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Ratings

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Research Update:

U.K.-Based Specialist Lender Jerrold Holdings Outlook To Negative On Potential Economic Deterioration; Rating Affirmed

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Overview

- In our view, the U.K.'s June 2016 referendum vote to leave the EU ("Brexit") has increased the risks of adverse economic developments in the country. As a result, we now see a negative trend for U.K. banking industry economic risk, which we use to derive our starting point for the ratings on specialist lender Jerrold Holdings Ltd. (which trades as "Together").
- We also believe that the U.K. has now entered into a correction phase, driven by our revised expectation that economic imbalances will worsen as credit growth slows and real house prices contract. However, we consider that lending institutions' underwriting standards, low interest rates, and low unemployment should mitigate the extent of losses in the sector.
- We are therefore revising the outlook on Together to negative from stable. We are affirming the rating on the company at 'BB-'.
- The negative outlook reflects our view that Together's creditworthiness could weaken over the next 12-18 months if prolonged economic uncertainty leads to a weaker operating environment.

Rating Action

On July 8, 2016, S&P Global Ratings revised its outlook on nonoperating holding company (NOHC) Jerrold Holdings Ltd. (which trades as "Together") to negative from stable. We affirmed the long-term counterparty credit rating at 'BB-'.

Rationale

The outlook revision reflects the growing risk of adverse economic developments and economic uncertainty arising from the recent Brexit vote, as a result of which we now see a negative trend for economic risk in the U.K. banking sector. This is applicable to Together, given its lending profile.

We believe that the U.K. economy is no longer in an expansionary phase and is now entering a correction phase. We expect the Brexit vote to reduce consumer confidence and the demand for credit in the near term. We believe that this and the potential reduced overseas demand for U.K. property will affect house prices. Nevertheless, we do not expect significant losses in the housing sector given the much-improved underwriting standards since the financial crisis, the still low--and declining--interest rates, and low unemployment.

In our opinion, the Brexit vote is a seminal event that will lead to a less predictable, stable, and effective policy framework in the U.K. The Brexit result could lead to a deterioration of the U.K.'s economic performance, including its large financial services sector, which is a major contributor to employment and public receipts. As such, we recognize that there is a high degree of uncertainty in the near term.

We believe that Together's very strong capitalization as measured by its risk-adjusted capital ratio of 22.6% as of March 31, 2016, its track record of operating through economic cycles, and the absence of short-term debt maturities, provide it with the ability to continue operations through an extended period of economic and market uncertainty. We therefore affirmed the 'BB-' long-term counterparty credit rating on Together. Nevertheless, heightened political and economic risks will likely create more challenging operating conditions. In particular, we believe this has the potential to constrain earnings in several ways:

- Credit growth will likely be more subdued. We believe there is now an increasing risk of a house price correction arising from the uncertainty generated by Brexit. In our view, households' high share of property assets increases the sensitivity of consumer demand to housing prices. This could directly affect Together given its focus on niche areas of the U.K. residential property market.
- Pressure on net interest margins could increase if, as appears likely, the Bank of England loosens its monetary policy further. We believe Together's high net interest margin of just above 8% and potential asset repricing could absorb some of this effect, however.
- Credit losses will likely increase, albeit from a relatively low base, given that possible declines in collateral values and a higher level of customer defaults would lead to additional provisioning needs. This risk is somewhat mitigated by the 52.5% weighted-average indexed loan-to-value (LTV) ratio of Together's total loan portfolio as of March 31, 2016.

Our view of economic risk in the U.K. could weaken--potentially leading to a downward revision in our economic risk score to '5' from '4'--if:

- A significant correction in asset prices becomes increasingly likely, with credit losses jumping to levels well above the 69 basis point long-term average, and closer to levels seen during the global financial crisis; or
- Factors such as sterling's loss of status as a reserve currency, or another referendum that leads to Scottish independence, result in significant further institutional, financial, and economic uncertainty.

We set Together's preliminary anchor, the starting point in deriving the ratings, three notches below the anchor for U.K. banks. The three-notch differential reflects Together's lack of access to central bank funding, its lack of regulatory oversight relative to licensed U.K. banks, and potential susceptibility to strong competition given banks' typical lower financing costs.

Outlook

The negative outlook on Together reflects the negative trend we see for economic risks following the U.K.'s decision to leave the EU. We believe that Together's creditworthiness could weaken over the next 12-18 months if prolonged economic uncertainty leads to a weaker operating environment. Although Together's strong capitalization and robust earnings track record somewhat mitigate this risk, we nevertheless identify risks to asset prices, asset quality, and Together's revenue generation, which may result in pressure on the current ratings.

Downside scenario

We could lower the ratings on Together by one notch in the next 12-18 months if we revised down the starting point for our ratings on U.K. non-bank financial institutions. This could occur if we observe a weakening in the U.K.'s economic resilience and if Brexit-related uncertainty creates a weaker operating environment for U.K.-focused lending institutions such as Together.

Upside scenario

We could revise the outlook back to stable if we take a more favorable view of the systemwide risks for domestic U.K. lending institutions. While less likely at this stage, we could also revise the outlook back to stable if Together demonstrates continued growth without deterioration in new lending standards or pricing, and improved bottom-line earnings.

Ratings Score Snapshot

Jerrold Holdings Ltd.

	To	From
Issuer Credit Rating	BB-/Negative/--	BB-/Stable/--
Group credit profile	bb-	bb-
Anchor*	bb+	bb+
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Very Strong (+2)	Very Strong (+2)
Risk position	Moderate (-1)	Moderate (-1)
Funding/Liquidity	Moderate/Adequate (-1)	Moderate/Adequate (-1)
Comparable ratings adjustment	Negative (-1)	Negative (-1)
Support	0	0
GRE	0	0
Group	0	0
Sovereign	0	0
Additional factors	0	0

*The typical anchor for a nonbank financial institution is three notches below the bank anchor, derived from our Banking Industry Country Risk Assessment. The anchor for a bank operating in the U.K. is 'bbb+'.

Related Criteria And Research

- Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Jerrold Holdings Ltd.		
Counterparty Credit Rating	BB-/Negative/--	BB-/Stable/--
Jerrold FinCo PLC		
Senior Secured*	BB-	

*Guaranteed by Jerrold Holdings Ltd.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.