

CREDIT OPINION

15 November 2022

Update



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RATINGS

Santander UK Group Holdings plc

Domicile	London, United Kingdom
Long Term CRR	Not Assigned
Long Term Debt	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

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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CLIENT SERVICES

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Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Santander UK Group Holdings plc

Update following rating action

Summary

We rate A1 the long-term deposit and senior debt ratings of [Santander UK plc](#) (Santander UK) and Baa1 the senior unsecured debt ratings of the group holding company [Santander UK Group Holdings plc](#) (Santander UK Group). On 25 October 2022, we affirmed Santander UK's long-term deposit, issuer rating and senior unsecured debt ratings and we changed the outlook to negative from stable.

The A1 long-term deposit and senior debt ratings of Santander UK incorporate: (1) the bank's standalone creditworthiness, reflected in its baa1 Baseline Credit Assessment (BCA); (2) limited financial and operational connections to its parent, [Banco Santander S.A.](#) (Banco Santander, A2/A2 stable, baa1), which shields Santander UK from a potential deterioration in its parent's creditworthiness; (3) very low loss-given-failure, providing two notches of uplift under our Advanced Loss Given Failure (LGF) analysis; and (4) our assessment of a moderate probability of support from the [Government of United Kingdom](#) (Aa3 negative), providing one additional notch to the ratings.

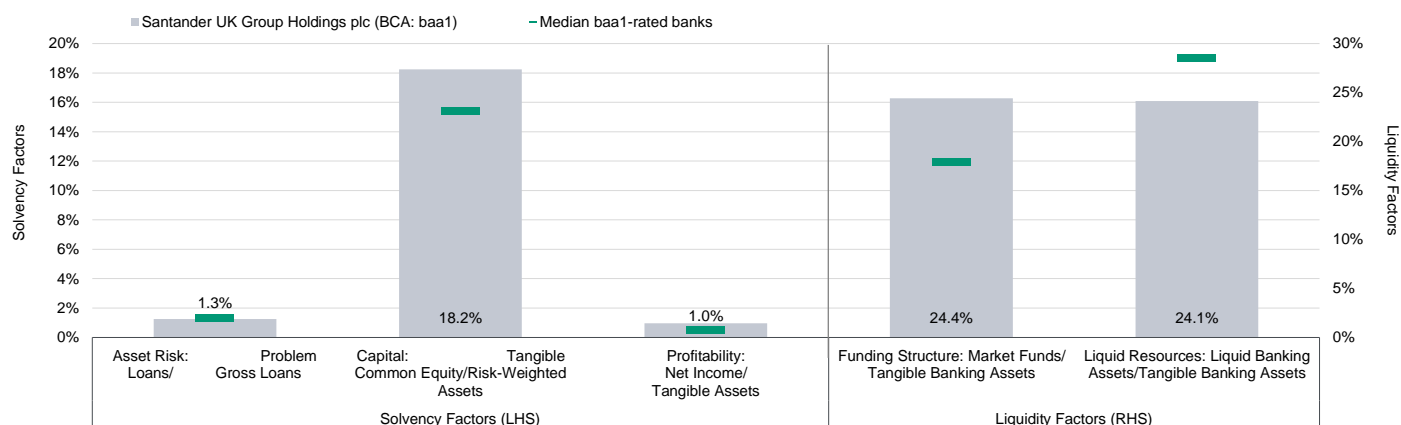
The Baa1 senior unsecured debt ratings of Santander UK Group incorporate: 1) its notional BCA of baa1 2) the instrument's moderate Advanced LGF, resulting in no uplift and 3) low probability of government support, which does not provide any uplift.

We align the ratings of the group's non-ring-fenced bank [Santander Financial Services plc](#) (SFS) with those of Santander UK, reflecting the predominance of Santander UK.

Santander UK's baa1 BCA reflects: 1) low stock of problem loans; 2) solid capitalisation; 3) improved profitability, benefiting from wider margins, healthy mortgage volumes and low credit provisions, and 4) modest business diversification in line with mortgage-focused peers, reflected in one notch negative qualitative adjustment in our scorecard.

Exhibit 1

Rating Scorecard - Key financial ratios as at 30 June 2022



We assign a BCA to Santander UK based on the consolidated financials of Santander UK Group. The chart above shows the financial ratios of Santander UK Group.

Source: Moody's Investors Service

Credit strengths

- » Asset risk supported by low stock of problem loans
- » Solid capitalisation
- » Improved profitability, benefiting from wider lending margins due to rising interest rates, healthy mortgage volumes and low credit provisions

Credit challenges

- » Lower than peers' leverage ratio
- » Expected deterioration in credit quality as inflation and cost of living pressures bite

Outlook

The outlook on Santander UK's long-term deposit, issuer rating and senior unsecured debt ratings is negative, reflecting the negative outlook on the UK sovereign debt rating, and the proximity of its issuer ratings to the UK sovereign debt ratings. A downgrade of the UK sovereign debt rating, which is currently on a negative outlook, would reduce the likelihood of an uplift to Santander UK's long-term deposit, issuer rating and senior unsecured debt ratings by one notch.

Factors that could lead to an upgrade of the ratings

There is limited upward pressure on Santander UK's long-term deposit, issuer rating and senior unsecured debt ratings, as reflected by the negative outlook. The outlook could be stabilised in case the outlook on the UK's sovereign debt rating is changed to stable from negative, if there is a significant increase in the stock of more junior bail-in-able liabilities, or if the standalone BCA is upgraded. Santander UK's BCA could be upgraded if there is an improvement in profitability, a reduction in problem loans and a reduced reliance on its moderate market funding. The BCA could also be upgraded if the bank were able to increase the level of diversification of its business.

Factors that could lead to a downgrade of the ratings

Santander UK's long-term deposit, issuer rating and senior unsecured debt ratings could be downgraded if the BCA is downgraded, if there is a significant decline in the stock of bail-in-able liabilities, or if the UK sovereign debt rating is downgraded. Santander UK's BCA could be downgraded if there is a deterioration in the bank's asset quality metrics, a material weakening in profitability or a

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

deterioration in the bank's funding and liquidity positions, including a further reduction in the quantity or quality of its liquidity buffer. Santander UK Group's senior holdco debt rating could be downgraded following a downgrade of Santander UK's BCA or following a material reduction in the volume of bail-in-able debt.

Key indicators

Exhibit 2

Santander UK Group Holdings plc (Consolidated Financials) [1]

	06-22 ²	12-21 ²	12-20 ²	12-19 ²	12-18 ²	CAGR/Avg. ³
Total Assets (GBP Billion)	290.8	293.7	295.6	285.2	286.0	0.5 ⁴
Total Assets (USD Billion)	353.2	396.4	404.0	377.9	364.3	(0.9) ⁴
Tangible Common Equity (GBP Billion)	12.8	12.3	11.4	13.8	13.7	(1.9) ⁴
Tangible Common Equity (USD Billion)	15.6	16.6	15.6	18.2	17.5	(3.3) ⁴
Problem Loans / Gross Loans (%)	1.1	1.4	1.4	1.1	1.2	1.2 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	18.2	18.0	15.7	18.8	17.5	17.6 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	18.6	22.4	22.7	15.6	17.1	19.3 ⁵
Net Interest Margin (%)	1.4	1.3	1.1	1.2	1.3	1.3 ⁵
PPI / Average RWA (%)	3.4	2.7	1.8	2.3	2.3	2.5 ⁶
Net Income / Tangible Assets (%)	2.4	0.5	0.5	0.5	0.5	0.9 ⁵
Cost / Income Ratio (%)	50.1	55.6	64.3	59.5	56.6	57.2 ⁵
Market Funds / Tangible Banking Assets (%)	24.2	24.4	24.2	25.6	27.8	25.2 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	20.7	24.1	25.4	24.3	24.9	23.9 ⁵
Gross Loans / Due to Customers (%)	116.1	108.8	108.6	113.4	113.3	112.0 ⁵

[–] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Santander UK is a retail and commercial bank that operates exclusively in the UK. It is a large subsidiary of Banco Santander, accounting for around 20% of the group's assets at the end of June 2022. In the UK, Santander UK is the third-largest residential mortgage provider and is the fifth-largest current account provider.

As part of the implementation of the ring-fencing legislation in the UK, in 2018, Santander UK transferred its small corporate and investment banking division to the London branch of Banco Santander, and its branches in the Crown Dependencies to its sister company SFS, which became the non-ring-fenced bank of Santander UK Group. At present, in addition to the branches in the Crown Dependencies, SFS retains a small portfolio of legacy assets.

Detailed credit considerations

We assign a BCA to Santander UK based on the consolidated financials of Santander UK Group. The financial data in the following sections are sourced from Santander UK Group's consolidated financial statements, unless otherwise stated.

Concentration of revenue in UK residential mortgages

Santander UK's baa1 BCA incorporates a negative qualitative adjustment to reflect its modest business diversification, due to the high proportion of retail loans in Santander UK's loan book: 83% of Santander UK's portfolio consists of residential mortgages (followed by corporate and SME loans, 9%¹, consumer loans, 2%, credit cards and unsecured personal loans, 2%) at end-June 2022.

We apply the same one-notch negative qualitative adjustment to other UK banks with similar business models, in particular the building societies.

Asset risk supported by low stock of problem loans

The assigned a1 Asset Risk score reflects our expectation that problem loans will broadly stabilize at the current level or moderately deteriorate over the outlook period.

Santander UK's loan book has a low risk profile, largely comprising residential mortgages (83% of the total loan book), with a relatively low average loan-to-value ratio of 40% at end-June 2022. Buy-to-let mortgages are low, representing just 7% of the loan book. Lending to corporate and small and medium-sized enterprises at 9% of total loans is relatively low compared with that of its peers, although the bank aims to gradually increase its market share. Consumer finance lending is small when compared with other large UK banks, representing 2% of total lending. The remainder of Santander UK's loan book (<1%) is largely composed of legacy assets and portfolios in run-off booked under the bank's corporate centre.

At the end of June 2022, Stage 3 loans were at 1.1%, 30bps lower than year end 2021 while Stage 2 loans decreased to 7.3% of loans from 7.8% at end-2021. We expect Stage 3 loans to broadly stabilize at current levels.

Solid capitalisation, but weaker than peers' leverage ratio

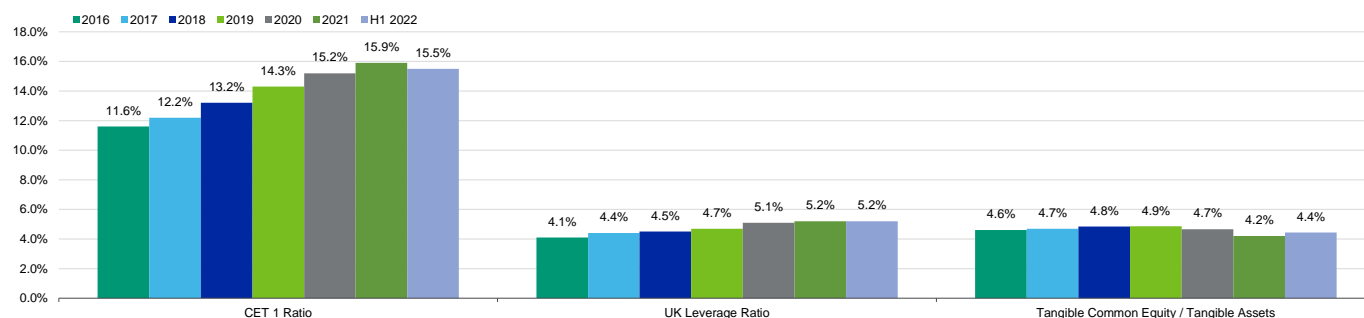
The assigned a1 Capital score is two notches below the aa2 Macro-Adjusted score, reflecting an expected decrease of capital levels and its weaker-than-peers leverage ratio.

Regulatory capital is currently solid: the Common Equity Tier 1 (CET1) capital ratio was 15.5% at end-September 2022 (16.6% at end-September 2021), 550 basis points above it's the Maximum Distributable Amount (MDA). The CET1 ratio has been improving (it was 14.3% at end-2019 and 13.2% at end-2018), reflecting stable retained earnings and a material decrease in risk-weighted assets, driven by a reduction in the exposure towards commercial real estate companies, together with ring-fencing transfers and securitisations. The Tangible Common Equity ratio was 18.2% at end-June 2022.

The leverage ratio calculated according to the UK Prudential Regulation Authority's recommendations (the so-called UK leverage ratio) was 5.3% at the end-September 2022, above requirements. However, our leverage ratio was 4.4% at end-June 2022, lower than most peers.

Exhibit 3

Santander UK's increase in CET1 ratio mainly reflects lower risk-weighted assets Santander UK's main capital ratios



Regulatory ratios on a transitional phase-in basis. The tangible Common Equity ratio excludes high-trigger AT1 instruments from 2020

Source: Moody's Investors Service, company reports

Improved profitability, benefiting from wider margins, rising interest rates, healthy mortgage volumes and low credit provisions

The assigned baa3 Profitability score is two notches below the baa1 Macro-Adjusted score and reflects our profits expectation over the outlook period.

Santander UK's profitability has been relatively stable in recent years and pre-coronavirus, due to its concentration in residential mortgages and a smaller than-peers impact from legacy issues such as payment protection insurance (PPI) redress.

In FY 2021, Santander UK reported £1,405 million profit after tax, an increase of 221% from the prior year, largely due to higher revenues and a credit write back of £233 million. Net interest income increased 18% during the year, benefiting from the repricing of

customer deposits, which offset the negative impact from lower rates. Fee income increased 2% during the same period. Operating costs increased 5%, leading to a positive revenue : cost jaw. The £233 million credit impairment write back largely reflected the improved economic outlook.

In the first nine months of 2022, Santander UK reported a profit after tax of £1.1 billion, a 4% increase compared to the same period in the prior year. Revenue increased 9% yoy, driven by a 11% yoy increase in net interest income due to the impact of base rate increases and higher mortgage lending. Banking net interest margin increased to 2.04% at the end of September 2022, up from 1.91% at the end of September 2021. The bank reported £256 million credit charges, compared to a £170 million credit write-back in the same period the previous year. Operating costs of £1.8 billion were 8% lower yoy, due to lower transformation programme costs.

We expect profitability to continue to benefit from healthy new business margins, volumes growth, rising interest rates and moderate credit provisions. We estimate around £1.5-1.6 billion net income in 2022. Longer-term, higher competition in the mortgage market will affect pricing on new mortgage lending and lower lending volumes will increase pressure on revenue. Further cost savings, driven by the transformation programme will partially mitigate these pressures.

Stable retail funding profile

The assigned baa1 Funding Structure score is in line with the Macro-Adjusted score. Being primarily a retail bank, customer deposits are Santander UK's main source of funding, accounting for about 70% of total funding at end-June 2022. In 2021, Santander UK replaced more price-sensitive deposit customers with current accounts, which are generally more stable and usually have more than one product with the bank. The bank's loan-to-deposit ratio was 116% at end-June 2022, a level higher than most of its peers.

Wholesale funding reliance is moderate and broadly stable, representing 24% of tangible banking assets at end-June 2022. The bank repaid all its outstanding central bank Term Funding Scheme (TFS) facility at end-2021 and had an outstanding balance of £31.9 billion under the new Term Funding Scheme introduced by the Bank of England in March 2020 (TFSME); MREL issuance will refinance maturities to continue to meet requirements.

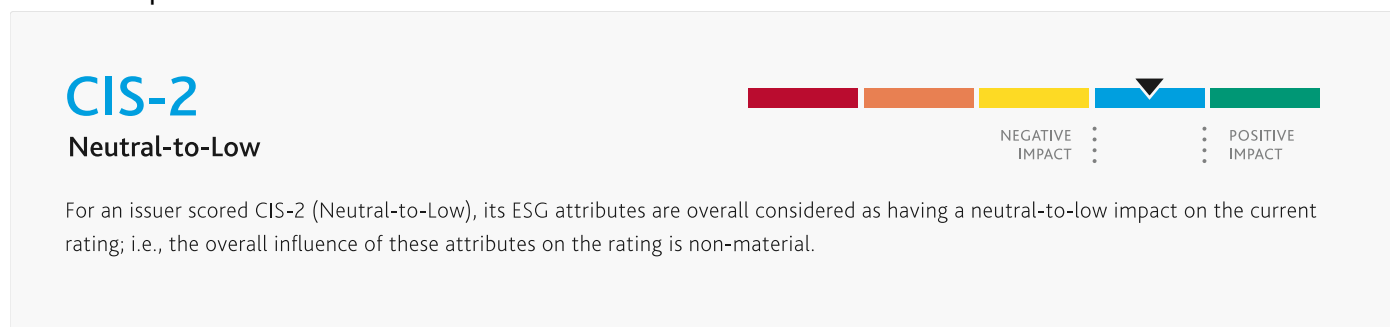
We assign a baa1 Liquid Resources score, in-line with the Macro-Adjusted score to reflect the expected trend. Santander UK has a good stock of liquid assets, representing 21% of the bank's tangible banking assets at end-June 2022. The bank reported a strong 172% liquidity coverage ratio at end-June 2022. The liquidity coverage ratio-eligible liquidity pool was £49.3 billion as of the same date, covering 5 times the wholesale funds with a residual maturity of less than one year.

ESG considerations

Santander UK Group Holdings plc's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 4

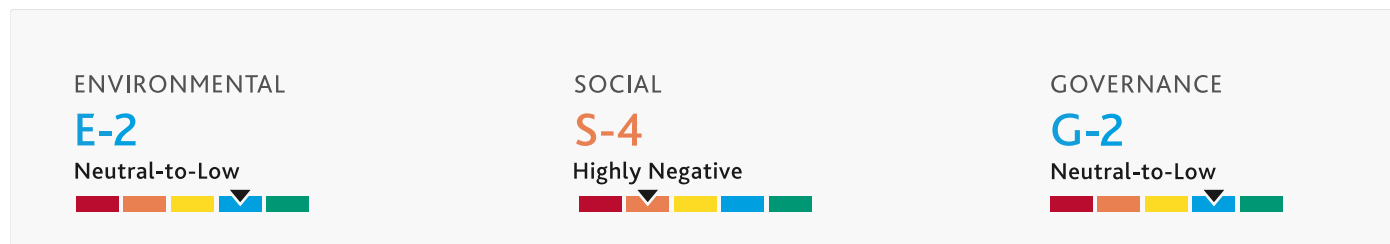
ESG Credit Impact Score



Source: Moody's Investors Service

Santander UK Group's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting limited credit impact from environmental and social factors on the rating to date, and low governance risks.

Exhibit 5

ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Santander UK Group faces lower-than-industry-average exposure to environmental risks. The bank has limited exposure to carbon transition risks because its loan book is concentrated in UK residential mortgages, with very low exposure to commercial loans.

Social

Santander UK Group faces high industry-wide social risks from customer relations: regulatory risk, litigation exposure and high compliance standards, as well as cyber risk and the financial and reputational implications of data breaches. The bank also faces industrywide moderate social risks related to potential competition from technology firms and other disruptors.

Governance

Santander UK Group faces low governance risks. The bank's risk management, policies, and procedures are in line with industry best practices and are suitable for its risk appetite, as evidenced by its good asset quality. The bank demonstrates sound management of capital and liquidity, while earnings generation has recently improved. Because SantanderUK is fully controlled by Banco Santander SA, we aligned the subsidiary's board structure, policies and procedures score with that of its parent, given the bank's strategic importance and public affiliation with the group, the parent's oversight of its subsidiary board and the regulated nature of both entities.

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

Support and structural considerations**Affiliate support**

We expect a high probability of support coming from Banco Santander, based on the size of Santander UK within the group and reputational risk to its parent. Our assumptions do not lead to any uplift, because the BCA of Santander UK is in line with that of Banco Santander.

Loss Given Failure (LGF) analysis

Santander UK is subject to the UK implementation of the EU Bank Recovery and Resolution Directive, which we consider to be an operational resolution regime. Our analysis assumes residual tangible common equity of 3%, 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, and it assigns a 25% probability to deposits being preferred to senior unsecured debt. These assumptions are in line with our standard assumptions. We also assume the proportion of deposits considered junior at 10%, relative to our standard assumption of 26%, because of the more retail, and small and medium-sized enterprise-oriented depositor base.

Our LGF analysis indicates that Santander UK's junior deposits and senior debt are likely to face very low loss-given-failure because of the loss absorption provided by limited subordinated debt and the volume of deposits and senior debt. This results in a two-notch uplift from the bank's BCA. For the senior unsecured debt of the holding company Santander UK Group, our LGF analysis shows moderate loss-given-failure, resulting from the combination of its own limited volume of debt and the amount of debt subordinated to it. This results in ratings in line with Santander UK Group's BCA.

The Additional Tier 1 high-trigger contingent convertible perpetual preferred securities issued by Santander UK Group are rated Ba1 (hyb) following the update of the methodology.

Government support

We expect a moderate probability of government support for Santander UK's deposits and senior debt, reflecting the bank's high market share for deposits and residential mortgages in the UK. This results in one notch of uplift to the long-term deposit and senior unsecured ratings.

For junior securities, and for the senior debt of the holding company, we believe that potential government support is low, and these ratings do not include any related uplift.

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

Santander UK's CR Assessments are Aa3(cr)/Prime-1(cr). The long-term CR Assessments, before government support, are three notches above the bank's standalone BCAs of baa1. The uplift results from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in one additional notch of uplift.

Santander UK's CRRs are Aa3/Prime-1. The long-term CRRs, before government support, are three notches above the bank's BCAs of baa1. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in one additional notch of uplift. Although Santander UK is likely to have more than a nominal volume of CRR liabilities at failure, this has no impact on the CRRs because the significant level of subordination below the CRR liabilities at the banks already provides the maximum amount of uplift under our rating methodology.

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 6

Santander UK Group Holdings plc

Macro Factors							
Weighted Macro Profile		Strong +		100%			
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	1.3%	aa3	↔	a1	Expected trend		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	18.0%	aa2	↔	a1	Expected trend	Nominal leverage	
Profitability							
Net Income / Tangible Assets	1.0%	baa1	↔	baa3	Expected trend		
Combined Solvency Score		a1		a2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	24.4%	baa1	↔	baa1	Market funding quality		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	24.1%	baa1	↔	baa1	Expected trend		
Combined Liquidity Score		baa1		baa1			
Financial Profile							
				a3			
Qualitative Adjustments				Adjustment			
Business Diversification				-1			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				-1			
Sovereign or Affiliate constraint				Aa3			
BCA Scorecard-indicated Outcome - Range				a3 - baa2			
Assigned BCA				baa1			
Affiliate Support notching				0			
Adjusted BCA				baa1			
Balance Sheet							
		in-scope (GBP Million)		% in-scope		at-failure (GBP Million)	% at-failure
Other liabilities		70,585		24.2%		84,176	28.8%
Deposits		194,151		66.5%		180,560	61.8%
Preferred deposits		174,736		59.8%		165,999	56.8%
Junior deposits		19,415		6.6%		14,561	5.0%
Senior unsecured bank debt		3,890		1.3%		3,890	1.3%
Dated subordinated bank debt		739		0.3%		739	0.3%
Junior subordinated bank debt		228		0.1%		228	0.1%
Preference shares (bank)		560		0.2%		560	0.2%
Dated subordinated holding company debt		832		0.3%		832	0.3%
Preference shares(holding company)		2,200		0.8%		2,200	0.8%
Equity		8,764		3.0%		8,764	3.0%
Total Tangible Banking Assets		281,949		100.0%		292,131	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	14.4%	14.4%	14.4%	14.4%	3	3	3	3	0	a1
Counterparty Risk Assessment	14.4%	14.4%	14.4%	14.4%	3	3	3	3	0	a1 (cr)
Deposits	14.4%	8.0%	14.4%	9.4%	2	2	2	2	0	a2
Senior unsecured bank debt	14.4%	8.0%	9.4%	8.0%	2	1	2	2	0	a2
Senior unsecured holding company debt	8.0%	4.6%	8.0%	4.6%	0	0	0	0	0	baa1
Dated subordinated bank debt	4.6%	4.0%	4.6%	4.0%	0	0	0	0	0	baa1
Dated subordinated holding company debt	4.6%	4.0%	4.6%	4.0%	0	0	0	0	0	baa1
Junior subordinated bank debt	4.0%	3.9%	4.0%	3.9%	-1	-1	-1	-1	-1	baa3
Non-cumulative bank preference shares	3.9%	3.0%	3.9%	3.0%	-1	-1	-1	-1	-2	ba1
Holding company non-cumulative preference shares	3.9%	3.0%	3.9%	3.0%	-1	-1	-1	-1	-2	ba1

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	a1	1	Aa3	Aa3
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3(cr)	
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	A1	A1
Senior unsecured holding company debt	0	0	baa1	0	Baa1	Baa1
Dated subordinated bank debt	0	0	baa1	0	Baa1	Baa1
Dated subordinated holding company debt	0	0	baa1	0		Baa1
Junior subordinated bank debt	-1	-1	baa3	0	Baa3 (hyb)	Baa3 (hyb)
Non-cumulative bank preference shares	-1	-2	ba1	0	Ba1 (hyb)	
Holding company non-cumulative preference shares	-1	-2	ba1	0	Ba1 (hyb)	

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

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
SANTANDER UK GROUP HOLDINGS PLC	
Outlook	Stable
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	Baa1
Senior Unsecured	Baa1
Subordinate	Baa1
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Other Short Term	(P)P-2
SANTANDER FINANCIAL SERVICES PLC	
Outlook	Negative
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
ST Issuer Rating	P-1
SANTANDER UK PLC	
Outlook	Negative
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate	Baa1
Jr Subordinate	Baa3 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

Endnotes

1 including Local Authorities and Housing Associations

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