FitchRatings

Banks
Universal Commercial Banks
United Kingdom

Lloyds Banking Group plc

Update

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

Key Rating Drivers

Solid Business Profile, Profitability: Lloyds Banking Group plc's (LBG) Long-Term Issuer Default Rating (IDR) and Viability Rating (VR) reflect its solid, diversified business profile in the UK, supported by the leading retail and business banking franchises. The ratings also reflect consistently solid profitability and strong capitalisation and funding profiles.

Group VR: 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 subsidiaries are one notch above LBG's VR to reflect available resolution debt buffers.

Tough Economic Backdrop: Fitch Ratings expects economic pressures to weigh on UK banks' performance in 2024, given weak economic growth, higher interest rates and rising unemployment. Nevertheless, we expect major UK banks to retain strong loss-absorption, capital and liquidity buffers against manageable weakening in profitability and asset quality.

Leading Franchise in UK Banking: LBG is the largest domestically-focused banking group in the UK, diversified across retail, commercial banking and insurance operations, and has a dominant market position. Business diversification supports earnings stability through the cycle, although it is highly correlated with the UK operating environment.

Conservative Underwriting: LBG's risk profile is underpinned by the high share of low-risk mortgage lending (end-2023: 71% of loans) with low loan-to-value ratios (stock average: 44%). However, the moderate share of higher-risk, unsecured consumer loans (5% of gross loans; including credit cards) and commercial lending (20%) increases risks in a tougher operating environment, although underwriting standards are conservative.

Resilient Asset Quality: LBG's impaired loans ratio remained resilient in 2023 (2.2%; end-2022: 2.3%), although we expect it to increase slightly to about 2.5% by end-2025, given higher interest rates and weak economic growth. Sound underwriting standards and a high proportion of low-risk mortgage loans should support asset quality. We expect non-performance to be higher in legacy, unsecured retail and commercial lending, including to SMEs. Loan impairment charges (LICs; 2023: 7bp of average loans) benefitted from a significant write back in 2023.

Profitability Better than Peers: LBG's profitability is consistently strong and compares favourably with domestic and European peers. However, we expect LBG's operating profit/risk-weighted assets (RWAs) ratio (2023: 3.5%) to moderate in 2024–2025, due to higher funding costs, continued asset-margin pressures and normalising LICs. Earnings should be supported by material structural hedge income and revenue diversification.

Strong Capitalisation; Distributions Expected: Solid profitability and contained RWAs growth support LBG's capitalisation. We expect the common equity Tier 1 (CET1) ratio (pro-forma end-2023: 13.7%, including insurance dividend and announced share buyback) to fall towards the bank's target of about 13.5% by end-2024, through higher capital distribution as management is committed to returning surplus capital.

Stable Funding Profile: LBG's funding and liquidity profile is sound, supported by a large and granular deposit base and leading retail franchise. We expect the loans/deposits ratio of 96% at end-2023 to rise a little as loan growth outpaces deposit growth, although liquidity should remain strong. Funding stability is underpinned by proven access to wholesale funding and contingent Bank of England facilities, if needed.

Applicable Criteria

Bank Rating Criteria (September 2023)

Related Research

Fitch Affirms Lloyds Banking Group at 'A'; Outlook Stable (December 2023)

Major UK Banks: Strong Profitability Will Continue to Provide Buffer Against Risks (February 2024)

Major UK Banks - Peer Review 2024 (February 2024)

UK Banks' Misconduct Risk Is Highlighted by FCA Motor Finance Probe (January 2024)

Fitch Affirms United Kingdom at 'AA-'; Outlook Negative (December 2023)

Global Economic Outlook (December 2023)

Analysts

Huseyin Sevinc
+44 20 3530 1027
huseyin.sevinc@fitchratings.com

Maria Shishkina
+44 20 3530 1379
maria.shishkina@fitchratings.com

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 deteriorates more significantly than we expect, particularly if the four-year average impaired loans ratio increases above 3% without a clear path to reduction, and a sustained deterioration in operating profit to below 1.5% of RWAs that also leads to the CET1 ratio falling below 13% on a sustained basis.

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

An upgrade of the VR is unlikely in the near term given the weaker macroeconomic outlook in the UK and 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, with the four-year average impaired loans ratio falling below 2%, and continued record of strong profitability, which together could support our assessment of LBG's capitalisation.

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/SSR	ns	ns	ns	a	a	a
Derivative Counterparty Rating	-	-	-	-	A+(dcr)	-

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 plc (HBOS), Lloyds Bank Corporate Markets plc (LBCM) and Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH (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 their strategic roles in the wider group, high level of ownership by LBG, and reputational risks for LBG in case of their potential default.

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.

Debt Class Ratings

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

Source: Fitch Ratings

Debt Ratings, Derivative Counterparty Rating (DCR)

The long-term senior unsecured debt and DCR of LBG and of its subsidiaries, where applicable, 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 (MDA) thresholds and we expect this will continue.

Significant Changes from Last Review

Profitability to Soften on Higher Costs and Risk Charges

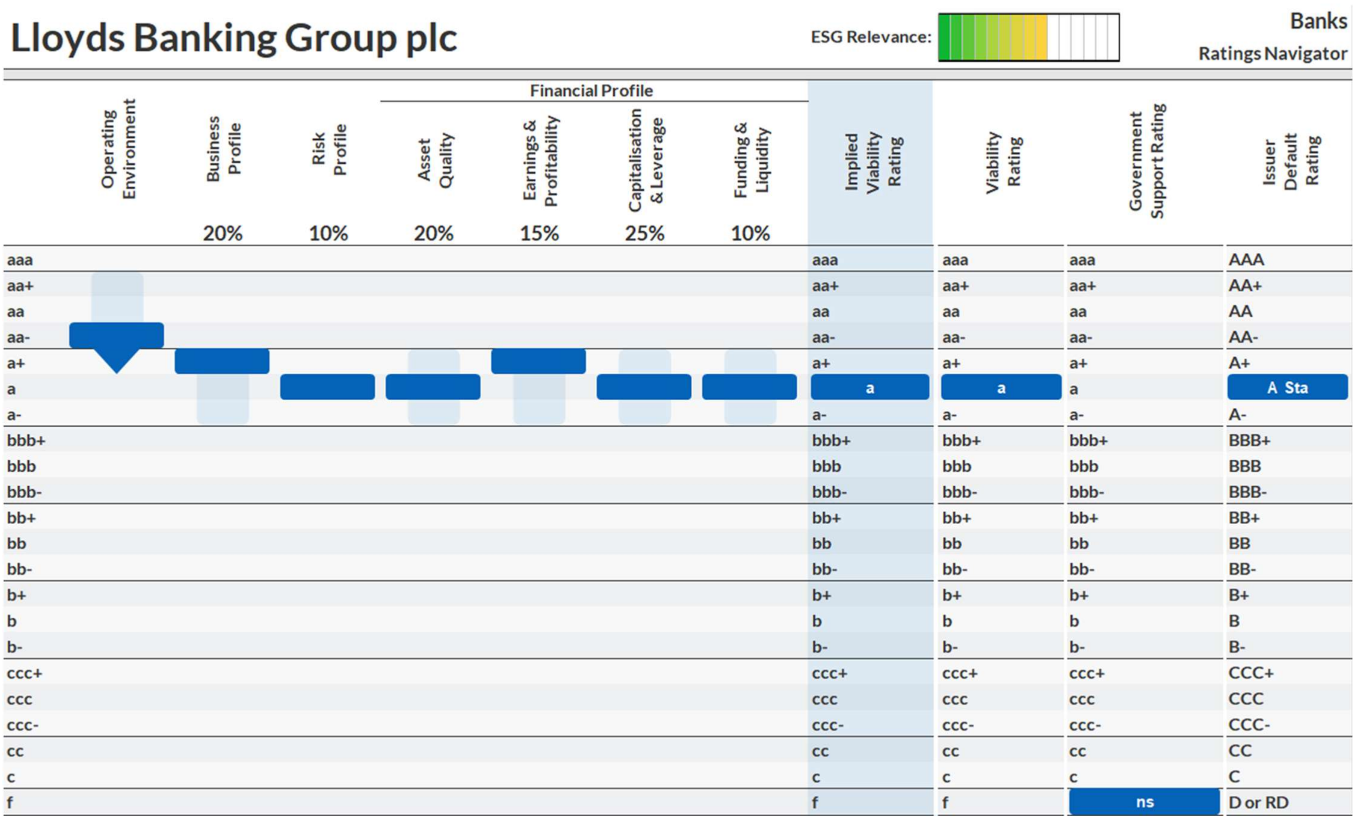
LBG's strong operating profit/RWAs ratio of 3.5% in 2023 (2022: 3.3%) primarily reflected higher net interest income and low LICs, which more than offset a strong increase in operating costs. The latter included a provision of GBP450 million set aside in relation to the Financial Conduct Authority's review into historical motor finance arrangement and higher operating lease depreciation. The 1% gross loan contraction last year was largely as a result of securitisation of legacy mortgages and unsecured loans. Deposits also decreased by 1%, with the shift from current accounts to term deposits slowing in 4Q23.

We expect higher interest rates to continue to support the bank's profitability in 2024, including through structural hedge income. However, LBG's net interest margin (NIM) is reducing, in line with our expectations, due to pressure on asset margins, particularly in mortgage lending, and the deposits' shift pushing funding costs up. We expect these trends to continue this year and NIM to decline further, but to remain above pre-2022 levels.

LBG's asset quality remained resilient in 2023, with a much lower cost of risk of 7bp of gross loans (2022: 30bp) on the back of a significant write-back in 4Q23. The reduction in LICs in 2023 was also driven by the improved economic outlook. Excluding the write-back and the updated outlook, LICs represented 29bp of gross loans. New-to-arrears in the legacy mortgage book increased above pre-pandemic levels, while the rest of the portfolios was generally stable The impaired loans ratio declined to 2.2% at end-2023, but we expect it to increase slightly in 2024, as unemployment increases and economic growth remains weak.

LBG's pro-forma CET1 ratio, including the dividend received from the insurance subsidiary in February 2024 and the full impact of the announced share buyback, was strong at 13.7% at end-2023 despite RWA increases mostly derived from CRD IV internal models' calibration. We expect the ratio to gradually fall towards the management's target of about 13.5% by end-2024 as strong profitability mostly offsets capital returns.

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 Dec 23		31 Dec 22	31 Dec 21	31 Dec 20
	Year end (USDm) Audited - unqualified	Year end (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified	Year End (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified
Summary income statement					
Net interest and dividend income	16,837	13,298	13,957	9,366	10,749
Net fees and commissions	2,318	1,831	1,503	1,423	1,160
Other operating income	5,152	4,069	2,749	5,535	3,217
Total operating income	24,307	19,198	18,209	16,324	15,126
Operating costs	14,216	11,228	9,781	10,802	9,656
Pre-impairment operating profit	10,091	7,970	8,428	5,522	5,470
Loan and other impairment charges	396	313	1,500	-1,380	4,155
Operating profit	9,695	7,657	6,928	6,902	1,315
Other non-operating items (net)	-195	-154	n.a.	n.a.	-89
Tax	2,513	1,985	1,373	1,017	-161
Net income	6,986	5,518	5,555	5,885	1,387
Other comprehensive income	139	110	-6,829	-950	110
Fitch comprehensive income	7,126	5,628	-1,274	4,935	1,497
Summary balance sheet					
Assets					
Gross loans	574,157	453,485	459,417	452,387	445,960
- Of which impaired	12,800	10,110	10,753	8,694	9,089
Loan loss allowances	4,706	3,717	4,518	3,820	5,760
Net loans	569,451	449,768	454,899	448,567	440,200
Interbank	13,628	10,764	10,632	7,001	8,060
Derivatives	28,305	22,356	24,753	22,051	29,613
Other securities and earning assets	372,803	294,450	267,506	306,733	295,608
Total earning assets	984,188	777,338	757,790	784,352	773,481
Cash and due from banks	98,895	78,110	91,388	76,420	73,257
Other assets	32,925	26,005	28,651	25,753	24,531
Total assets	1,116,008	881,453	877,829	886,525	871,269
Liabilities					
Customer deposits	596,834	471,396	475,331	476,344	450,651
Interbank and other short-term funding	103,837	82,013	86,877	66,851	72,268
Other long-term funding	89,316	70,544	64,101	69,394	82,563
Trading liabilities and derivatives	27,503	21,723	30,760	26,221	34,963
Total funding and derivatives	817,490	645,676	657,069	638,810	640,445
Other liabilities	237,958	187,946	172,769	192,414	178,706
Preference shares and hybrid capital	9,377	7,406	5,767	8,055	8,611
Total equity	51,182	40,425	42,224	47,246	43,507
Total liabilities and equity	1,116,008	881,453	877,829	886,525	871,269
Exchange rate		USD1 = GBP0.789827	USD1 = GBP0.828638	USD1 = GBP0.74438	USD1 = GBP0.745156

Source: Fitch Ratings, Fitch Solutions, Lloyds Banking Group plc

Key Ratios

	31 Dec 23	31 Dec 22	31 Dec 21	31 Dec 20
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	3.5	3.3	3.5	0.7
Net interest income/average earning assets	2.1	1.8	1.3	1.7
Non-interest expense/gross revenue	58.4	53.7	66.2	63.8
Net income/average equity	13.4	12.6	13.0	3.2
Asset quality				
Impaired loans ratio	2.2	2.3	1.9	2.0
Growth in gross loans	-1.3	1.6	1.4	0.5
Loan loss allowances/impaired loans	36.8	42.0	43.9	63.4
Loan impairment charges/average gross loans	0.1	0.3	-0.3	0.9
Capitalisation				
Common equity Tier 1 ratio	14.6	15.1	17.3	16.2
Fully loaded common equity Tier 1 ratio	14.5	14.9	16.9	15.0
Fitch Core Capital ratio	n.a.	n.a.	n.a.	n.a.
Tangible common equity/tangible assets	3.2	3.4	4.3	4.0
Basel leverage ratio	5.2	4.9	5.2	5.3
Net impaired loans/common equity Tier 1	20.0	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	96.2	96.7	95.0	99.0
Gross loans/customer deposits + covered bonds	93.4	93.8	91.6	94.0
Liquidity coverage ratio	142.0	144.0	135.0	136.0
Customer deposits/total non-equity funding	74.5	74.4	75.8	72.5
Net stable funding ratio	130.0	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, Lloyds Banking Group plc

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 in the event these issuers become non-viable given 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.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

SOLICITATION & PARTICIPATION STATUS

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.