

CREDIT OPINION

30 October 2023

Update



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RATINGS

Lloyds Banking Group plc

Domicile	London, United Kingdom
Long Term CRR	Not Assigned
Long Term Debt	A3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Lloyds Banking Group plc

Update following H1 2023 results

Summary

We assign ratings of A3/P-2 to the senior unsecured debt of [Lloyds Banking Group plc](#) (LBG).

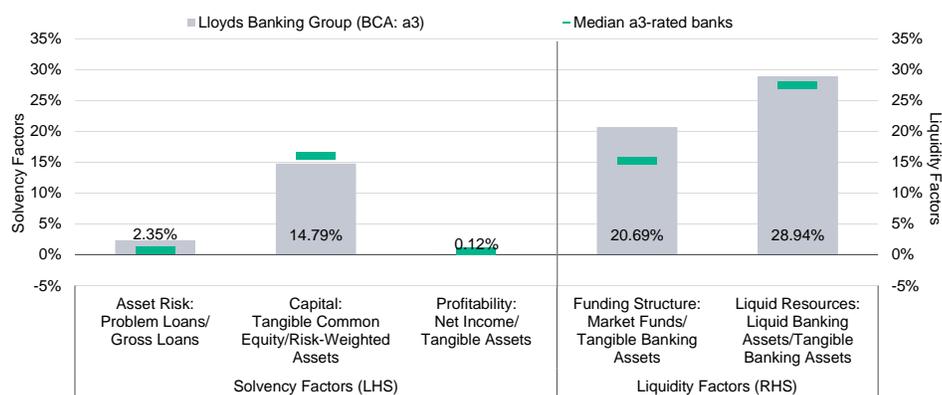
The A3 long term senior unsecured debt rating of LBG reflects (1) the group's standalone creditworthiness, expressed in an a3 Baseline Credit Assessment (BCA); (2) moderate loss-given-failure, which results in no uplift under our Advanced Loss Given Failure (LGF) analysis; and (3) our assessment of a low probability of support from the [Government of United Kingdom](#) (Aa3 stable), which results in no uplift.

LBG's a3 BCA takes into account: i) strong levels of capital; ii) stable retail funding and ample liquidity; iii) solid profitability supported by strong growth in net interest income; iv) and low cost of credit.

LBG's insurance and wealth activities, which includes the subsidiary [Scottish Widows Limited](#) (Scottish Widows, IFRS A2 stable) provide earnings diversification to the group's banking activities carried out by the ring-fenced bank [Lloyds Bank plc](#) (LB, A1 stable/A1 stable, a3¹), and the non-ring-fenced bank [Lloyds Bank Corporate Markets plc](#) (LBCM, A1 stable/A1 stable, baa3²).

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

- » Low asset risk
- » Strong capital
- » Stable retail funding and ample liquidity
- » Solid profitability benefiting from high net interest income and moderate cost of risk

Credit challenges

- » Deteriorating macroeconomic environment likely to weaken credit demand, particularly affecting SMEs
- » Inflationary pressures and higher interest rates to negatively affect households' discretionary income and debt servicing capacity

Outlook

The outlook on LBG's senior ratings is stable. The outlook reflects our view that high capitalisation, solid profitability and ample liquidity mitigate moderate asset risk and, wholesale funding exposures.

Factors that could lead to an upgrade of the ratings

LBG's long-term ratings could be upgraded following an upgrade of its notional BCA supported by higher capital levels, increased profitability, or lower problem loans. LBG's senior unsecured debt ratings could also be upgraded following an increase in the stock of holding company senior unsecured debt or a significant increase in the stock of subordinated debt issued by LBG.

Factors that could lead to a downgrade of the ratings

LBG's ratings could be downgraded following a downgrade of its notional BCA driven by a material deterioration in the group's capital and asset risk metrics or following a significant reduction in its stock of externally issued unsecured debt.

Key indicators

Exhibit 2

Lloyds Banking Group plc (Consolidated Financials) [1]

	06-23 ²	12-22 ²	12-21 ²	12-20 ²	12-19 ²	CAGR/Avg. ³
Total Assets (GBP Billion)	860.2	854.3	863.3	837.2	790.2	2.5 ⁴
Total Assets (USD Billion)	1,093.6	1,027.7	1,165.1	1,144.4	1,046.8	1.3 ⁴
Tangible Common Equity (GBP Billion)	31.8	38.5	40.7	35.1	39.8	(6.2) ⁴
Tangible Common Equity (USD Billion)	40.5	46.3	55.0	48.0	52.7	(7.3) ⁴
Problem Loans / Gross Loans (%)	2.4	2.3	1.9	2.0	2.0	2.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	14.8	18.3	20.8	17.3	19.6	18.1 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	29.3	25.0	19.5	22.2	20.3	23.3 ⁵
Net Interest Margin (%)	1.6	1.6	1.1	1.3	1.3	1.4 ⁵
PPI / Average RWA (%)	4.3	3.9	2.6	2.4	2.7	3.2 ⁶
Net Income / Tangible Assets (%)	0.6	-1.3	0.6	0.7	0.8	0.2 ⁵
Cost / Income Ratio (%)	51.4	55.3	67.8	66.0	69.7	62.1 ⁵
Market Funds / Tangible Banking Assets (%)	21.3	20.7	18.2	20.4	22.1	20.5 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	26.4	28.9	30.3	31.0	26.4	28.6 ⁵
Gross Loans / Due to Customers (%)	95.1	95.2	94.1	97.2	105.0	97.3 ⁵

[.] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Profile

LBG is the holding company of a leading UK-based financial services group providing a wide range of banking and financial services, focused on personal and commercial customers. The group's main business activities are retail and commercial banking, as well as general insurance and life, pensions and investment provision carried out by Scottish Widows and its subsidiaries. The group operates the largest retail banking network of the UK via different brands (mainly Lloyds Bank, Halifax, Bank of Scotland), and has a large and diversified customer base.

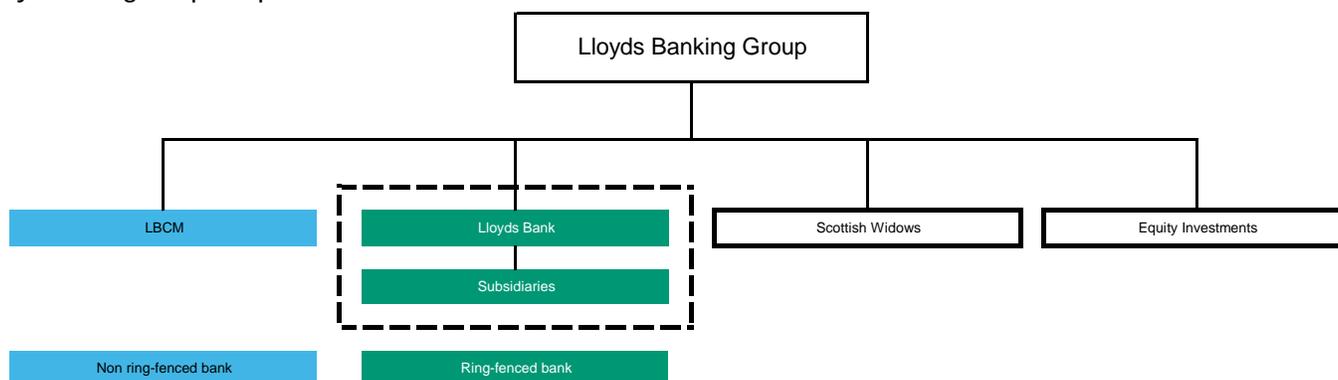
LBG is organised along four business divisions: Retail, Commercial Banking, Insurance and Wealth, and Equity Investments and Central Items. On 1 July 2022, LBG migrated Business Banking and Commercial Cards to Commercial Banking from Retail and Wealth to Retail from Insurance, Pensions and Investments (previously Insurance and Wealth).

Following the implementation of the UK's structural reform (so-called ring-fencing) most of LBG's banking activities, including more than 95% of the loan portfolio and most of the retail, small and medium-sized enterprise business, and corporate deposits, remained in the ring-fenced LB. In 2018, capital markets activities, business outside of the European Economic Area and lending to financial institutions were transferred to a non-ring-fenced entity, LBCM, which accounted for around 5% of the group's loans and about 10% of risk-weighted assets (RWAs) at end-2022.

Under the current structure, LBG owns directly Lloyds Bank, Scottish Widows and LBCM and has a strategic partnership with Schroders plc, which includes a joint-venture for affluent clients, and a 19.9% stake in Cazenove Capital.

Exhibit 3

Lloyds Banking Group's simplified structure



Sources: Moody's Investors Service, LBG

As part of its strategy, LBG aims to drive revenue growth and diversification both in its consumer and commercial businesses: in the Consumer business, it targets to deepen and innovate in consumer banking and create a new mass affluent offering; in the Commercial business, it targets to digitise and diversify its SME business and to increase its Corporate & Institutional offering and cross-selling. These initiatives should help the firm to grow revenue, with an expected overall impact expected to benefit profits from 2024 as revenue benefits outweigh net costs.

Detailed credit considerations

The financial data in the following sections are sourced from LBG's consolidated financial statements, unless otherwise stated.

Low asset risk

We assign an a3 Asset Risk score, taking into account LBG's good credit quality and its higher than some peers exposure to buy-to-let mortgages and unsecured consumer credit products.

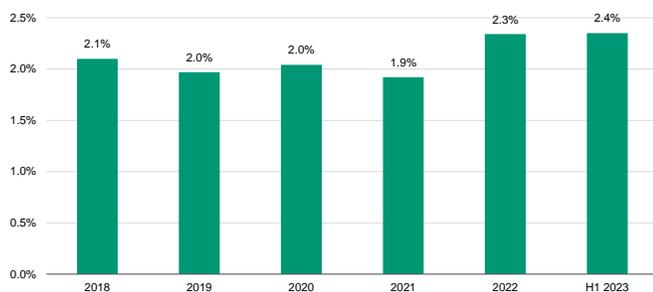
The group's lending book is focused on prime UK residential mortgages, a low-risk segment. Within UK residential mortgages, 16% are buy-to-let loans, which represents a higher proportion than for some of LBG's peers. LBG has increased its presence in unsecured consumer finance, following the acquisition of credit card provider MBNA Ltd in 2017. IFRS9 Stage 3 loans were 2.4% of total loans at

end-June 2023, a slight increase vs the 2.3% at end-2022, and up from the 1.9% at end-2021. Stage 2 loans were 14.4% of loans at end-June 2023, up from 14.3% at end-2022 and up from 9.2% at end-2021.

Exhibit 4

LBG has a low level of problem loans

Problem loans as a percentage of gross loans



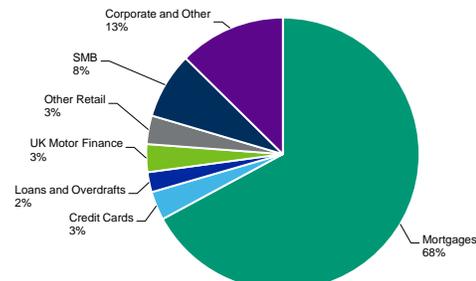
Problem loan data from 2018 are classified under IFRS9; previous figures were reported under IAS39. Amongst problem loans we also include the purchased or originated credit-impaired that LBG classifies under Stage 3.

Source: LBG's financial reports

Exhibit 5

LBG's loan book has a high level of retail secured loans

Loan book composition, end-June 2023



SMB (previously SME)

Source: LBG's financial reports

We expect LBG's problem loan ratio to increase slightly over the next 12-18 months as a result of high inflation and rising interest rates adding additional pressure on both household and corporate finances.

In line with its business model, LBG's market risk is limited, with market risk representing just 1.8% of total RWA at end-June 2023. Value at risk (VaR) is low: the average one-day VaR with a 95% confidence level was £1.5 million in 2022.

The insurance division has elevated investment risk. Risk assets according to our definition, which includes real estate, equities and non-investment grade debt, are high, accounting for 3.5-4x of adjusted equity. This level is however in line with Scottish Widows' peers and partially mitigated by the insurer's liability profile. The with-profit design enables the company to share part of the decline in asset values with policyholders (subject to minimum guarantees and smoothing costs), and the hedge programme protects against the impact of declines in equities in the non-profit and the with-profit fund. The group's real estate and other illiquid asset classes are used to back the insurers' long-term illiquid annuity liabilities, minimizing reinvestment risks. At the subsidiary level this is achieved through formal risk transfers between LB and Scottish Widows.

Strong capital

LBG's capitalisation is a key strength. Our assigned Capital score is a1, reflecting our expectation of a moderate decrease in capital ratios in the next 12-18 months.

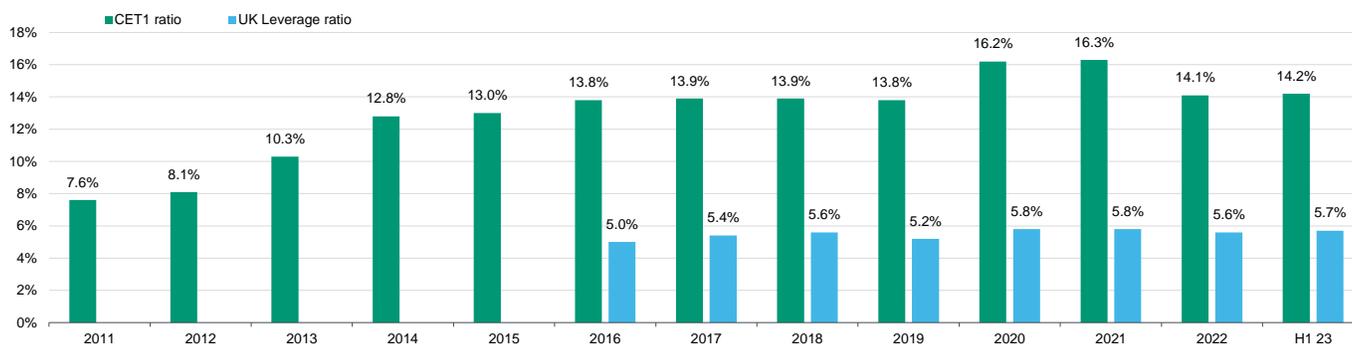
LBG reported a Common Equity Tier 1 (CET1) capital ratio of 14.2% at end-June 2023 from 14.1% at end-2022, reflecting 111 basis points of capital build year-to-date, offset by 36 basis points due to phased reductions in IFRS 9 transitional relief and adjustment for the anticipated impact of CRD IV models. Management expects 2023 capital generation, post CRD IV and transitional headwinds, to be c.175bps.

LBG's pro forma leverage ratio, as calculated under the current UK framework was 5.7% at end-June 2023 (5.6% at end-2022; 5.8% at end-2021).

Exhibit 6

LBG's CET1 capital ratio decreasing as dividends and share buybacks aim to reduce ratio towards target by 2024

LBG's CET1 and UK leverage ratios



Source: LBG's financial reports

Capital of the insurance subsidiaries is managed as part of the overall LBG strategy. In recent years Scottish Widows up streamed a material amount of dividends, but it maintained a buffer over solvency capital requirements that is consistent with having a reasonable buffer over solvency capital requirements after a one-in-ten-year stress scenario as calculated by the group. At end-2022 the insurance division reported a pre-dividend Solvency II ratio of 163% (155% after the dividend paid to LBG in February 2023). While this is at the lower end of the range for UK peers, we believe that this is at least partly offset by a well-defined risk appetite and a risk management framework adequate to the business written.

Our tangible common equity (TCE)/RWA) ratio of 14.8% at end-June 2023³ incorporates the entire equity of Scottish Widows. There are, however, limitations to capital fungibility within the group; in particular, the dividend policy of Scottish Widows is subject to its own independent board, and it requires supervisory approval. Nevertheless, we believe that in times of stress within the banking business, LBG will be able to upstream a significant amount of dividends from Scottish Widows; in the event of extreme stress, LBG may also dispose of its insurance subsidiary, providing capital benefit.

Solid profitability benefiting from high net interest income growth and moderate cost of risk

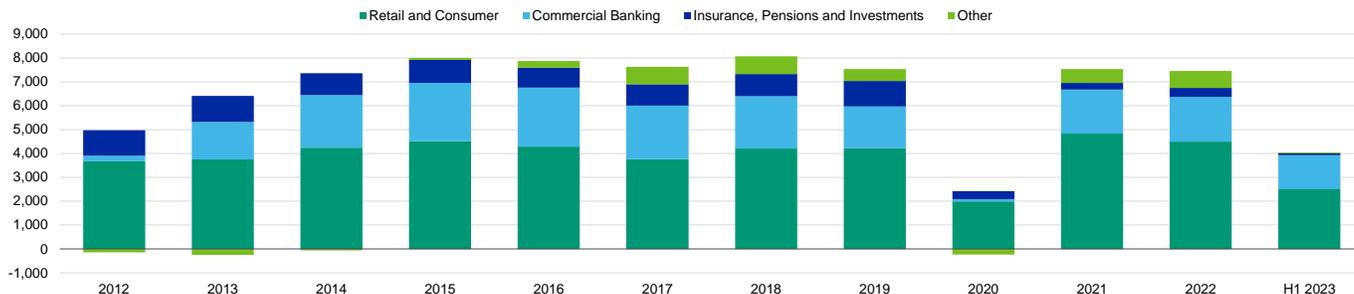
We assign a baa2 Profitability score to reflect our expectation that the group's net income will stabilize around £5.0-5.5 billion in 2023 and 2024, reflecting improved revenue supported by a high net interest margin, and a moderate increase in the cost of risk from a low base. However, persistent inflationary pressures will continue to constrain household incomes and debt servicing capacity affecting both demand for credit and new arrears formation.

LBG reported a net income of £2.9 billion H1 2023 (£2.4 billion in H1 2022), equal to a return on tangible equity (RoTE) of 16.6%. Revenue increased 11% year-on-year, driven by a stronger net interest margin and an increase in other income, partially offset by an increase in lease depreciations. Operating costs increased 6% due to higher planned strategic investments, new business costs and continued inflationary pressures. LBG reported a credit provision of £662 million in H1 2023 versus an impairment charge of £377 million in H1 2022: the increase was driven by a £657 million charge pre-updated macroeconomic scenarios (MES) and a small £5 million MES charge which reflected the assessment of improved near-term GDP outlook relative to the year-end assessment.

For 2023, management guides to a return on tangible equity (RoTE) of greater than 14%, supported by an enhanced guidance of a banking net interest margin of above 310 bps points, operating cost of c.£9.1 billion and credit impairments less than 30 bps of customer loans.

Exhibit 7

Growth in Insurance, Pensions and Investments and Retail and Commercial Banking partly offset contraction in Retail and Consumer Underlying profits by division



2012 and 2013 figures include earnings from former banking subsidiary TSB. Prior to 2017, the Insurance and Wealth division only included insurance. 2019 and 2021 figures were as restated by Lloyds in their 2020 and 2022 accounts, respectively.

Source: LBG's financial reports

Business diversification is a key strength for LBG: the group benefits from the revenue diversification provided by its commercial lending book and its life and non-life insurance subsidiaries. At end-June 2023, retail revenue accounted for 62% of underlying group net income, commercial banking for 30%, and insurance, pensions and investments revenue accounted for 6%. At the same time, net interest income represented 76% of underlying group net income and other income 28%.

Stable retail funding

We assign a baa1 Combined Liquidity score, reflecting a baa1 Funding Structure score and an a3 Liquid Resources score.

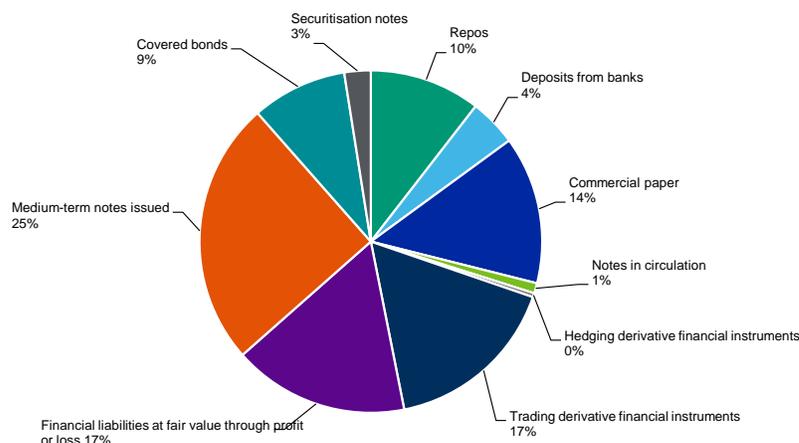
LBG benefits from its stable and granular retail deposit base. In the UK, its market share for personal current accounts is the highest in the country. Moody's calculated loan-to-deposit ratio for LBG, which includes certificates of deposits and term deposits, stood at 95% at end-June 2023.

LBG's reliance on wholesale funding is moderate, representing 21.3% of tangible banking assets at end-June 2023, and lower than its main UK peers. LBG's market funding composition is well-diversified; however, market funding maturing within one year is 47% of total market funds. LBG's pro forma MREL ratio was 31.0% (transitional) at end-June 2023.

The total outstanding drawings from the Term Funding Scheme with additional incentives for SMEs (TFSME) was stable at £30.0 billion at end-June 2023 (end-2022: £30.0 billion), with maturities in 2025 and 2027.

Exhibit 8

Market funds composition



Values are as reported by LBG at end-June 2023

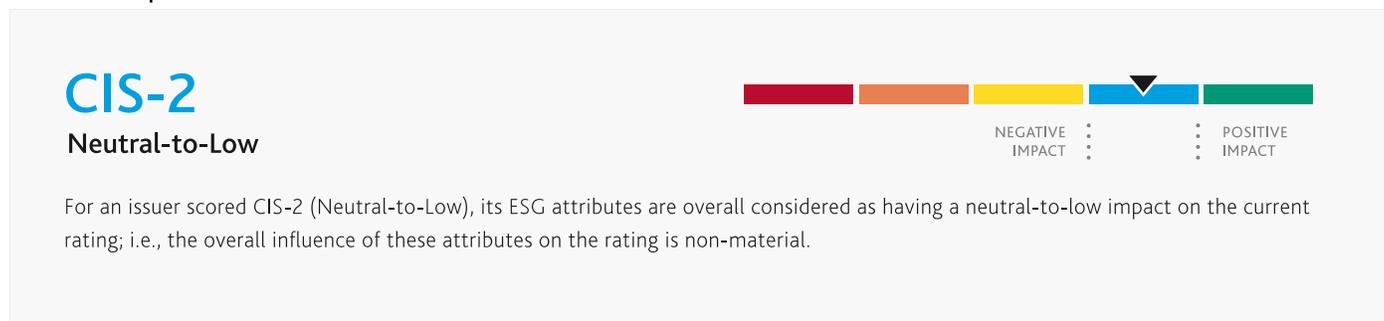
Source: LBG's financial reports

LBG's liquidity mitigates its moderate reliance on wholesale funding; material amounts of pre-positioned contingent liquidity with the Bank of England, further mitigating short term funding risk: the group's eligible assets to be included in the 142% liquidity coverage ratio (LCR) at end-June 2023 (144% at end-2022) were more than three times wholesale maturities in the next 12 months. We expect its liquid assets to remain broadly stable.

ESG considerations

Lloyds Banking Group plc's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 9
ESG Credit Impact Score



Source: Moody's Investors Service

Lloyds Banking Group' **CIS-2** indicates that ESG considerations do not have a material impact on the rating to date. In particular, governance risks are low, and take into consideration the group's stable and credible management along with sound capital, liquidity and risk management.

Exhibit 10
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Lloyds Banking Group faces moderate environmental risks mainly because of its portfolio exposure to carbon transition risk as a diversified, universal banking group. In line with peers, the bank is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, Lloyds Banking Group is actively engaging in optimizing its loan portfolio longer-term toward less carbon intensive assets.

Social

Lloyds Banking Group faces high social risks from customer relations, because of considerable focus on consumer protection in the UK, exposing banks to potential fines from regulators and litigation from customers as well as cyber risk and the financial and reputational implications of data breaches. The group's developed policies and procedures help manage associated credit risks. The group also faces moderate social risks related to potential competition from technology firms and other disruptors.

Governance

Lloyds Banking Group's governance risk is low. The bank has sound board structure, risk management, and capital and liquidity management. Management has a strong track record of simplification and efficiency. The group's organizational structure is straight forward, with Lloyds Bank containing the ring-fenced business and representing more than 90% of assets and revenue. The board structure and composition is in line with industry best practice.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

We apply our advanced LGF analysis to LBG because the bank is incorporated in the UK, which we consider to be an operational resolution regime.

Our analysis assumes residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, in line with our standard assumptions. Our advanced LGF analysis indicates that LBG's senior unsecured debt is likely to face moderate loss-given-failure because of the loss absorption provided by the inclusion of Additional Tier 1 (AT1) instruments, the subordinated debt issued by LBG and by its subsidiaries, and the volume of LBG's senior debt itself. This results in no uplift from the BCA.

Government support considerations

We incorporate a low probability of support for the debt issued by LBG's holding company, which does not result in any uplift.

About Moody's Bank scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 11

Lloyds Banking Group plc

Macro Factors							
Weighted Macro Profile		Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	2.4%	a2	↔	a3	Sector concentration		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	14.8%	a1	↔	a1			
Profitability							
Net Income / Tangible Assets	0.1%	b3	↑↑	baa2	Expected trend		
Combined Solvency Score		baa1		a3			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	20.7%	baa1	↔	baa1	Extent of market funding reliance		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	28.9%	a3	↔	a3	Expected trend	Stock of liquid assets	
Combined Liquidity Score		baa1		baa1			
Financial Profile							
				a3			
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				0			
Sovereign or Affiliate constraint				Aa3			
BCA Scorecard-indicated Outcome - Range				a2 - baa1			
Assigned BCA				a3			
Affiliate Support notching				0			
Adjusted BCA				a3			
Balance Sheet							
		in-scope (GBP Million)		% in-scope		at-failure (GBP Million)	% at-failure
Other liabilities		607,653		90.0%		607,653	90.0%
Deposits		0		0.0%		0	0.0%
Preferred deposits		0		0.0%		0	0.0%
Junior deposits		0		0.0%		0	0.0%
Dated subordinated bank debt		1,161		0.2%		1,161	0.2%
Junior subordinated bank debt		201		0.0%		201	0.0%
Senior unsecured holding company debt		29,978		4.4%		29,978	4.4%
Dated subordinated holding company debt		9,687		1.4%		9,687	1.4%
Junior subordinated holding company debt		10		0.0%		10	0.0%
Preference shares(holding company)		6,268		0.9%		6,268	0.9%
Equity		20,256		3.0%		20,256	3.0%
Total Tangible Banking Assets		675,214		100.0%		675,214	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Senior unsecured holding company debt	10.0%	5.6%	10.0%	5.6%	1	1	1	0	0	a3
Dated subordinated holding company debt	5.6%	4.0%	5.6%	4.0%	-1	-1	-1	-1	0	baa1
Holding company non-cumulative preference shares	3.9%	3.0%	3.9%	3.0%	-1	-1	-1	-1	-2	baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Senior unsecured holding company debt	0	0	a3	0	A3	A3
Dated subordinated holding company debt	-1	0	baa1	0	Baa1	Baa1
Holding company non-cumulative preference shares	-1	-2	baa3	0	Baa3 (hyb)	Baa3 (hyb)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 12

Category	Moody's Rating
LLOYDS BANKING GROUP PLC	
Outlook	Stable
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Senior Unsecured	A3
Subordinate	Baa1
Bkd Jr Subordinate -Dom Curr	Baa2 (hyb)
Pref. Stock Non-cumulative	Baa3 (hyb)
Pref. Shelf Non-cumulative	(P)Baa3
Other Short Term -Dom Curr	(P)P-2
LLOYDS BANK PLC	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Senior Unsecured	A1
Subordinate -Dom Curr	Baa1
Commercial Paper	P-1
Other Short Term -Dom Curr	(P)P-1
LLOYDS BANK CORPORATE MARKETS PLC	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Commercial Paper	P-1
Other Short Term	(P)P-1

LLOYDS BANK CORPORATE MARKETS PLC, NY**BRANCH**

Counterparty Risk Rating	A1/P-1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Commercial Paper	P-1

SCOTTISH WIDOWS LIMITED

Outlook	Stable
Insurance Financial Strength	A2
Subordinate -Dom Curr	Baa1 (hyb)

BANK OF SCOTLAND PLC

Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Bkd Senior Unsecured	A1
Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)

HBOS PLC

Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Subordinate	Baa1
Jr Subordinate -Dom Curr	Baa2 (hyb)
ST Issuer Rating	P-1

Source: Moody's Investors Service

Endnotes

- [1](#) Deposit rating, senior unsecured rating, BCA
- [2](#) Deposit rating, senior unsecured/issuer rating, BCA
- [3](#) Where certain other reserve accounts have not been disclosed in the H1 2023 results, the year-end 2022 value has been used as a proxy.

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