FitchRatings

21 NOV 2024

Fitch Upgrades Lloyds Banking Group to 'A+'; Outlook Stable

Fitch Ratings - London - 21 Nov 2024: Fitch Ratings has upgraded Lloyds Banking Group plc's (LBG) Long-Term Issuer Default Rating (IDR) to 'A+' from 'A' and Viability Rating (VR) to 'a+' from 'a'.

Fitch has also upgraded the Long-Term IDRs of LBG's ring-fenced bank subsidiaries, Lloyds Bank plc (LB), HBOS plc, Bank of Scotland Plc (BOS) and Lloyds Bank GmbH (LGmbH), and its non-ring-fenced bank subsidiaries, Lloyds Bank Corporate Markets plc (LBCM) and Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH (LBCMW), to 'AA-' from 'A+'. A full list of rating actions is below.

The upgrades reflect LBG's consistently solid profitability through various economic and interest-rate cycles and its conservative risk profile, which result in resilient asset quality and sound capital and liquidity buffers. These factors are underpinned by LBG's solid and diversified business model.

The recent UK Court of Appeal ruling in favour of customers regarding commissions that lenders pay to car dealerships for arranging loans raises considerable uncertainty and potentially significant implications for bank lenders, including for LBG. Notwithstanding this uncertainty, the upgrade reflects LBG's solid loss-absorption capacity against potential customer redress costs and our view that its credit profile will be relatively unscathed by this process.

Key Rating Drivers

Leading UK Bank: LBG's ratings reflect its solid, diversified business profile in the UK, supported by its leading retail and business banking franchises and insurance operations. The ratings also reflect consistently solid profitability and strong capitalisation and funding profiles.

Conservative Risk Profile: LBG's risk profile is underpinned by the high share of low-risk mortgage lending (68% of loans at end-3Q24) with low loan-to-value ratios (stock average: 43%). Higher-risk unsecured consumer loans (6% of gross loans) and commercial lending (19%) increase risks, although they are mitigated by conservative underwriting standards. Our assessment also incorporates LBG's strong and resilient performance through economic cycles, underpinned by robust risk controls.

Asset Quality to Remain Strong: We expect LBG's asset quality to remain strong over the next two years, with the impaired loans ratio (end-3Q24: 2.2%) close to 2% by end-2026. Asset quality should be supported by the improving macroeconomic outlook and sound underwriting standards. Loan impairment charges should remain easily absorbable given the largely secured loan portfolio.

Consistently Solid Profitability: LBG's profitability has been consistently strong and compares well with large UK and European peers. Its operating profit/risk-weighted assets (RWAs) ratio moderated in

9M24 (3.1%; 2023: 3.5%), largely driven by lower net interest income, but we expect it to remain strong at over 3% in 2025-2026 supported by structural hedge income, falling funding costs and contained LICs. Revenue diversification and strategic investments to boost non-interest income should also support earnings.

LBG's loss absorption capacity is significant, given we forecast an annual pre-impairment operating profit of about GBP8 billion in 2025-2026, which provides a solid buffer to mitigate any material redress costs that may arise from the FCA's motor finance review or from the recent Court of Appeal ruling.

Strong Capitalisation: We expect LBG's capitalisation to remain strong and commensurate with its rating despite its target to reduce the common equity Tier 1 (CET1) ratio (end-3Q24: 14.3%) to 13% by end-2026, through further capital distributions. Our assessment is supported by LBG's solid capital generation and prudent risk management. LBG could also retain capital in case of a new significant requirement for provisions against motor finance to support capital ratios.

Sound Funding and Liquidity: LBG's funding and liquidity profile is sound, supported by a large and granular deposit base and leading franchise. We expect the loans/deposits ratio (end-3Q24: 97%) to remain broadly stable and liquidity to remain strong. Funding stability is underpinned by proven access to diversified wholesale funding and contingent Bank of England facilities, if needed.

LBG's Short-Term IDR of 'F1' is the lower of two options mapping to the 'A+' Long-Term IDR, as our assessment of the group's funding and liquidity profile does not warrant a higher rating. The Short-Term IDRs of LBG's subsidiaries are at 'F1+', the only option mapping to their 'AA-' Long-Term IDRs.

Group VR: LBG acts as the holding company for the group, and its VR is equalised with that of its core banks, LB and BOS, reflecting LBG's high integration with the group, and low double leverage. The Long-Term IDRs of LBG's subsidiaries are one notch higher than LBG's to reflect available resolution debt buffers.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

LBG's ratings could come under pressure if the impact of the FCA motor finance review and the broader implications of the recent court ruling is more significant than we currently expect, particularly if remediation costs materially affect earnings, capital ratios and strategic execution over a prolonged period.

LBG's ratings could also come under pressure if we expected the four-year average impaired loans ratio to increase above 3% without a clear path to reduction, and a sustained deterioration in operating profit to below 2.5% of RWAs that also led to the CET1 ratio falling below 13% on a sustained basis.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

A further upgrade of LBG's ratings is currently unlikely, given the group's high concentration in the UK market. An upgrade would therefore require a significant strengthening of the UK operating environment, together with a substantial strengthening of the group's business profile, coupled with continued record of solid operating profitability, strong asset quality and capitalisation.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Debt Ratings, Derivative Counterparty Rating (DCR)

The long-term senior unsecured debt and DCR of LBG and of its subsidiaries, where applicable, are in line with the respective Long-Term IDRs.

Tier 2 debt issued by LBG, LB and HBOS is rated two notches below their VRs (LBG's VR for HBOS). This is the baseline notching under our criteria, reflecting high loss severity for this type of debt.

The ratings of legacy upper Tier 2 subordinated debt issued by LBG, LB, HBOS and BOS are notched down three times: twice for loss severity and once for incremental non-performance risk.

Additional Tier 1 and legacy Tier 1 and preferred stock issued by LBG are four notches below the anchor VR, two each for loss severity and incremental non-performance risk. Our assessment is based on the group operating with a CET1 ratio comfortably above the maximum distributable amount (MDA) thresholds and we expect this will continue.

GOVERNMENT SUPPORT RATINGS (GSR)

The GSRs of 'no support' for LBG, LB and BOS reflect Fitch's view that senior creditors cannot rely on extraordinary support from the UK authorities if these issuers become non-viable, due to UK legislation and regulations that provide a framework requiring senior creditors to participate in losses after a failure.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The senior unsecured debt and DCRs of these entities, where available, would be downgraded if their Long-Term IDRs were downgraded.

The ratings assigned to Tier 2 debt, AT1, legacy Tier 1 debt and preferred stock, where relevant, would be downgraded if the respective VRs were downgraded.

AT1 and other discretionary Tier 1 instruments are also sensitive to Fitch changing its assessment of the probability of their non-performance relative to the risk captured in LBG's VR and could be downgraded if the headroom to MDA-thresholds dropped below 100bp.

Factors that Could, Individually or Collectively Lead to Positive Rating Action/Upgrade

The long-term senior unsecured debt ratings and DCRs would be upgraded if the Long-Term IDRs of the respective entities were upgraded.

The Tier 2 debt, AT1, legacy Tier 1 debt and preferred stock ratings would be upgraded if the respective VRs were upgraded.

Any upgrade of the GSRs of LBG, LB and BOS would be contingent on a positive change in the sovereign's propensity to support domestic banks, which Fitch considers highly unlikely in light of the resolution framework in place.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The 'AA-' Long-Term IDRs of LB and BOS are notched up once from their VRs to reflect the presence of a large buffer of qualifying junior debt and senior holding company debt downstreamed in a subordinated manner, underpinned by minimum requirement for own fund and eligible liabilities regulations. We also incorporate this benefit into the IDRs of HBOS, LBCM, LBCMW and LGmbH. These entities have not been assigned VRs as Fitch believes that these entities cannot be assessed meaningfully on a standalone basis. Their IDRs reflect a very high probability of shareholder support from LBG, if needed.

The 'a+' Shareholder Support Ratings (SSRs) of HBOS, LBCM and LBCMW reflect a very high probability of shareholder support in case of need, given their strategic roles in the wider group, high level of ownership by LBG, and reputational risks for LBG in case of their potential default. LGmbH's 'aa-' SSR reflects its direct and strategic ownership by LB.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The subsidiaries' IDRs that benefit from an uplift due to resolution funds could be downgraded if we no longer expect that the group's resolution planning and requirements afford the subsidiaries' senior creditors protection in a group failure scenario. The SSRs and IDRs of HBOS, LBCM, LGmbH and LBCMW are also sensitive to a reduction in their parents' ability or propensity to support the entities.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

The subsidiaries' SSRs and IDRs would be upgraded if LBG's IDRs were upgraded.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visithttps://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
HBOS plc	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	Shareholder Support	a+	Upgrade		a
• subordinated	LT	BBB+	Upgrade		BBB

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• subordinated	LT	A-	Upgrade		BBB+
Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	Shareholder Support	a+	Upgrade		a
Lloyds Banking Group plc	LT IDR	A+	Upgrade		A
	ST IDR	F1	Affirmed		F1
	Viability	a+	Upgrade		a
	Government Support	ns	Affirmed		ns
• subordinated	LT	BBB+	Upgrade		BBB
• subordinated	LT	BBB	Upgrade		BBB-
• senior unsecured	LT	A+	Upgrade		A

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• subordinated	LT	A-	Upgrade		BBB+
• senior unsecured	ST	F1	Affirmed		F1
Bank of Scotland Plc	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	Viability	a+	Upgrade		a
	DCR	AA-(dcr)	Upgrade		A+(dcr)
	Government Support	ns	Affirmed		ns
• senior unsecured	LT	AA-	Upgrade		A+
• subordinated	LT	BBB+	Upgrade		BBB
Lloyds Bank plc	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	Viability	a+	Upgrade		a
	DCR	AA-(dcr)	Upgrade		A+(dcr)
	Government	ns	Affirmed		ns

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Support				
• senior unsecured	LT	AA-	Upgrade		A+
• subordinated	LT	BBB+	Upgrade		BBB
• subordinated	LT	A-	Upgrade		BBB+
• senior unsecured	ST	F1+	Upgrade		F1
Lloyds Bank GmbH	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	Shareholder Support	aa-	Upgrade		a+
Lloyds Bank Corporate Markets plc	LT IDR	AA-	Upgrade		A+
	ST IDR	F1+	Upgrade		F1
	DCR	AA-(dcr)	Upgrade		A+(dcr)
	Shareholder Support	a+	Upgrade		a

ENTITY/DEBT		RATING		RECOVERY	PRIOR
• senior unsecured	LT	AA-	Upgrade		A+
• senior unsecured	ST	F1+	Upgrade		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◉	◆
STABLE	○	

Applicable Criteria

Bank Rating Criteria (pub.15 Mar 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Bank of Scotland Plc	UK Issued, EU Endorsed
HBOS plc	UK Issued, EU Endorsed
Lloyds Bank Corporate Markets plc	UK Issued, EU Endorsed
Lloyds Bank Corporate Markets Wertpapierhandelsbank GmbH	UK Issued, EU Endorsed
Lloyds Bank GmbH	UK Issued, EU Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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