Moody's Investors Service

Rating Action: Moody's downgrades Arab Bank Australia to Baa2, following rating action on parent

Global Credit Research - 12 May 2011

Sydney, May 12, 2011 -- Moody's Investors Service has downgraded the long-term debt rating of Arab Bank Australia Limited to Baa2 from Baa1, and its subordinated debt rating to (P) Baa3 from (P) Baa2. The short-term rating of Prime-2 and the bank financial strength rating (BFSR) of D+ have been confirmed. Concurrently, Moody's has assigned a negative outlook to all ratings.

Today's rating actions conclude the review commenced by Moody's on 16 February 2011, which was triggered by the review initiated on Arab Bank Australia's parent, Arab Bank plc on 14 February 2011.

RATINGS RATIONALE

"The downgrade of Arab Bank Australia to Baa2 reflects our view that whilst the potential for support from its parent Arab Bank plc remains very high, the ability of the parent to provide that support has weakened", said Daniel Yu, an Analyst with Moody's Sydney office.

"Nevertheless, the potential for parental support remains an important, positive rating factor for Arab Bank Australia", explained Yu. "It lifts the bank's Baa2 debt rating two notches above its stand-alone rating of Ba1".

The changes to Arab Bank Australia's ratings are a direct result of its parent's stand-alone rating being downgraded from A3 to Baa1 with a negative outlook (BFSR of C-). The change was mainly driven by the parent's sizeable regional exposure to countries in the Middle East and North Africa which are facing increased political and economic risks following the recent political turmoil.

Moody's incorporates the potential for parental support using its joint default analysis framework. The potential for parental support of a foreign subsidiary uses the parent's stand-alone rating as the reference rating, as opposed to the parent's senior debt rating. This is because the parent's senior debt rating may incorporate the potential for systemic support for the parent in its home market -- and which its home market regulator is unlikely to extend to a foreign subsidiary.

The negative outlook on Arab Bank Australia's debt rating reflects the negative outlook of the parent's stand-alone rating.

On a stand-alone basis, Arab Bank Australia's BFSR of D+ now maps to Ba1 on the long-term scale and carries a negative outlook. This change reflects current asset quality pressures, which have seen impaired loans rise 76% during FY2010 to AUD21.1m. This is likely to pressure provisioning costs, which will have an impact on profitability. Despite generally conservative underwriting standards, Arab Bank Australia does take on very large exposures for a bank of its size -- and which are significant enough to have a noticeable impact on its asset quality ratios. Furthermore, these exposures are concentrated in construction related lending which tends which to be higher risk in nature.

There is no impact on the Aaa rating of debt securities the bank issued under the Australian government's guarantee scheme.

The principal methodologies used in this rating were Bank Financial Strength Ratings: Global Methodology published in February 2007, and Incorporation of Joint-Default Analysis into Moody's Bank Rating Methodology: A Refined Methodology published in March 2007.

Arab Bank Australia is headquartered in Sydney, Australia. It reported assets of AUD1.34billion (approximately USD1.36billion) at FY2010, period ending 31 December 2010.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings and public information.

Moody's Investors Service considers the quality of information available on the issuer or obligation satisfactory for the purposes of maintaining a credit rating.

Moody's adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

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