FitchRatings

Banks
Universal Commercial Banks
United Kingdom

Lloyds Banking Group plc

Update

Key Rating Drivers

Business Profile, Profitability Underpin Ratings: Lloyds Banking Group plc's (LBG) Long-Term Issuer Default Rating (IDR) and Viability Rating (VR) reflect its strong business profile in the UK, where the group maintains solid retail and business banking franchises. The ratings also reflect strong core profitability and solid capitalisation and funding profiles.

Weak Economic Outlook: Fitch Ratings expects a recession, higher interest rates, high inflation and rising unemployment to push credit losses up later this year, albeit from low levels, and to slow loan growth. Net interest income growth will slow across banks, in our view, driven by materially higher funding costs and tight asset margins.

Leading Domestic Franchise: LBG is the largest domestically focused banking group in the UK, with a stable and diversified business model. Business diversification supports earnings stability through the cycle, although it is highly correlated with the UK operating environment.

Conservative Underwriting: Mortgage loans underpin credit risk and we view this asset class as low risk, due to conservative collateralisation (average loan to value: 42% at end-1Q23). However, the moderate share of higher-risk, unsecured consumer loans (6% of gross loans; including credit cards) and commercial lending (20%) increases risks in the tougher operating environment, although LBG's conservative underwriting standards mitigate these.

Asset Quality to Deteriorate: LBG's asset quality remained resilient in 1Q23. However, we expect the weaker economic outlook to increase the impaired loans ratio (end-1Q23: 2.3%) towards, but not materially above, 3% into 2024, given the group's sound underwriting standards and a high proportion of low-risk mortgage loans. Non-performance is likely to be higher in legacy, unsecured consumer finance and commercial lending, including to SMEs.

Solid Profitability: LBG's profitability is consistently strong and compares favourably with peers'. However, we expect LBG's operating profit/risk-weighted assets (RWAs) ratio (1Q23: 4.4%) to moderate, due to increasing funding costs, continued asset-margin pressures and our expectation of higher loan impairment charges. Lower business volumes and market uncertainty will weigh on fee and commission income, but LBG's record of controlling costs should support earnings in the inflationary environment.

Strong Capitalisation: Solid profitability and RWAs optimisation support LBG's capitalisation. We expect the common equity Tier 1 (CET1) ratio (end-1Q23: 14.1%) to gradually fall towards the bank's target of about 13.5% through higher capital distribution.

Stable Funding Profile: LBG's funding and liquidity profile is sound, supported by a large deposit base, leading retail franchise and good access to wholesale funding markets. Deposit outflows in 1Q23 led to a marginal increase in the loans/deposits ratio to 97% (end-1Q22: 95%), and we expect it to rise further as affordability pressures reduce savings rates and savers seek higher yields in a higher-interest-rate environment. LBG's wholesale funding needs are manageable.

The Short-Term IDRs of 'F1' for LBG and its rated subsidiaries are the lower of two options mapping to the Long-Term IDRs, as our assessment of the group's funding and liquidity profile does not warrant a higher Short-Term IDR.

Group VR Drives Ratings: LBG acts as the holding company for the group, and its VR is equalised with that of its core banks, Lloyds Bank plc (LB) and Bank of Scotland Plc (BOS), reflecting LBG's high integration with the group, and its low holding-company double leverage. The Long-Term IDRs of LBG's rated subsidiaries are one notch above LBG's VR to reflect available resolution debt buffers.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Government Support Rating	ns
Sovereign Risk (United Kingdom)	
Long-Term Foreign-Currency IDR	AA-
Long-Term Local-Currency IDR	AA-
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Affirms Lloyds Banking Group at 'A'; Outlook Stable (December 2022)

Stable Rating Outlooks for Major UK Banks Despite Deteriorating Sector Outlook (December 2022)

Global Banks 2023 Outlook Compendium (January 2023)

Fitch Affirms United Kingdom at 'AA-'; Outlook Negative (December 2022)

Global Economic Outlook (March 2023)

Major UK Banks' Strong Performance to Soften as Funding Costs, Impairments Rise (May 2023)

UK Banks' Net Interest Margins Are Close to Peaking (February 2023)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

LBG's ratings are primarily sensitive to its VR. LBG retains rating headroom, even in the case of a one-notch downgrade of the operating environment score for UK banks to 'a+' from 'aa-'. However, the VR could come under pressure if the operating environment deteriorated more significantly than we expect, resulting in the four-year average impaired loans ratio increasing above 3% without a clear path to reduction, and there being significant and sustained deterioration in operating profit to below 1.5% of RWAs that also led to the CET1 ratio falling below LBG's target of 13.5% on a sustained basis.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the VR is unlikely given the weaker macroeconomic outlook in the UK and the negative outlooks on the operating environment score and the UK sovereign. Over the medium term, and with a stabilisation of the operating environment at the current level, an upgrade of LBG's VR could result from an improvement in asset quality and continued record of strong profitability, which together could support our assessment of LBG's capitalisation, particularly in terms of the group's sustained internal capital generation capacity.

Other Debt and Issuer Ratings

Issuer Ratings (Including Main Issuing Entities)

Rating level	LBG	LB	BOS	HBOS plc	LBCM	LBCMW
Long-Term IDR/outlook	A/Stable	A+/Stable	A+/Stable	A+/Stable	A+/Stable	A+/Stable
Short-Term IDR	F1	F1	F1	F1	F1	F1
Viability Rating	a	a	a	-	-	-
GSR[a]/SSR[b]	ns[a]	ns[a]	ns[a]	a[b]	a[b]	a[b]
Derivative Counterparty Rating	-	-	-	-	A+(dcr)	-

LB, BOS and HBOS are the ring-fenced entities of the group and Lloyds Bank Corporate Markets plc (LBCM) and Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH (LBCMW) are the group's non-ring-fenced entities
[a] Government Support Rating
[b] Shareholder Support Rating
Source: Fitch Ratings

Opco Rating Uplift

The 'A+' Long-Term IDRs of LB and BOS are notched up once from their VRs to reflect the presence of a large (more than 10% of RWAs) buffer of qualifying junior debt and senior holding company debt downstreamed in a subordinated manner, underpinned by minimum requirement for own fund and eligible liabilities regulations. We also incorporate this benefit into the IDRs of HBOS, LBCM and LBCMW. The latter have not been assigned VRs as Fitch believes that these entities cannot be assessed meaningfully on a standalone basis. Their IDRs reflect a very high probability of shareholder support from LBG, if needed.

The 'a' Shareholder Support Ratings of HBOS, LBCM and LBCMW reflect a very high probability of shareholder support in case of need, given the issuers' strategic roles in the wider group, their high level of ownership by LBG, and reputational risks for LBG in case of their potential default.

Debt Ratings, Derivative Counterparty Rating (DCR)

Rating level	LBG	LB	BOS	HBOS plc	LBCM
Senior unsecured debt	A/F1	A+/F1	A+	A+	A+/F1
Tier 2 subordinated debt	BBB+	BBB+		BBB+	-
Legacy upper Tier 2	BBB	BBB	BBB	BBB	-
Legacy innovative Tier 1 non-discretionary/preference stock	BBB-	-	-	-	-
Additional Tier 1 debt	BBB-	-	-	-	-

LB, BOS and HBOS are the ring-fenced entities of the group and Lloyds Bank Corporate Markets plc (LBCM) and Lloyds Bank Corporate Markets Wertpapierhandelsbank (LBCMW) are the group's non-ring-fenced entities
Source: Fitch Ratings

The long-term senior unsecured debt and DCR of LBG and of its subsidiaries, where available, are in line with the respective Long-Term IDRs.

Tier 2 debt issued by LBG, Lloyds Bank plc and HBOS is rated two notches below their VRs (LBG's VR for HBOS). This is the baseline notching under our criteria, reflecting high loss severity for this type of debt.

The ratings of legacy upper Tier 2 subordinated debt issued by LBG, LB, HBOS and BOS are notched down three times: twice for loss severity and once for incremental non-performance risk.

Additional Tier 1 and legacy Tier 1 and preferred stock issued by LBG are four notches below the anchor VR, two each for loss severity and incremental non-performance risk. Our assessment is based on the group operating with a CET1 ratio comfortably above the maximum distributable amount thresholds and we expect this will continue.

Significant Changes from Last Review

Higher Funding Costs and Impairment Charges to Soften Performance

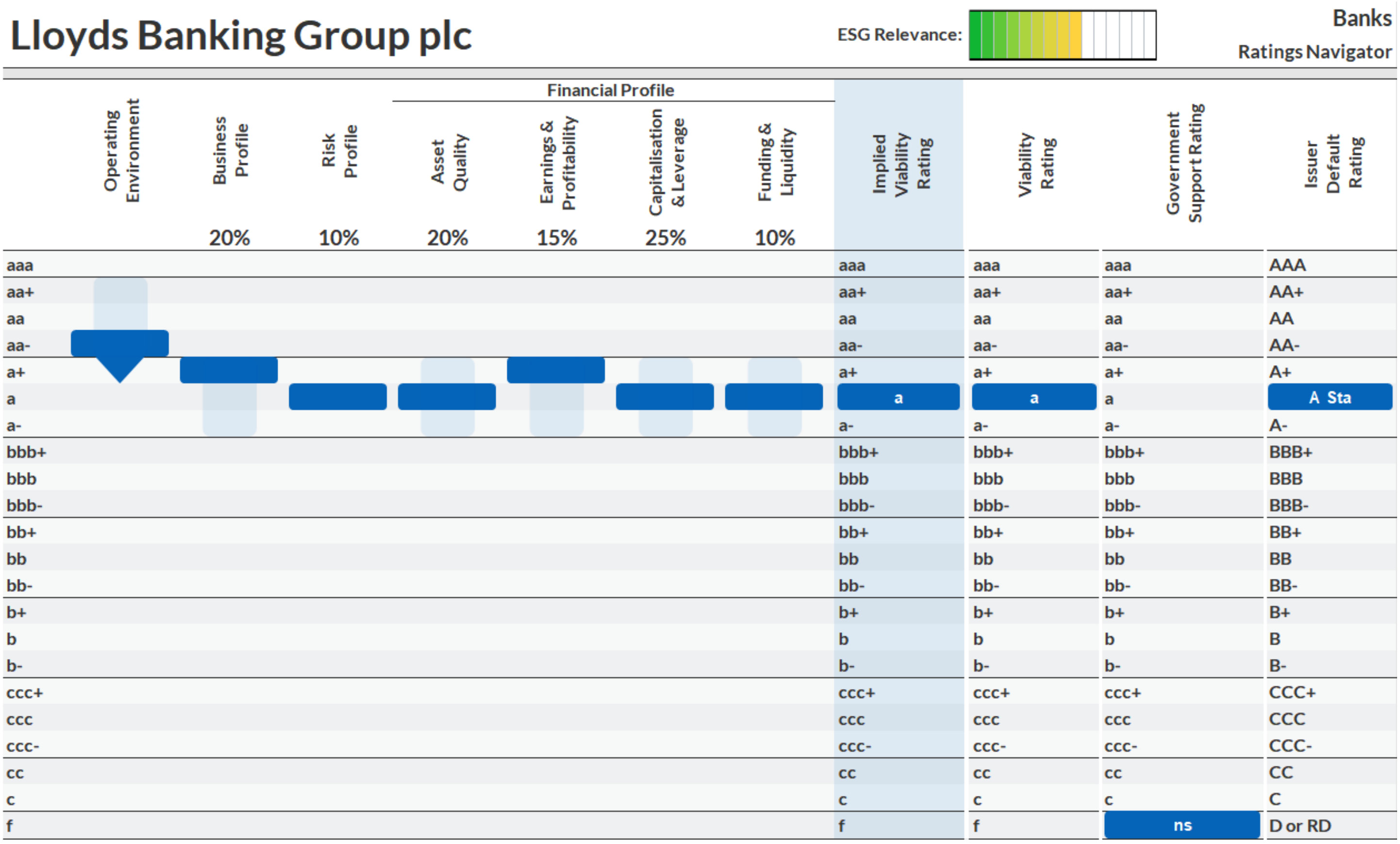
LBG's performance remained solid in 1Q23, with a strong operating profit/RWAs of 4.4%. A significant increase in net interest income yoy as a result of higher policy rates more than offset moderately higher risk charges, resulting in a 40% increase in operating profit yoy. Gross loans contracted in 1Q23, largely due to a sale of a legacy mortgage portfolio. Deposits decreased by 2% yoy, more so in retail current accounts, given higher spending and increased competition for savings. The bank is proactively managing deposit movements and holds a substantial liquidity buffer (high-quality liquid assets of GBP140.5 billion, or 30% of customer deposits) together with significant central bank borrowing capacity.

We expect the higher-interest-rate environment to continue to support the bank's strong profitability. However, for the rest of the year the incremental benefit will gradually be eroding by the increasing pass-through rate on deposits together with the increasing share of interest-bearing deposits, while asset margins, particularly on mortgage loans, remain tight due to competitive pressures.

LBG's underlying asset quality remained resilient in 1Q23. The increase in 1Q23 impairment charges yoy was largely driven by credit deterioration in the legacy mortgage book, additional charges on a pre-existing corporate default case and stage 1 loans. Non-legacy assets performed well, with the stage 3 ratio unchanged at 2.3% in 1Q23. We expect it to edge up towards 3% later this year, especially as unemployment increases. The bank is guiding for loan impairment charges/gross loans of about 30bp in 2023, broadly in line with our expectations, barring a worse-than-expected deterioration in the UK operating environment.

LBG's CET1 ratio was 14.1% at end-March 2023, and we expect it to gradually fall towards the management's ongoing target of about 13.5% by end-2024 with the distribution of excess capital. Strong profitability and excess capital provide headroom against economic uncertainty.

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The operating environment score of ‘aa-’ is at the lower end of the range because it is constrained by the UK sovereign rating of ‘AA-’/Negative (negative).

Financials

Financial Statements

	31 Mar 23		31 Dec 22	31 Dec 21	31 Dec 20
	3 months - 1st quarter (USDm) Unaudited	3 months - 1st quarter (GBPm) Unaudited	Year end (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified
Summary income statement					
Net interest and dividend income	4,375	3,535.0	13,957.0	9,366.0	10,749.0
Net fees and commissions	n.a.	n.a.	1,503.0	1,423.0	1,160.0
Other operating income	1,556	1,257.0	2,749.0	5,535.0	3,217.0
Total operating income	5,930	4,792.0	18,209.0	16,324.0	15,126.0
Operating costs	2,818	2,277.0	9,781.0	10,802.0	9,656.0
Pre-impairment operating profit	3,112	2,515.0	8,428.0	5,522.0	5,470.0
Loan and other impairment charges	301	243.0	1,500.0	-1,380.0	4,155.0
Operating profit	2,812	2,272.0	6,928.0	6,902.0	1,315.0
Other non-operating items (net)	-15	-12.0	n.a.	n.a.	-89.0
Tax	766	619.0	1,373.0	1,017.0	-161.0
Net income	2,031	1,641.0	5,555.0	5,885.0	1,387.0
Other comprehensive income	n.a.	n.a.	-6,829.0	-950.0	110.0
Fitch comprehensive income	2,031	1,641.0	-1,274.0	4,935.0	1,497.0
Summary balance sheet					
Assets					
Gross loans	565,715	457,126.0	459,417.0	452,387.0	445,960.0
- Of which impaired	12,930	10,448.0	10,753.0	8,694.0	9,089.0
Loan loss allowances	6,007	4,854.0	4,518.0	3,820.0	5,760.0
Net loans	559,708	452,272.0	454,899.0	448,567.0	440,200.0
Interbank	n.a.	n.a.	10,632.0	7,001.0	8,060.0
Derivatives	n.a.	n.a.	24,753.0	22,051.0	29,613.0
Other securities and earning assets	n.a.	n.a.	267,506.0	306,733.0	295,608.0
Total earning assets	559,708	452,272.0	757,790.0	784,352.0	773,481.0
Cash and due from banks	n.a.	n.a.	91,388.0	76,420.0	73,257.0
Other assets	536,388	433,428.0	28,651.0	25,753.0	24,531.0
Total assets	1,096,096	885,700.0	877,829.0	886,525.0	871,269.0
Liabilities					
Customer deposits	585,484	473,100.0	475,331.0	476,344.0	450,651.0
Interbank and other short-term funding	n.a.	n.a.	86,877.0	66,851.0	72,268.0
Other long-term funding	n.a.	n.a.	64,101.0	69,394.0	82,563.0
Trading liabilities and derivatives	n.a.	n.a.	30,760.0	26,221.0	34,963.0
Total funding and derivatives	585,484	473,100.0	657,069.0	638,810.0	640,445.0
Other liabilities	451,333	364,700.0	172,769.0	192,414.0	178,706.0
Preference shares and hybrid capital	n.a.	n.a.	5,767.0	8,055.0	8,611.0
Total equity	59,279	47,900.0	42,224.0	47,246.0	43,507.0
Total liabilities and equity	1,096,096	885,700.0	877,829.0	886,525.0	871,269.0
Exchange rate		USD1 = GBP0.80805	USD1 = GBP0.828638	USD1 = GBP0.74438	USD1 = GBP0.745156

Source: Fitch Ratings

Key Ratios

	31 Mar 23	31 Dec 22	31 Dec 21	31 Dec 20
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	4.4	3.3	3.5	0.7
Net interest income/average earning assets	2.4	1.8	1.3	1.7
Non-interest expense/gross revenue	47.5	53.7	66.2	63.8
Net income/average equity	14.8	12.6	13.0	3.2
Asset quality				
Impaired loans ratio	2.3	2.3	1.9	2.0
Growth in gross loans	-0.5	1.6	1.4	0.5
Loan loss allowances/impaired loans	46.5	42.0	43.9	63.4
Loan impairment charges/average gross loans	0.2	0.3	-0.3	0.9
Capitalisation				
Common equity Tier 1 ratio	14.1	15.1	17.3	16.2
Fully loaded common equity Tier 1 ratio	14.0	14.9	16.9	15.0
Fitch Core Capital ratio	n.a.	n.a.	n.a.	n.a.
Tangible common equity/tangible assets	5.4	3.4	4.3	4.0
Basel leverage ratio	4.8	4.9	5.2	5.3
Net impaired loans/common equity Tier [1]	18.8	19.6	14.4	10.1
Net impaired loans/Fitch Core Capital	n.a.	n.a.	n.a.	n.a.
Funding and liquidity				
Gross loans/customer deposits	96.6	96.7	95.0	99.0
Liquidity coverage ratio	143.0	144.0	135.0	136.0
Customer deposits/total non-equity funding	100.0	74.4	75.8	72.5
Net stable funding ratio	129.0	n.a.	n.a.	n.a.

Source: Fitch Ratings

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	a or a-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AA-/ Negative
Size of banking system	Negative
Structure of banking system	Negative
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

The GSRs of 'no support' for LBG, LB and BOS reflect Fitch's view that senior creditors cannot rely on extraordinary support from the UK authorities if these issuers become non-viable, due to UK legislation and regulations that provide a framework requiring senior creditors to participate in losses after a failure.

Environmental, Social and Governance Considerations

FitchRatings **Lloyds Banking Group plc**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Lloyds Banking Group plc has 5 ESG potential rating drivers

- Lloyds Banking Group plc has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.