

# MOODY'S

## INVESTORS SERVICE

### CREDIT OPINION

18 November 2022

Update



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#### RATINGS

##### Lloyds Bank plc

Domicile	London, United Kingdom
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A1
Type	Senior Unsecured - Fgn Curr
Outlook	Negative
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 plc

### Update following rating action

#### Summary

We assign a rating of A1 to the long-term deposit and senior unsecured debt of [Lloyds Bank plc](#) (LB), the ring-fenced bank of the [Lloyds Banking Group plc](#) (LBG, senior unsecured rating A3 Stable).

On 25 October 2022, we affirmed LB's and its subsidiaries' long-term issuer ratings, senior unsecured ratings and backed senior unsecured ratings (where applicable) at A1 and we changed the outlook to negative from stable.

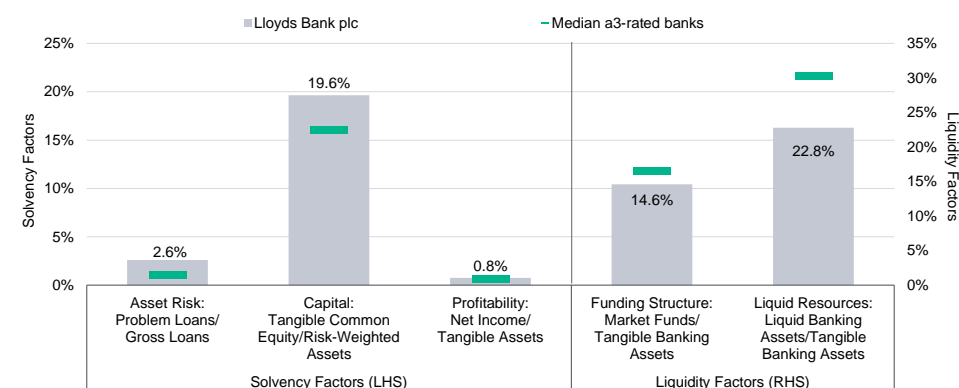
LB's A1 long-term deposit and senior unsecured ratings reflects (1) the bank's standalone creditworthiness, expressed in an a3 Baseline Credit Assessment (BCA); (2) low loss-given-failure, which provides one notch of uplift under our Advanced Loss Given Failure (LGF) analysis; and (3) our assessment of a moderate probability of support from the [Government of the United Kingdom](#) (Aa3 negative), which provides one notch of uplift.

LB's a3 BCA reflects its strong capital, good asset quality, stable retail funding and ample liquidity, and its improving levels of profitability as revenues recover and rates rises support net interest income.

We align the ratings of [HBOS plc](#) and [Bank of Scotland plc](#) subsidiaries to those of LB, to reflect their high integration with LB.

Exhibit 1

#### Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

## Credit strengths

- » Strong capital
- » Low asset risk
- » Stable retail funding and ample liquidity

## Credit challenges

- » Profitability improving due to higher lending margins and moderate cost of risk; however, the macroeconomic environment is deteriorating

## Outlook

The outlook on LB's senior unsecured ratings is negative, reflecting the negative outlook on the UK sovereign debt rating and the proximity of its senior unsecured rating to the UK sovereign debt ratings. A downgrade of the UK sovereign debt rating, which is currently on a negative outlook, would reduce the likelihood of an uplift to LB's A1 senior unsecured ratings by one notch. The outlook on LB's long-term deposit rating is stable reflecting our view that the combined solvency and liquidity metrics will, on a forward-looking basis, remain in line with our current assessment, as its asset quality normalises and its profitability stabilizes, following the pandemic-induced deterioration in 2020, and taking into account tail winds from rising interest rates and headwinds from current macroeconomic pressures.

## Factors that could lead to an upgrade of the ratings

There is limited upward pressure on LB's senior unsecured ratings, as reflected by the negative outlook. The outlook could be stabilised in case the outlook on the UK's sovereign debt rating is changed to stable from negative, if there is a significant increase in the stock of more junior bail-in-able liabilities, or the standalone BCA is upgraded. LB's BCA could be upgraded if the bank's profitability, capital or asset quality improve.

## Factors that could lead to a downgrade of the ratings

LB's senior unsecured ratings could be downgraded if the BCA is downgraded, if there is a significant decline in the stock of bail-in-able liabilities, or if the UK sovereign debt rating is downgraded.

LB's BCA could be downgraded following (1) a deterioration of the UK operating environment beyond our current expectations, or (2) a material decline in the group's capital metrics. A one notch downgrade of the bank's BCA would lead to a downgrade of all its ratings.

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's.com> for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Lloyds Bank plc (Consolidated Financials) [1]

	06-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	12-18 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (GBP Billion)	626.3	602.8	590.5	567.8	578.8	2.3 <sup>4</sup>
Total Assets (USD Billion)	760.6	813.6	807.2	752.2	737.2	0.9 <sup>4</sup>
Tangible Common Equity (GBP Billion)	30.1	31.7	29.6	33.5	35.4	(4.5) <sup>4</sup>
Tangible Common Equity (USD Billion)	36.6	42.8	40.4	44.4	45.0	(5.8) <sup>4</sup>
Problem Loans / Gross Loans (%)	2.6	2.0	2.1	2.0	2.1	2.1 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	17.3	19.6	17.3	19.5	20.3	18.8 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	33.6	24.4	25.6	22.9	23.1	25.9 <sup>5</sup>
Net Interest Margin (%)	2.0	1.8	1.8	2.2	2.1	2.0 <sup>5</sup>
PPI / Average RWA (%)	4.2	3.2	3.2	4.4	3.4	3.7 <sup>6</sup>
Net Income / Tangible Assets (%)	0.8	0.7	1.0	0.9	0.5	0.8 <sup>5</sup>
Cost / Income Ratio (%)	55.4	63.0	62.3	53.5	60.2	58.9 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	17.7	14.6	16.2	17.2	19.5	17.0 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	24.5	22.8	23.5	21.4	21.6	22.8 <sup>5</sup>
Gross Loans / Due to Customers (%)	96.9	96.7	100.6	106.0	108.4	101.7 <sup>5</sup>

[–] 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

## Profile

LB is the ring-fenced bank of Lloyds Banking Group plc (LBG), a leading UK-based financial services group providing a wide range of banking and financial services, focused on retail and commercial customers. LB operates also through other brands, mainly Halifax and Bank of Scotland. The bank retains most of the group's banking businesses, including more than 95% of loans and most of the retail, small and medium-sized enterprise, and corporate deposits.

Besides LB, LBG's other main subsidiaries are the insurer [Scottish Widows Limited](#) (Scottish Widows, IFRS A2 stable), and the non-ring-fenced bank [Lloyds Bank Corporate Markets plc](#) (LBCM, A1/A1 stable), holding capital markets activities, business outside of the European Economic Area and lending to financial institutions.

## Detailed credit considerations

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

### Low asset risk

We assign an a3 Asset Risk score, one notch below the Macro-Adjusted score, reflecting our expectation that Stage 3 loans will moderately increase and then stabilize at just above 2% of loans. IFRS9 Stage 3 loans were 1.9% of gross loans at end-September 2022 (end-June 2022: 1.8%; end-2021: 1.3%) and that Stage 2 loans were 13.2% (end-June 2022: around 10%; end-2021: 7%).

LB's lending book includes high exposure to lower-risk retail mortgages (71%), followed by unsecured and auto lending (9%), and commercial lending (16%) at end-September 2022. LB classifies 4% of its loan book as "Other".

Underwriting standards in the mortgage book are higher than the market's average. The bank remains focused on the prime UK residential mortgage business, a segment with low risks. Riskier mortgages with high loan-to-values of above 90% accounted for 0.4% of gross lending at end-June 2022, lower than the 4.5% market average. Within UK residential mortgages, 17% are buy-to-let loans, which represents a higher proportion than for some of its peers.

### Strong capital

We assign an aa3 Capital score as we expect capital levels to stabilise at current levels in the coming quarters.

LB reported a high Common Equity Tier 1 (CET1) capital ratio of 15.0% at end-September 2022 (16.7% at end-2021), with a significant headroom over c.11% regulatory requirement. The UK leverage ratio was 5.2% at end-September 2022 from 5.3% at end-2021. Our tangible common equity (TCE) ratio was 17.3% at end-June 2022.

### Profitability will significantly improve in 2022; however, long-term trends are uncertain

We assign a baa3 Profitability score, reflecting our expectation that LB's net income will stabilize around £4-4.5 billion in the medium-term, reflecting improved revenue supported by higher net interest margin in 2022, and a moderate increase in the cost of risk in 2023 from a low base. Inflationary pressures, if they persist in 2023, will constrain household incomes and debt servicing capacity and impact business and consumer confidence, weakening credit demand.

For the first nine months of 2022, LB reported profit after tax of £3.3 billion (down from £4.9 billion in the prior period). The decrease largely reflects an impairment charge of £1 billion, most of which related to revisions around the economic outlook including additional risks from a higher inflation and interest rate environment, versus a £791 million impairment reversal in the prior period. Revenue increased by 9% yoy reflecting higher net interest income and net fee and commission income; operating costs decreased by 2% yoy.

### Stable retail funding and ample liquidity

We assign an a3 Combined Liquidity score, reflecting an a3 Funding Structure score and a baa1 Liquid Resources score. LB's Combined Liquidity score is one notch above LBG's, reflecting lower market funding.

LB benefits from its stable and granular retail deposit base: its market share in the UK for personal current accounts was 24% at end-2021, the highest in the country.

LB's reliance on wholesale funding is moderate, representing 18% of tangible banking assets at end-June 2022.

In 2020, LBG replaced all Term Funding Scheme (TFS) balances and Funding for Lending Scheme (FLS) drawings with £13.7 billion borrowings under the Term Funding Scheme with additional incentives for SMEs (TFSME), which allows banks to borrow at an interest close to the Bank Rate for a period of four years. In 2021, LB made net drawings of £16.3 billion from TFSME, taking the total outstanding amount to £30 billion as of end-2021 and has remained at this level through to end-June 2022.

## ESG considerations

### Lloyds Bank plc's ESG Credit Impact Score is Neutral-to-Low CIS-2

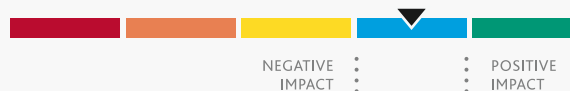
Exhibit 3

#### ESG Credit Impact Score

# CIS-2

## Neutral-to-Low

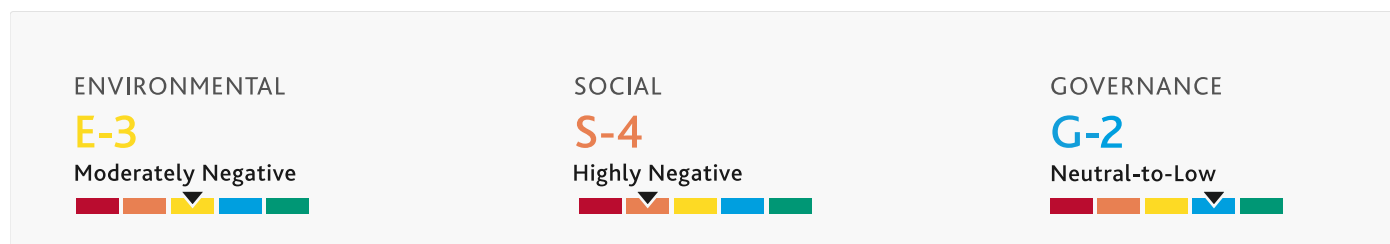
For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.



Source: Moody's Investors Service

Lloyds Bank's ESG Credit Impact Score is neutral-to-low (CIS-2), reflecting limited credit impact from environmental and social factors on the rating to date. Lloyds Bank's governance risk is low, and takes into consideration the group's strong track record of successful streamlining and simplifying the business, stable and credible management along with sound capital, liquidity and risk management.

Exhibit 4

**ESG Issuer Profile Scores**

Source: Moody's Investors Service

**Environmental**

Lloyds faces moderate industrywide 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 is actively engaging in optimizing its loan portfolio longer-term toward less carbon intensive assets.

**Social**

Lloyds Bank faces high industrywide social risks from customer relations: regulatory risk, litigation exposure and high compliance standards, as well as cyber risk and the financial and reputational implications of data breaches. The group also faces industrywide moderate social risks related to potential competition from technological firms and other disruptors.

**Governance**

Lloyds Bank'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. Because Lloyds Bank is fully controlled by Lloyds Banking Group, we have aligned the subsidiary's board structure, policies and procedures score with that of its parent, given the bank's strategic importance and public affiliation with the group (Lloyds Bank contains the ring-fenced business of the group and represents more than 90% of group assets and revenue), the parent's oversight of its subsidiary board and the regulated nature of both entities.

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****Affiliate support**

We expect a very high probability of support from LBG, based on the size and importance of LB within the group. Our assumptions do not lead to any uplift, because LBG and LB have the same BCA.

**Loss Given Failure analysis**

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

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

Our LGF analysis assumes residual TCE of 3%, post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits, and it assigns a 25% probability to deposits being preferred to senior unsecured debt. These assumptions are in line with our standard assumptions. We also assume that the junior proportion of LB's deposits is 26%. These are in line with our standard assumptions.

Our LGF analysis indicates that LB's deposits and senior unsecured debt are likely to face a very low and low loss-given-failure respectively because of the loss absorption provided by subordinated debt (including the debt down-streamed from LBG), and the volume of deposits and senior debt themselves. This results in a two-notch uplift for the long-term deposit and a one-notch uplift to the senior unsecured debt ratings from the BCA.

### Government support considerations

Given LB's systemic importance to the UK economy, reflecting its large national market share of residential mortgages and deposits, we incorporate a moderate probability of government support for deposits and senior unsecured debt, which leads to no uplift for the long-term deposit and a one-notch uplift for the senior unsecured debt ratings.

We believe that potential government support is low for LB's subordinated liabilities, which does not result in any uplift.

### Counterparty Risk (CR) Assessments and Counterparty Risk Ratings (CRRs)

LB's CR Assessments are Aa3(cr)/Prime-1(cr). The long-term CR Assessments, before government support, are three notches above the bank's standalone BCAs of a3. The uplift results from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in no additional notch of uplift.

LB's CRRs are Aa3/Prime-1. The long-term CRRs, before government support, are three notches above the bank's BCAs of a3. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in no additional notch of 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 5

Lloyds Bank 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	2.6%	a2	↔	a3	Sector concentration		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	19.6%	aa2	↔	aa3	Expected trend		
Profitability							
Net Income / Tangible Assets	0.8%	baa1	↔	baa3	Expected trend		
Combined Solvency Score		a1		a3			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	14.6%	a2	↔	a3			
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	22.8%	baa1	↔	baa1			
Combined Liquidity Score		a3		a3			
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			
<b>Balance Sheet</b>		<b>in-scope (GBP Million)</b>	<b>% in-scope</b>	<b>at-failure (GBP Million)</b>	<b>% at-failure</b>		
Other liabilities		93,932	15.7%	139,798	23.4%		
Deposits		449,663	75.2%	403,797	67.5%		
Preferred deposits		332,751	55.6%	316,113	52.8%		
Junior deposits		116,912	19.5%	87,684	14.7%		
Senior unsecured bank debt		5,859	1.0%	5,859	1.0%		
Junior senior unsecured bank debt		17,775	3.0%	17,775	3.0%		
Dated subordinated bank debt		7,183	1.2%	7,183	1.2%		
Junior subordinated bank debt		169	0.0%	169	0.0%		
Preference shares (bank)		5,707	1.0%	5,707	1.0%		
Equity		17,947	3.0%	17,947	3.0%		
Total Tangible Banking Assets		598,235	100.0%	598,235	100.0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional Preliminary	
	Instrument	Sub- volume + subordination	Instrument	Sub- ordination volume + subordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	Notching	Rating Assessment
Counterparty Risk Rating	23.8%	23.8%	23.8%	23.8%	3	3	3	3	0	aa3
Counterparty Risk Assessment	23.8%	23.8%	23.8%	23.8%	3	3	3	3	0	aa3 (cr)
Deposits	23.8%	8.2%	23.8%	9.1%	3	3	3	2	0	a1
Senior unsecured bank debt	23.8%	8.2%	9.1%	8.2%	3	1	2	1	0	a2
Dated subordinated bank debt	5.2%	4.0%	5.2%	4.0%	-1	-1	-1	-1	0	baa1
Junior subordinated bank debt	4.0%	4.0%	4.0%	4.0%	-1	-1	-1	-1	-1	baa2

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	aa3	0	Aa3	Aa3
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3(cr)	
Deposits	2	0	a1	0	A1	A1
Senior unsecured bank debt	1	0	a2	1	A1	A1
Dated subordinated bank debt	-1	0	baa1	0	Baa1	(P)Baa1
Junior subordinated bank debt	-1	-1	baa2	0	Baa2 (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 6

Category	Moody's Rating
<b>LLOYDS BANK PLC</b>	
Outlook	Stable(m)
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
Jr Subordinate -Dom Curr	Baa2 (hyb)
Commercial Paper	P-1
Other Short Term -Dom Curr	(P)P-1
<b>PARENT: LLOYDS BANKING GROUP PLC</b>	
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
<b>BANK OF SCOTLAND PLC</b>	
Outlook	Stable(m)
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
Jr Subordinate -Dom Curr	Baa2 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)
<b>HBOS PLC</b>	
Outlook	Negative
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

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