

CREDIT OPINION

3 June 2019

Update

✓ Rate this Research

RATINGS

Lloyds Bank Corporate Markets plc

Domicile	United Kingdom
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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 Bank Corporate Markets plc

Update to credit analysis

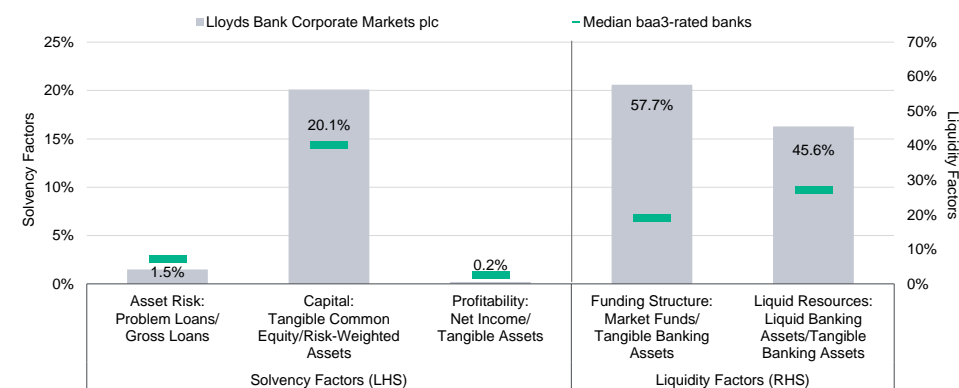
Summary

The A1 long-term deposit and issuer ratings of [Lloyds Bank Corporate Markets plc](#) (LBCM) reflect the bank's standalone creditworthiness, as indicated by a baseline credit assessment (BCA) of baa3; our assessment of a very high probability of affiliate support from [Lloyds Banking Group plc](#) (notional BCA a3), which results in a two-notch uplift to an adjusted BCA of baa1; and extremely low loss given failure, which results in a three-notch uplift. Low probability of government support does not result in additional uplift.

LBCM's BCA of baa3 reflects the bank's sound capitalisation and ample liquidity, as well as high single-name and sector concentration risk in percentage terms relative to equity, and lack of track record as an independent subsidiary.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

- » Sound capitalisation
- » Ample liquidity
- » Very strong interlinkages with Lloyds Banking Group

Credit challenges

- » High exposure to single-name and sector concentration risk relative to equity
- » Limited operating history and lack of track record as an independent subsidiary

Rating outlook

The outlook on LBCM's long-term deposit and issuer ratings is stable, reflecting our expectation of the evolution of the financial metrics for the bank and for Lloyds Banking Group, and for moderate economic growth in the UK.

Factors that could lead to an upgrade

LBCM's long-term deposit and issuer ratings could be upgraded following an upgrade of the bank's BCA, or following an upgrade of the notional BCA of Lloyds Banking Group.

LBCM's BCA could be upgraded following a good track record of stable earnings as an independent entity, or a more limited reliance on market funding.

Factors that could lead to a downgrade

LBCM's deposit and issuer ratings could be downgraded following a material reduction of its stock of bail-in-able debt, a downgrade of LBCM's BCA, or a downgrade of the notional BCA of Lloyds Banking Group.

LBCM's BCA could be downgraded following a material deterioration of the bank's profitability, or by a demonstration of a more aggressive risk appetite in its lending book or capital markets franchise. Furthermore, LBCM's BCA could be downgraded following a material reduction of capital or liquid assets.

Key Indicators

Exhibit 2

Lloyds Bank Corporate Markets plc (Consolidated Financials) [1]

	12-18 ²	CAGR/Avg. ³
Total Assets (GBP Billion)	75.8	.4
Total Assets (USD Billion)	96.5	.4
Tangible Common Equity (GBP Billion)	4.0	.4
Tangible Common Equity (USD Billion)	5.1	.4
Problem Loans / Gross Loans (%)	1.5	1.5 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	20.1	20.1 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.4	7.4 ⁵
Net Interest Margin (%)	0.1	0.1 ⁵
PPI / Average RWA (%)	0.9	0.9 ⁶
Net Income / Tangible Assets (%)	0.2	0.2 ⁵
Cost / Income Ratio (%)	60.0	60.0 ⁵
Market Funds / Tangible Banking Assets (%)	57.7	57.7 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	45.6	45.6 ⁵
Gross Loans / Due to Customers (%)	77.4	77.4 ⁵

[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 due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.

Source: Moody's Investors Service; Company Filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Profile

LBCM is the main non-ring-fenced bank of the Lloyds Banking Group, accounting for around 10% of the group's total assets, following the transfer of the group's wholesale banking operations from [Lloyds Bank plc](#) (the now ring-fenced bank of Lloyds Banking Group) in May 2018.

Compared with other UK non-ring-fenced banks (e.g. [NatWest Markets Plc](#)), LBCM's capital markets and financing activities are simpler and largely client-oriented, leveraging the corporate and institutional client base of the Lloyds Banking Group. LBCM is mainly funded via repurchase agreements with clients, off-shore deposits through its Jersey-based subsidiary [Lloyds Bank International Limited](#) (LBIL, BCA baa2, adjusted BCA baa1, long-term deposit and issuer rating Baa1 stable), and via debt instruments underwritten by Lloyds Banking Group; external wholesale funding (i.e. not coming from Lloyds Banking Group) will gradually increase, but it will remain marginal.

Detailed credit considerations

LBCM published its first full set of financials in 2019. Our historic ratios only reflect numbers as at December 2018.

High single-name and sector concentration risk

Our score for LBCM's asset risk is baa1, four notches below the aa3 Macro Adjusted score to reflect the bank's markets-focused business and structurally high single-name and sector concentrations.

LBCM's stock of problem loans is small at 1.5% of gross loans; however, LBCM is not primarily a lender. For this reason, our expectations of a low stock of problem loans for LBCM in the medium-term is not a key driver in assessing the bank's asset risk.

At December 2018 the fair value of LBCM's derivatives represented more than 20% of the bank's total assets. Even though LBCM's derivatives are driven by customer demand, or they are used to hedge the interest rate and foreign exchange risk of Lloyds Banking Group, they expose LBCM to market and operational risk and to greater income volatility.

Sound capitalisation

LBCM's capitalisation is sound, as reflected in our assigned score of aa2. The score is one notch below the aa1 Macro Adjusted score, reflecting our expectation that capital will slightly reduce.

As at December 2018, LBCM reported a Common Equity Tier 1 (CET1) ratio of 13.7%, which is sound. Our ratio for Tangible Common Equity (TCE) to risk-weighted assets (RWA), which includes high-trigger Additional Tier 1 (AT1) instruments, was 20.1%, which is equivalent to a Macro Adjusted Score of aa1. We expect the capital ratios to slightly reduce as LBCM grows its assets, leading to a one notch negative adjustment. The TCE is 5.3% of LBCM's tangible assets, which is low.

LBCM maintains capitalisation close to internal minimum requirements with any excess being upstream to Lloyds Banking Group. Conversely it receives capital from Lloyds Banking Group as required.

Moderate profitability

We expect LBCM's profitability to be moderate, as reflected in our assigned score of baa3, four notches above the Macro Adjusted score.

In 2018, LBCM reported a £153 million net profit, equivalent to a modest 0.2% return on tangible assets and equivalent to a b1 Macro Adjusted score. This score does not however represent LBCM's earning generation capacity, because most of its assets were transferred in May 2018. We expect LBCM to be able to generate substantially higher profits, driving the higher assigned score.

Ample liquidity

LBCM's Combined Liquidity Score is ba1, reflecting a low Funding Structure score of b3 and a high Liquid Resources score of aa3, which are both in line with the respective Macro Adjusted scores.

The b3 score for Funding Structure reflects LBCM's large stock of wholesale funding (mostly corporate deposits) and off-shore deposits through its Jersey-based subsidiary LBIL, which are partially offset by the stability provided by funding coming from Lloyds Banking Group and by repurchase agreements with clients.

As at December 2018 LBCM's market funds represented a high 58% of tangible banking assets, which excludes wholesale and off-shore deposits, reflecting its business model. We expect LBCM to remain highly reliant on wholesale funding.

We view LBCM's liquid resources as a key mitigating factor to the bank's high reliance on market funding. Our assigned aa3 score for Liquid Resources reflects the material portion of liquid assets for LBCM (46% of tangible banking assets in December 2018), in the form of short-term money market placements to banks and other financial institutions, reverse repurchase agreements with clients, or cash and central bank reserves.

Structurally higher risks and lack of track record

LBCM's BCA is baa3, two notches below the bank's financial profile of baa1.

We apply a one-notch qualitative negative adjustment for Opacity and Complexity, to reflect the more confidence-sensitive nature of the LBCM's capital markets activities; in particular, a material 20% of the bank's assets is composed by derivatives.

Furthermore, to reflect LBCM's limited operating history and lack of track record as an independent banking entity within the Lloyds Banking Group, we assign a BCA that is at the bottom of the baa1-baa3 scorecard-calculated BCA range.

Support and structural considerations

Affiliate support

LBCM's adjusted BCA of baa1 benefits from two notches of affiliate support from Lloyds Banking Group, reflecting our expectation of very high probability of support.

Our expectation balances on the one hand, the significant interconnection between LBCM and Lloyds Bank plc in terms of clients, and its small size in the context of the broader group; and on the other hand, regulatory constraints that limit support from ring-fenced entities in favour of non-ring fenced entities if support leads to a materially higher risks for depositors and bondholders of the ring-fenced entity.

LBCM's baa1 adjusted BCA is one notch below Lloyds Banking Group's a3 notional BCA.

Loss Given Failure (LGF) analysis

Following the implementation of ring-fencing in the UK, we believe that LBCM would be resolved separately from its ring-fenced sister bank, Lloyds Bank plc. As such our LGF analysis for LBCM reflects the entity's own liability structure.

We apply our advanced LGF analysis to LBCM because the bank is incorporated in the UK, which we consider to be an operational resolution regime as it is subject to the EU Bank Recovery and Resolution Directive. For this analysis, we assume residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, and a 25% run-off in junior wholesale deposits. Given that as a non-ring-fenced bank LBCM cannot take retail and SME deposits eligible for deposit insurance, we also assume that junior deposits represent 100% of total deposits. Finally, we assign a 25% probability to deposits being preferred to senior unsecured debt.

Our advanced LGF analysis indicates an extremely low loss-given-failure for junior depositors and senior unsecured bondholders of LBCM, resulting in a three-notch uplift to the relevant ratings from the bank's adjusted BCA of baa1.

Government support considerations

Given the limited interconnections between LBCM and other financial institutions, and the relatively small size of LBCM's operations, we believe there is a low probability of government support for LBCM's deposits and senior debt, resulting in no further uplift to the ratings.

Counterparty Risk (CR) Assessment

Counterparty Risk Assessments (CR Assessments) are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. CR assessments are opinions of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

LBCM's CR Assessments are positioned at A1(cr)/Prime-1(cr).

The long-term CR assessment is three notches above the bank's adjusted BCA of baa1. The uplift derives from the cushion against default provided to the operating obligations by substantial bail-in-able debt and deposits. Our assumption of low probability of government support does not result in further uplift.

The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

Counterparty Risk Ratings (CRRs)

Counterparty Risk Ratings (CRRs) are opinions on the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event that such liabilities are not honoured.

CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivative transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

LBCM's CRRs are positioned at A1/Prime-1

The long-term CRR is three notches above the bank's adjusted BCA of baa1. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. Although LBCM is likely to have more than a nominal volume of CRR liabilities at failure, this has no impact on the CRRs because the significant level of subordination below the CRR liabilities at the bank already provides the maximum amount of uplift under our rating methodology. Our assumption of low probability of government support does not result in further 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 3

Lloyds Bank Corporate Markets plc

Macro Factors

Weighted Macro Profile **Strong +** **100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.5%	aa3	←→	baa1	Sector concentration	Operational risk
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	20.1%	aa1	↓	aa2	Expected trend	
Profitability						
Net Income / Tangible Assets	0.2%	b1	↑↑	baa3	Expected trend	
Combined Solvency Score		a2		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	57.7%	b3	←→	b3	Market funding quality	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	45.6%	aa3	←→	aa3	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		
Financial Profile				baa1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				-1		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				Aa2		
Scorecard Calculated BCA range				baa1 - baa3		
Assigned BCA				baa3		
Affiliate Support notching				2		
Adjusted BCA				baa1		

Balance Sheet	In-scope (GBP Million)	% In-scope	At failure (GBP Million)	% At failure
Other liabilities	39,030	57.6%	43,913	64.8%
Deposits	19,533	28.8%	14,650	21.6%
Preferred deposits	0	0.0%	0	0.0%
Junior Deposits	19,533	28.8%	14,650	21.6%
Senior senior unsecured bank debt	0	0.0%	0	0.0%
Senior unsecured bank debt	45	0.1%	45	0.1%
Junior senior unsecured bank debt	0	0.0%	0	0.0%
Dated subordinated bank debt	725	1.1%	725	1.1%
Junior subordinated bank debt	0	0.0%	0	0.0%
Preference shares (bank)	0	0.0%	0	0.0%
Senior unsecured holding company debt	6,382	9.4%	6,382	9.4%
Dated subordinated holding company debt	0	0.0%	0	0.0%
Junior subordinated holding company debt	0	0.0%	0	0.0%
Preference shares(holding company)	0	0.0%	0	0.0%
Equity	2,032	3.0%	2,032	3.0%
Total Tangible Banking Assets	67,747	100.0%	67,747	100.0%

Debt Class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Rating	35%	35%	35%	35%	3	3	3	3	0	a1
Counterparty Risk Assessment	35%	35%	35%	35%	3	3	3	3	0	a1(cr)
Deposits	35%	13%	35%	14%	3	3	3	3	0	a1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1(cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1

[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 4

Category [Moody's Rating](#)

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
Commercial Paper	P-1

PARENT: 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)
Other Short Term -Dom Curr	(P)P-2

LLOYDS BANK INTERNATIONAL LIMITED

Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa1

Source: Moody's Investors Service

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