MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Clydesdale's covered bonds to Aaa; actions conclude review

Global Credit Research - 05 Jun 2015

New counterparty risk assessment affects the covered bond anchor

London, 05 June 2015 -- Moody's Investors Service has today upgraded to Aaa from Aa1 (on review for upgrade) the ratings on the mortgage covered bonds of Clydesdale Bank plc (the issuer, deposits Baa1; stable; adjusted baseline credit assessment baa3; Counterparty Risk (CR) Assessment A3(cr)).

Today's upgrade concludes the review of the covered bonds' ratings that Moody's initiated on 17 March 2015 (see "Moody's reviews for upgrade 69 European covered bond ratings").

RATINGS RATIONALE

Today's rating action on the covered bonds follows Moody's assignment of a new CR Assessment to Clydesdale, the underlying institution supporting the covered bonds (see "Moody's concludes review on 14 UK banks' ratings; assigns CR Assessments to 17 UK banks" published on 05 Jun 2015). The CB anchor for this programme is the CR Assessment plus one notch. With the assignment a CR Assessment of A3(cr), the CB anchor is now two notches higher than before.

Please refer to: http://www.moodys.com/viewresearchdoc.aspx?docid=PR_326836

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for this programme is CR Assessment plus one notch. The CR Assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR Assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for Clydesdale mortgage covered bonds are 20.4%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 17.0% and collateral risk of 3.4%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 5.0%.

The over-collateralisation (OC) in the cover pool is 114.4%, of which Clydesdale Bank plc provides 25.8% on a "committed" basis. The minimum OC level consistent with the Aaa rating target is 16.0%, of which 16.0% should be in "committed" form. These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the most recent Performance Overviews and Moody's most recent modelling based on data, as of 31 December 2014.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

Factors that would lead to an upgrade or downgrade of the rating:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

The TPI assigned to this programme is Probable. The TPI Leeway for this programme is one notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by two notches, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB anchor and the TPI; (2) a multiple-notch downgrade of the CB anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in this rating was "Moody's Approach to Rating Covered Bonds" published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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