

## CREDIT OPINION

4 December 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	A1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
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

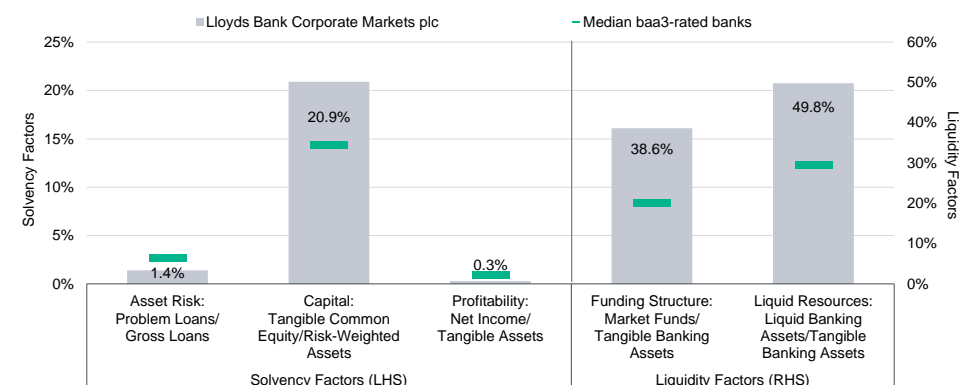
#### Summary

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.

## 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, or a downgrade of LBCM's BCA.

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]

	06-19 <sup>2</sup>	12-18 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (GBP Billion)	78.0	60.9	64.4 <sup>4</sup>
Total Assets (USD Billion)	99.3	77.5	64.1 <sup>4</sup>
Tangible Common Equity (GBP Billion)	4.1	4.0	5.8 <sup>4</sup>
Tangible Common Equity (USD Billion)	5.2	5.1	5.7 <sup>4</sup>
Problem Loans / Gross Loans (%)	1.3	1.5	1.4 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	20.9	20.1	20.5 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.1	7.4	7.2 <sup>5</sup>
Net Interest Margin (%)	0.2	0.2	0.2 <sup>5</sup>
PPI / Average RWA (%)	1.7	0.9	1.3 <sup>6</sup>
Net Income / Tangible Assets (%)	0.3	0.3	0.3 <sup>5</sup>
Cost / Income Ratio (%)	56.5	60.0	58.2 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	46.1	38.6	42.3 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	44.2	49.8	47.0 <sup>5</sup>
Gross Loans / Due to Customers (%)	66.7	64.5	65.6 <sup>5</sup>

[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](http://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](#) (now the 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 branches in the Crown Dependencies, and via debt instruments underwritten by Lloyds Banking Group; external wholesale funding (i.e. not coming from Lloyds Banking Group) has been gradually increasing, 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 of December 2018 and June 2019.

### 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 1.4% 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.

In June 2019 the fair value of LBCM's derivatives represented 19% 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, counterparty and operational risk and to greater income volatility.

### Sound risk-weighted capitalisation

LBCM's capitalisation is sound, as reflected in our assigned score of aa3. The score is two notches below the aa1 Macro Adjusted score, reflecting a relatively low leverage ratio and our expectation that capital will slightly reduce.

As at June 2019, LBCM reported a Common Equity Tier 1 (CET1) ratio of 14.6%, 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 20.9%, 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, and the reported leverage ratio is 3.8%, which are low, leading to an additional notch of adjustment.

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.

### Profitability challenged by weakening operating environment

We expect LBCM's profitability to be modest, as reflected in our assigned score of ba2, in line with the Macro Adjusted score.

In the first half of 2019, LBCM reported a £122 million net profit, equivalent to 0.3% return on tangible assets. The weakening operating environment in the UK has been challenging business activity, leading to modest profitability; we expect this to remain the case in 2020.

### Ample liquidity

LBCM's Combined Liquidity Score is baa3, reflecting a low Funding Structure score of b1 and a high Liquid Resources score of aa3.

The b1 score for Funding Structure is two notches below the ba2 Macro Adjusted score to reflect LBCM's large stock of corporate and off-shore deposits (which are more price- and confidence-sensitive than retail deposits), 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 39% of tangible banking assets. 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, which is in line with the Macro Adjusted score, reflects the material portion of liquid assets for LBCM (44% of tangible banking assets in June 2019), in the form of trading assets excluding derivatives (46% of total liquid assets), cash and central bank reserves (42%), or short-term money market placements to banks and other financial institutions (12%).

### 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 17% of the bank's assets is composed of derivatives, according to our adjustments<sup>1</sup>.

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.

### ESG Considerations

In line with our general view for the banking sector, LBCM has a low exposure to Environmental risks and moderate exposure to Social risks. See our [Environmental risks heatmap](#) and [Social risks heatmap](#) for further information.

Governance is highly relevant for LBCM, as it is to all banks. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for LBCM we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

### 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. 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 a 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	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.4%	aa3	↓↓	baa1	Sector concentration	Operational risk
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	20.9%	aa1	↓	aa3	Nominal Leverage	Expected Trend
Profitability						
Net Income / Tangible Assets	0.3%	ba2	↔	ba2	Return on assets	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	38.6%	ba2	↔	b1	Market funding quality	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	49.8%	aa3	↔	aa3	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		
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		
BCA Scorecard-indicated Outcome - 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%	
Junior deposits		19,533	28.8%	14,650	21.6%	
Senior unsecured bank debt		45	0.1%	45	0.1%	
Dated subordinated bank debt		725	1.1%	725	1.1%	
Senior unsecured holding company debt		6,382	9.4%	6,382	9.4%	
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	Assigned	Additional	Preliminary
	Instrument	Sub-	Instrument	Sub-	De Jure	De Facto	Notching	LGF		
	volume +	ordination	volume +	ordination			Guidance	notching	Notching	Rating
	subordination	subordination	subordination	subordination			vs.			Assessment
							Adjusted			
							BCA			
Counterparty Risk Rating	35.2%	35.2%	35.2%	35.2%	3	3	3	3	0	a1
Counterparty Risk Assessment	35.2%	35.2%	35.2%	35.2%	3	3	3	3	0	a1 (cr)
Deposits	35.2%	13.5%	35.2%	13.6%	3	3	3	3	0	a1
Senior unsecured bank debt	35.2%	13.5%	13.6%	13.5%	3	3	3	3	0	a1

Instrument Class	Loss Given		Additional	Preliminary Rating	Government		Local Currency	Foreign
	Failure	notching			Support	notching	Rating	Currency
				Assessment				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
Senior unsecured bank debt	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
<b>LLOYDS BANK CORPORATE MARKETS PLC</b>	
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
<b>PARENT: LLOYDS BANKING GROUP PLC</b>	
Outlook	Negative
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)
Preference Shelf	(P)Baa3
Other Short Term -Dom Curr	(P)P-2

Source: Moody's Investors Service

## Endnotes

- 1 We net derivative asset and liability amounts, together with related collateral, that are eligible for offset under enforceable market netting agreements but are presented on a gross basis on the balance sheet. Without the adjustment, LBCM's derivatives are 19% of the bank's assets.



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EMEA	44-20-7772-5454