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CREDIT OPINION
8 February 2019

Update

Rate this Research

RATINGS

Lloyds Bank plc

Domicile	United Kingdom
Long Term CRR	Aa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Aa3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Aa3
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 affirmation of deposit and senior debt ratings

Summary

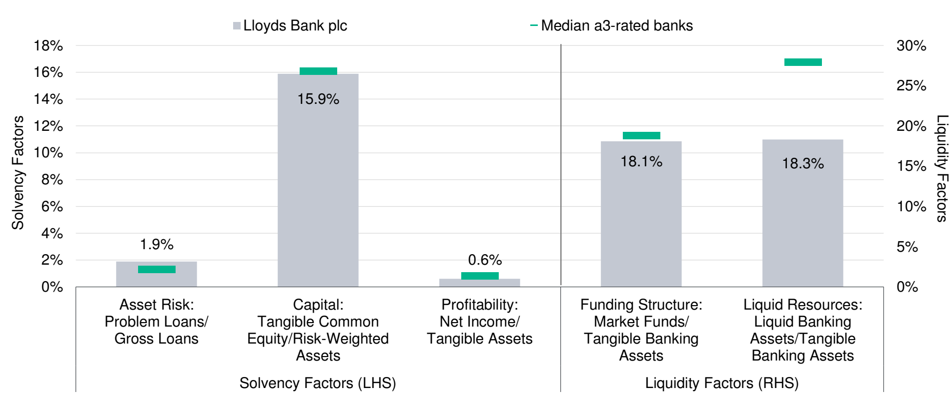
The Aa3 long-term deposit and senior unsecured ratings of Lloyds Bank plc (Lloyds Bank), the ring-fenced bank of the Lloyds Banking Group plc (LBG, senior unsecured rating A3 stable) reflect (1) the bank's a3 Baseline Credit Assessment (BCA); (2) very low loss-given-failure, which provides two notches of uplift under our Advanced Loss Given Failure (LGF) analysis; and (3) a moderate probability of support from the Government of the United Kingdom (Aa2 stable), which leads to an additional notch of uplift.

Lloyds Bank's a3 BCA reflects its low asset risk, stable core earnings, and stable funding, but also weak leverage and our expectation that loan impairments will increase.

We also assign ratings to Lloyds Bank's subsidiaries HBOS plc and Bank of Scotland plc, in line with those of Lloyds Bank, to reflect the high integration with Lloyds Bank.

The outlook on Lloyds Bank's long-term deposit and senior unsecured debt rating is stable. The stable outlook reflects our view that the bank will be resilient to an expected moderate deterioration in the UK operating environment.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Banking Financial Metrics

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Credit strengths

» Low asset risk

» Stable core earnings

» Stable retail funding

Credit challenges

» Weak leverage

» Likely increase in loan impairments

» Volatile conduct-risk costs, albeit reducing

Outlook

The outlook on Lloyds Bank's long-term deposit and senior unsecured debt rating is stable. The outlook reflects our view that the bank will be resilient to an expected moderate deterioration in the UK operating environment.

Factors that could lead to an upgrade

The BCA of Lloyds Bank could be upgraded following a material reduction in conduct risk, higher capital buffers, and an improvement in profitability. An upgrade of the BCA would lead to an upgrade of all long-term ratings of Lloyds Bank.

Factors that could lead to a downgrade

The BCA of Lloyds Bank could be downgraded following a more-acute-than-expected deterioration in the UK's operating environment or a material decline in the bank's capital metrics. Our base case assumption remains that a withdrawal agreement between the UK and the European Union (EU) will be approved with a transition period. A downgrade of the BCA would result in the downgrade of all long-term ratings.

Furthermore, the senior debt ratings of Lloyds Bank could be downgraded following a reduction in the stock of unsecured debt issued to the parent or externally.

Key indicators

Exhibit 2

Lloyds Bank plc (Consolidated Financials) [1]

	6-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (GBP billion)	674	811	813	790	834	-5.9[4]
Total Assets (EUR billion)	762	914	952	1,072	1,074	-9.3[4]
Total Assets (USD billion)	890	1,097	1,005	1,164	1,300	-10.3[4]
Tangible Common Equity (GBP billion)	30	40	39	37	37	-6.4[4]
Tangible Common Equity (EUR billion)	34	45	46	50	48	-9.8[4]
Tangible Common Equity (USD billion)	39	54	48	54	58	-10.7[4]
Problem Loans / Gross Loans (%)	-	1.7	1.9	2.1	2.9	2.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	15.9	19.3	18.1	16.4	15.5	17.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	-	18.5	20.4	24.2	32.6	23.9[5]
Net Interest Margin (%)	2.0	1.9	1.5	1.4	1.3	1.6[5]
PPI / Average RWA (%)	2.7	3.7	2.5	3.0	2.1	2.8[6]
Net Income / Tangible Assets (%)	0.7	0.7	0.9	0.1	0.6	0.6[5]
Cost / Income Ratio (%)	65.1	54.4	63.0	33.4	67.9	56.8[5]
Market Funds / Tangible Banking Assets (%)	23.4	18.1	17.9	19.5	20.1	19.8[5]

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Liquid Banking Assets / Tangible Banking Assets (%)	17.9	18.3	19.2	26.1	25.1	21.3[5]
Gross Loans / Due to Customers (%)	111.3	109.3	107.1	106.7	109.4	108.8[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 Financial Metrics

Profile

Lloyds Bank is the ring-fenced bank of the Lloyds Banking Group plc (LBG), a leading UK-based financial services group providing a wide range of banking and financial services, focused on personal and commercial customers.

The bank retains most of the group's businesses, including 97% of the loan portfolio and most of the retail, small and medium-sized enterprise business, and corporate deposits.

Besides Lloyds Bank, LBG's other main subsidiaries are insurer Scottish Widows Limited (Scottish Widows, IFRS A2 stable), the non-ring-fenced bank Lloyds Bank Corporate Markets plc (LBCM, A1/A1 stable, baa3/baa1[1]), and its offshore bank Lloyds Bank International Limited (LBIL, Baa1/Baa1 stable, baa2/baa1).

In the first quarter of 2018, as part of the UK's structural reform (so-called ring-fencing) capital markets activities, non-EEA business and lending to financial institutions were transferred to LBCM and LBIL from Lloyds Bank.

Detailed credit considerations

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

Low asset risk, but impairments will increase

We assign a baa1 Asset Risk score, three notches below the Macro-Adjusted score, taking into account (1) our expectation of a mild increase in the stock of problem loans, driven by a weakening operating environment in the UK, (2) moderate exposure to higher risk buy-to-let mortgages and unsecured consumer credit products, and (3) remaining conduct and litigation risks.

The assigned Asset Risk score for Lloyds Bank is in line with that for LBG. The amount of capital market activities transferred to LBCM was too small to materially reduce Lloyds Bank's asset risk.

Good risk-weighted capital ratios, but weak leverage

Capital is a strength for Lloyds Bank. We assign an a1 score to the bank's Capital assessment, one notch below the Macro Adjusted score to reflect high leverage, as well as our expectation that Lloyds Bank's capital ratios will decline in line with the group's targets.

In June 2018 Lloyds reported a Common Equity Tier 1 (CET1) ratio of 15.1%; this is equivalent to our Tangible Common Equity (TCE) over risk-weighted assets of 15.9%, which is high.

Strong risk-weighted capitalisation is partly offset by relatively high leverage, with TCE representing 4.4% of tangible assets as of June 2018.

The assigned Capital score for Lloyds Bank is two notches below LBG, reflecting (1) LBG's ownership of Scottish Widows, which provides a stable source of dividends and which LBG could dispose in an extremely stressed scenario, and (2) better leverage for LBG.

Stable core earnings, conduct-risk related costs are reducing, but they will remain volatile

The baa3 assigned Profitability score for Lloyds Bank is one notch below the Macro Adjusted score, reflecting our expectation that Lloyds Bank's profitability will reduce.

The historic ratios incorporate the result of insurer Scottish Widows, which Lloyds Bank transferred to LBG in 2018. Excluding the result of the insurance subsidiary, and the proceeds from its sale, we calculate that in H1 2018 Lloyds Bank would have reported an annualised return on tangible assets of around 0.5%; this is equivalent to a baa3 Macro Adjusted score.

Cost of risks will mildly increase, in line with our macro-economic assumptions for the UK.

Finally, we believe that conduct-related costs will remain volatile in 2019. In particular, charges related to Payment Protection Insurance (PPI) have changed frequently in response to shifting claimant behaviour.

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The assigned Profitability scores for Lloyds Bank and LBG are the same. Nevertheless, we believe that Lloyds Bank's profitability is weaker than the group, as LBG's insurance subsidiary Scottish Widows provides earnings diversification to the group.

Stable retail funding

We assign a baa1 Combined Liquidity score, reflecting an a3 Funding Structure score and a baa2 Liquid Resources score, which are both in line with their respective Macro Adjusted scores.

The Combined Liquidity score of Lloyds Bank is in line with that of LBG. In line with its retail nature, Lloyds Bank is less reliant on market funds, and its Funding Structure score is one notch higher than LBG's; the funding of the holding company is entirely wholesale, and it does not entirely downstream its funding to Lloyds Bank.

At the same time, the Liquid Resources score ratio of Lloyds Bank is two notches lower than LBG's, reflecting the high stock of liquid assets held by non-ring-fenced LBCM.

Support and structural considerations

Loss Given Failure analysis

Lloyds Bank is subject to the UK implementation of the European Union's Bank Recovery and Resolution Directive (BRRD), which we consider to be an operational resolution regime.

Our analysis assumes residual tangible common equity 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 Lloyds Bank's deposits is consistent with the estimated European Union-wide average of 26%. These are in line with our standard assumptions.

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

Junior securities issued by Lloyds Bank are likely to face a high level of loss-given-failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity. We also incorporate additional notching for junior subordinated and preference share instruments, reflecting the coupon features.

Government support considerations

Given Lloyds Bank'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, leading to a one-notch uplift for the long-term deposit and senior unsecured debt ratings.

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

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and they 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; and (2) apply to counterparty obligations and contractual commitments, rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

Lloyds Bank's CR Assessments are positioned at Aa2(cr)/Prime-1(cr)

The long-term CR Assessment, before government support, is three notches above the bank's standalone BCA of a3. The uplift results from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. Moderate probability of government support result in one additional notch of uplift. The main difference from the Advanced LGF approach that is used to determine instrument rating is that the CR Assessment captures the probability of default on certain senior obligations, rather than the expected loss. Therefore, we focus purely on subordination and take no account of the volume of the instrument class.

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Counterparty Risk Ratings (CRRs)

The 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.

Lloyds Bank's CRRs are positioned at Aa2/Prime-1

The long-term CRR, before government support, is three notches above the bank's BCA of a3. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. Moderate probability of government support results in one additional notch of uplift. Although Lloyds Bank 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.

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.

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Rating methodology and scorecard factors

Exhibit 3

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	1.9%	a1	↓	baa1	Expected trend	Litigation risk
Capital						
TCE / RWA	15.9%	aa3	↓	a1	Nominal leverage	Expected trend
Profitability						
Net Income / Tangible Assets	0.6%	baa2	←→	baa3	Expected trend	
Combined Solvency Score		a2		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	18.1%	a3	←→	a3	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.3%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		baa1		baa1		
Financial Profile				a3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				a2-baa1		
Assigned BCA				a3		
Affiliate Support notching				0		
Adjusted BCA				a3		

Balance Sheet is not applicable.

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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				
Counterparty Risk Rating	--	--	--	--	--	--	--	3	0	aa3
Counterparty Risk Assessment	--	--	--	--	--	--	--	3	0	aa3 (cr)
Deposits	--	--	--	--	--	--	--	2	0	a1
Senior unsecured bank debt	--	--	--	--	--	--	--	2	0	a1
Dated subordinated bank debt	--	--	--	--	--	--	--	-1	0	baa1
Junior subordinated bank debt	--	--	--	--	--	--	--	-1	-1	baa2 (hyb)
Cumulative bank preference shares	--	--	--	--	--	--	--	-1	-2	baa3 (hyb)

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	1	Aa2	Aa2
Counterparty Risk Assessment	3	0	aa3 (cr)	1	Aa2 (cr)	--
Deposits	2	0	a1	1	Aa3	Aa3
Senior unsecured bank debt	2	0	a1	1	Aa3	Aa3
Dated subordinated bank debt	-1	0	baa1	0	Baa1	Baa1
Junior subordinated bank debt	-1	-1	baa2 (hyb)	0	Baa2 (hyb)	Baa2 (hyb)
Cumulative bank preference shares	-1	-2	baa3 (hyb)	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 Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
LLOYDS BANK PLC	
Outlook	Stable
Counterparty Risk Rating	Aa2/P-1
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Senior Unsecured	Aa3
Subordinate	Baa1
Jr Subordinate	Baa2 (hyb)
Pref. Stock	Baa3 (hyb)
Commercial Paper	P-1
Other Short Term -Dom Curr	(P)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)
Preference Shelf	(P)Baa3
Other Short Term -Dom Curr	(P)P-2
BANK OF SCOTLAND PLC	
Outlook	Stable
Counterparty Risk Rating	Aa2/P-1
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3

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Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Issuer Rating	Aa3
Bkd Senior Unsecured	Aa3
Subordinate -Dom Curr	Baa1
Jr Subordinate	Baa2 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)
HBOS PLC	
Outlook	Stable
Counterparty Risk Rating	Aa2/P-1
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Issuer Rating	Aa3
Subordinate	Baa1
Jr Subordinate -Dom Curr	Baa2 (hyb)
ST Issuer Rating	P-1
HBOS CAPITAL FUNDING NO. 1 L.P.	
BACKED Pref. Stock Non-cumulative	Baa3 (hyb)
HALIFAX LIMITED	
Bkd Subordinate -Dom Curr	Baa1
Bkd Jr Subordinate -Dom Curr	Baa3 (hyb)
HBOS CAPITAL FUNDING NO. 2 L.P.	
BACKED Pref. Stock Non-cumulative	Baa3 (hyb)
HBOS GROUP STERLING FINANCE L.P.	
BACKED Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)
BANK OF SCOTLAND CAPITAL FUNDING L.P.	
BACKED Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)

Source: Moody's Investors Service

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Endnotes

1 The bank's ratings shown in this report are the deposit rating, senior unsecured debt/issuer rating, and the BCA and adjusted BCA respectively.

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