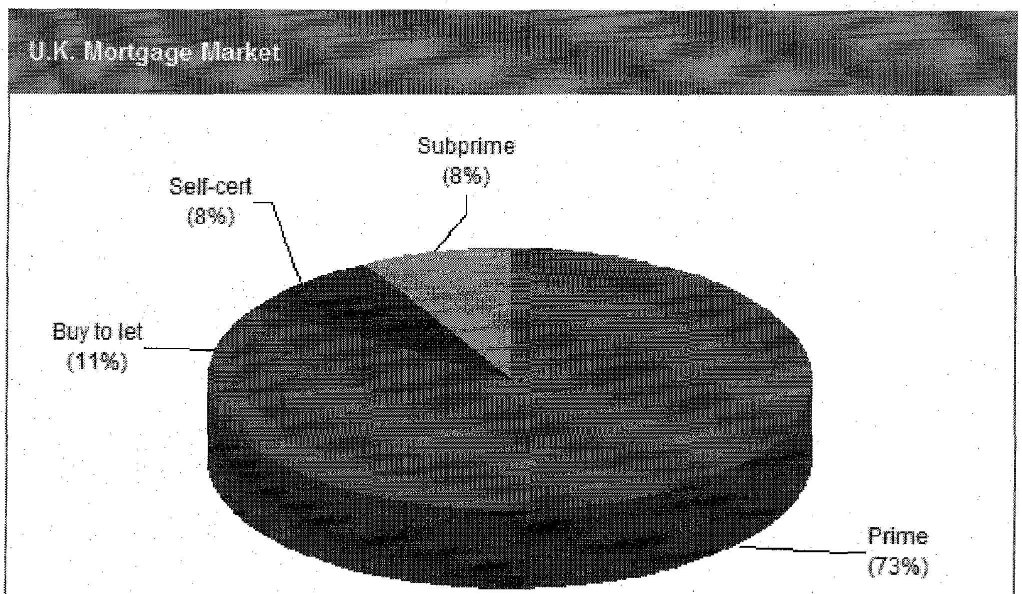
Borrowing costs have increased in recent years, leading to a steady squeeze on household finances and payment shock for the estimated 1.4 million households with mortgages that are due to reset by the end of 2008, and they may not fall back despite the predicted cuts in interest rates. However, mortgage serviceability is not yet near the peaks seen in the early 1990s, and the additional factors of rapidly falling house prices and significantly rising unemployment are not yet in place.

Arrears will continue to trend higher over the coming year--the Council of Mortgage Lenders predicts that repossessions could rise to 45,000 by the end of 2008 (from 22,700 in 2006), with the number of mortgages more than three months in arrears going up by 17% to 170,000. However, even if this does occur, there would be only a modest effect on the overall credit quality of banks' prime mortgage books. Indeed, the comfortable profit margins of most U.K. banks provide good capacity to withstand all but the most extreme loss rates without eroding capital.

U.K. specialist mortgage under greater scrutiny

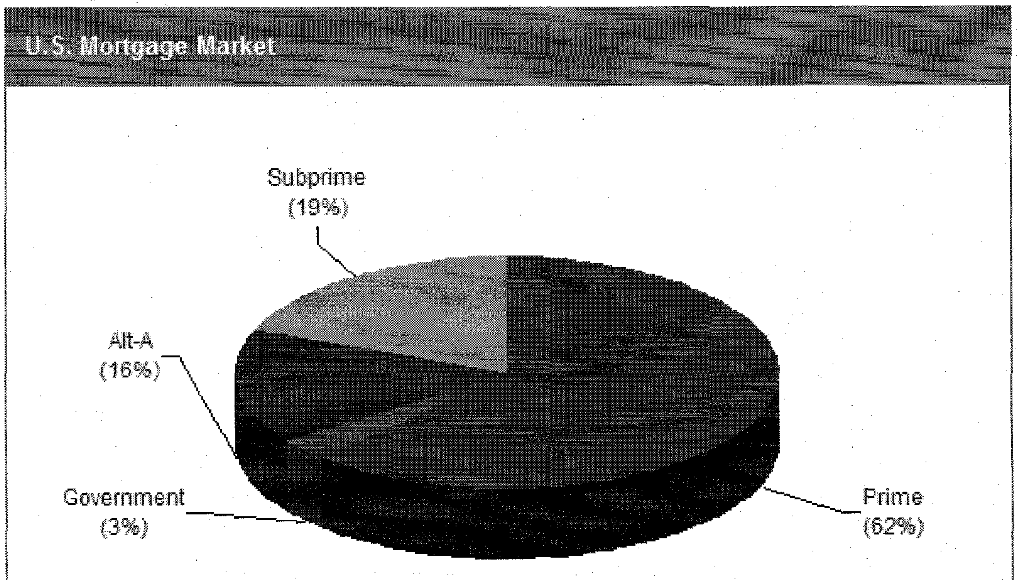
The woes of the U.S. subprime market and the more gloomy economic outlook for the U.K. have brought renewed attention to the U.K. "specialist" mortgage market, which accounts for about 27% of new lending and mainly comprises the subprime, self-certified, and BTL subsectors (see chart 9 and chart 10).

Chart 9



Source: Standard & Poor's, Council of Mortgage Lenders, and Bradford & Bingley PLC. Figures are for gross mortgage originations, 2006.

Chart 10

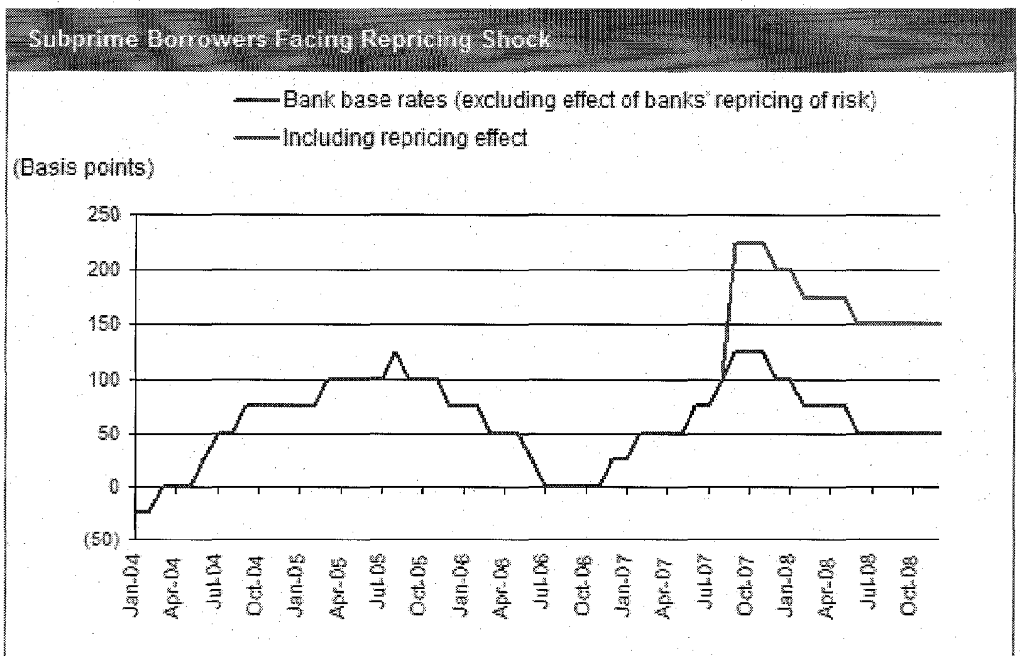


Source: Standard & Poor's, Council of Mortgage Lenders, and Bradford & Bingley PLC. Figures are for gross mortgage originations, H1 2006.

Standard & Poor's is more cautious when it comes to these subsectors as they are relatively new products and their likely performance through a downturn is uncertain. In this sense they are all rightly regarded as higher risk, a feature also reflected in their pricing. However, we do distinguish between them, noting in particular that the BTL subsector has continued to perform well, with arrears below those of the general market.

Standard & Poor's does not consider that rated U.K. mortgage lenders are as exposed as were certain U.S. lenders by the type of weaknesses that have emerged in the U.S. subprime market. This is for several reasons: the U.K. subprime market is proportionately smaller; it has a higher average credit quality as it also includes "near-prime" loans; the relaxation of lending standards in recent years has been less severe; and few U.K. rated lenders have a material exposure to the market. In addition, the fairly prescriptive regulatory regime for mortgages sales in the U.K. should mean that the U.K. market has avoided the riskier practices and apparent widespread misselling seen in the U.S. Nevertheless, there are parallels between the two markets and, while borrowers may have managed to stay afloat until now, many will experience acute payment shock, resulting from the lenders' repricing of credit in this segment and the lack of financing alternatives following the withdrawal of many products (see chart 11). Significant deterioration can therefore be expected in this segment.

Chart 11

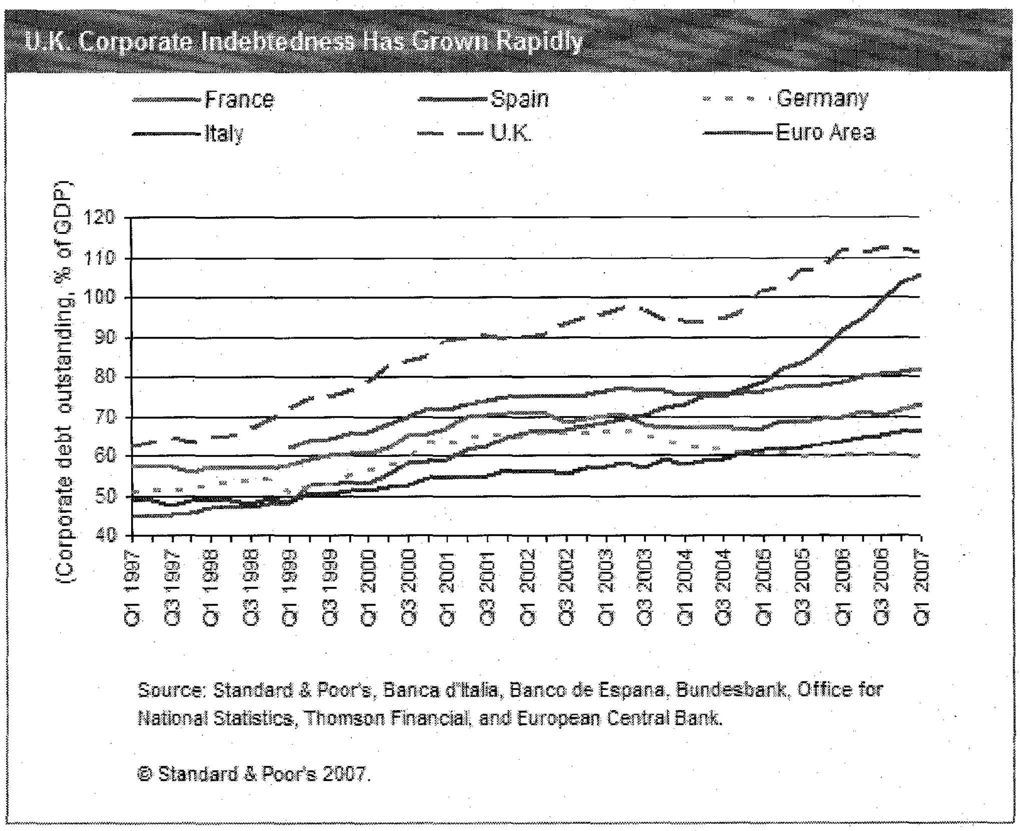


Source: Standard & Poor's and Bank of England.

Strong corporate sector profitability and asset quality

Corporate asset quality in the U.K. remains relatively sound, thanks to good profitability and cash flow. This remains the case despite the fact that capital gearing, which rose strongly in 1999-2003, remains high (see chart 12). The net debt-equity ratio of U.K. private nonfinancial companies was about 32% in the second quarter of 2007, which, while down from a peak of 36% in 2003, is almost 2x the level of the late 1990s and equivalent to levels seen in the early 1990s.

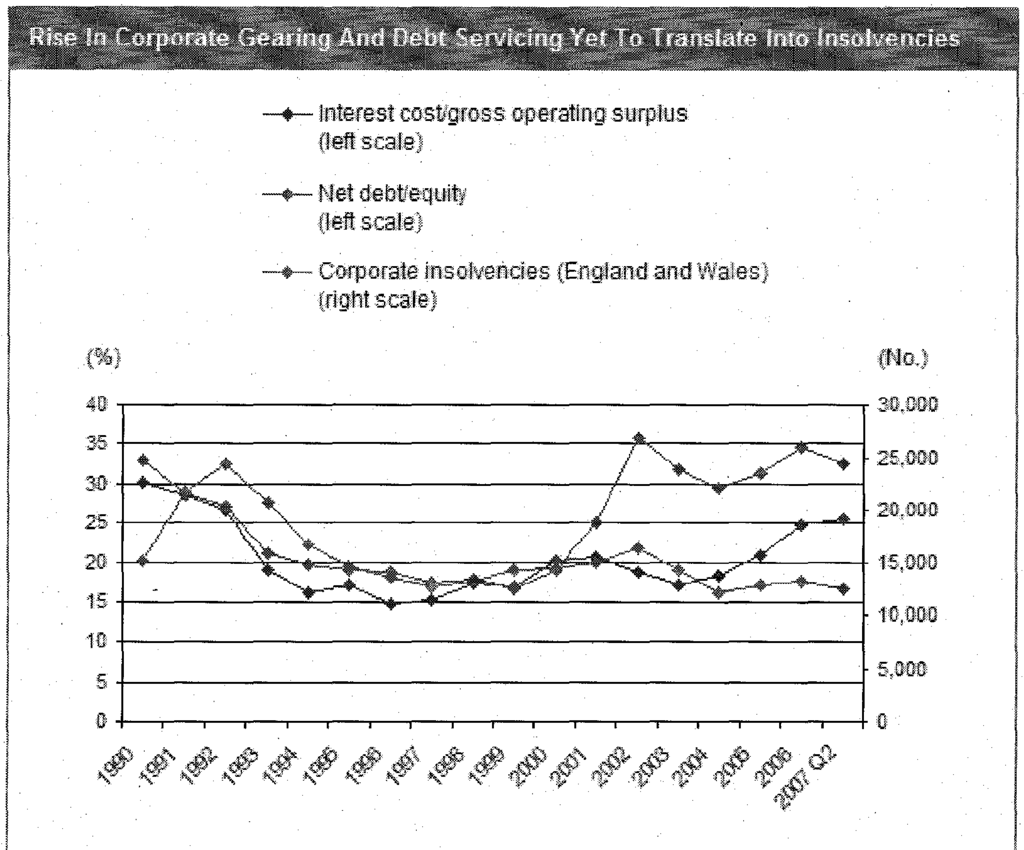
Chart 12



Source: Standard & Poor's, Banca d'Italia, Banco de Espana, Bundesbank, Office for National Statistics, Thomson Financial, and European Central Bank.

U.K. banks experienced a significant increase in corporate bad debts in 2002, but since then, general corporate credit quality has improved markedly. In contrast to households, corporate insolvencies in the second quarter of 2007 remain close to their lowest level for 20 years, although, like household finances, corporate finances have been stretched by interest rate rises--interest cost as a proportion of gross operating surplus now stands at 25%, a level last exceeded in 1992 (see chart 13). The current market dislocation will bring further discomfort as many corporate loans are referenced to three-month LIBOR, not base rates.

Chart 13



Source: Standard & Poor's, Office for National Statistics, and Insolvency Service.

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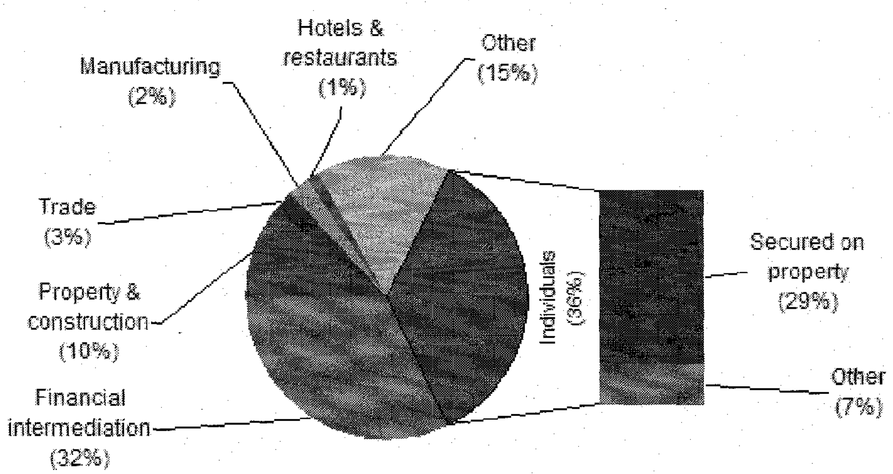
Generally speaking, risk management for corporate exposures has improved across the spectrum, with greater focus on reducing concentrated exposure to industrial sectors and individual counterparties. Nevertheless, some banks (Barclays, The Royal Bank of Scotland PLC (RBS), and HBOS PLC) have increased their involvement in the leveraged loan market in recent years and are now seeing a moderate reintermediation of credit as distribution capacity has weakened. More widely, an economic downturn, which could be hastened by a prolonged contraction in the supply of credit, could lead to a rapid increase in corporate loan-loss provisions from the current very low levels, as reduced consumer spending causes firms to restructure or downsize.

The recession of the early 1990s demonstrated the potential volatility of commercial property prices, which resulted in significant losses for many U.K. banks. Commercial property and construction remains a significant exposure for the sector as a whole and a number of institutions have grown their property books rapidly over recent years (see chart 14). Although lending practices and risk-mitigation techniques have undoubtedly improved and there is much less lending on speculative developments than in the late 1980s, a downturn in the wider economy could still lead to problems. The slowdown in the housing market could also put pressure on residential property developers, although this element of banks' loan books is relatively small.

Chart 14

Lending Remains Relatively Broadly Spread, But With Some Dependency On Property (Sept. 30, 2007)



Outstanding U.K. bank lending to U.K. residents, Q3 2007 (total is £2,062 billion).
Source: Standard & Poor's and Bank of England.

Gross problematic asset range remains manageable

For all the banking systems it analyses, Standard & Poor's estimates the potential level of gross problematic assets (GPAs), expressed as a percentage of domestic private sector credit, that could result in the 12 months following a reasonable, but severe, economic downturn. GPAs are defined as assets more than 90 days past due. In this high-probability, low-impact scenario, Standard & Poor's estimates that GPAs in the U.K. banking system could rise to 5%-15%, the lowest of six categories used. This illustrates the relative strength of the U.K. banking system, despite the potential challenges of high indebtedness.

Industry Risk

The U.K. banking system is relatively concentrated, with the largest five banks dominating the domestic lending and savings markets. This follows an extended period of demutualization and consolidation. The end of consolidation opportunities and the quest for organic growth and the arrival of new competitors have contributed to pressure on interest margins, although to date this has generally been offset by strong volume growth. Going forward, weaker economic prospects and ongoing funding constraints mean that revenue growth, particularly in retail banking, will be a key challenge for the sector. Higher loan loss provisions, albeit from a low base, will further affect profitability. All this can be expected to lead to a tightly disciplined approach to capital-efficient investment in the U.K., further focus on foreign opportunities for growth, and renewed emphasis on cost control to sustain profit. Profitability should, nevertheless, remain above that of most systems, and geographic and business line diversification should