

## UK Banks

## Motor finance uncertainty

## Industry Overview

## Keeping the cost of equity high

It will be Q3 before we know if the Financial Conduct Authority's (FCA) motor finance review will lead to a compensation scheme or how it will be structured. In the meantime, we expect investors to worry where, in our £1-13bn range, the industry cost could land and the extent to which it will affect capital distributions. This is a wide range but substantially below the cost of PPI (payment protection insurance) remediation. Early indications are that the FCA is aiming for a better managed process than PPI, that the industry hopes will provide insight on the ultimate cost much sooner. A 16% share of the motor finance market makes Lloyds the most impacted in our coverage. We expect uncertainty to limit near term capital distributions and hold back a re-rating, particularly combined with 2024E margin decline, and [downgrade to Neutral](#) (report link).

## Decision expected in Q3

Having banned discretionary commissions incentivising brokers to increase motor finance interest rates in 2021, the FCA has launched an investigation into industry conduct. Should it find that consumers have lost out, the FCA will establish a framework for identifying those impacted and compensating them. Next steps will be outlined in 3Q24 and customers will have until February 2026 to lodge complaints.

## £1-£13bn potential industry cost

As the FCA has already identified concerns on this market, a compensation framework for affected customers seems the likely outcome. The overall cost to the industry is much more uncertain, potentially from £1bn to £13bn, depending on how the compensation is structured and how retrospective it is. The data retention constraints of GDPR (General Data Protection Regulation) mean that 10 years is likely to be the limit to retrospective claims.

## £1bn based on the FCAs baseline estimate, effective 2016

The FCA has estimated a £165m annual overpayment for the industry as a result of this practice. If backdated to 2016 that would be £0.8bn of cumulative overpayments. With 8% annual interest and compounding, the total remediation cost would be £1.4bn. Applying this 10 years retrospectively and adding 25% administration expenses would increase the cost to £3.6bn.

## £13bn on Ombudsman ruling backdated 10 years

Financial Ombudsman Service rulings in favour of two customers have been a key prompt for the FCA review. The case in respect to Lloyds recompensed the customer to the lowest interest rate available and applied 8% annual interest to the implied overpayment. Scaling this up for the industry suggests a much more severe outcome, ranging from £9bn from 2016, when this particular loan was made, to £13bn if it's applied to all lending over the past 10 years and there's a 25% administration cost.

15 January 2024

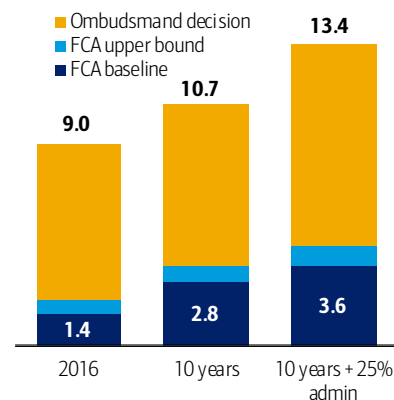
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**Exhibit 1: Motor finance review could cost the industry £1-13bn**

Cost to UK motor finance providers (£bn)



Source: BofA Global Research estimates  
BofA GLOBAL RESEARCH

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Refer to important disclosures on page 4 to 7. Analyst Certification on page 2. Price Objective Basis/Risk on page 2.

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Timestamp: 15 January 2024 12:00AM EST

**Exhibit 2: Stocks mentioned**

Prices and ratings for stocks mentioned in this report

<b>BofA Ticker</b>	<b>Bloomberg ticker</b>	<b>Company name</b>	<b>Price</b>	<b>Rating</b>
LLDTF	LLOY.LN	Lloyds Banking Group	44.98p	B-2-7
LYG	LYG US	Lloyds Banking Group	US\$ 2.27	B-2-7

Source: BofA Global Research

BofA GLOBAL RESEARCH

**Price objective basis & risk****Lloyds Banking Group (LLDTF / LYG)**

We value Lloyds using a Gordon Growth methodology using 2026E as a base year and a 13% CoE. We add to this valuation the present value of our forecast dividends and share buybacks through to 2026E discounted at the cost of equity. This is then cross checked against sector PE multiples and our economic scenarios analysis to arrive at our PO of 52p (\$2.64).

Downside risks to our price objective are weaker earnings than anticipated from higher impairment losses if the UK economy performs worse than we presently expect, a weaker interest rate outlook, tougher regulation and/or increased competition. Upside risks are stronger UK growth fewer interest rate cuts, a more constructive pricing environment and lower conduct costs.

**Analyst Certification**

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## EMEA - Banks Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Allied Irish Banks	AIBRF	AIBG ID	Alastair Ryan
	Bank of Ireland Group	XBOIF	BIRG ID	Alastair Ryan
	BFF Banking Group	XBBZF	BFF IM	Antonio Reale
	BNP Paribas	BNPQF	BNP FP	Tarik El Mejjad
	BNP Paribas	BNPQY	BNPQY US	Tarik El Mejjad
	CaixaBank	CIXPF	CABK SQ	Antonio Reale
	Credit Agricole	CRARF	ACA FP	Tarik El Mejjad
	Danske Bank	DNSKF	DANSKE DC	Tarik El Mejjad
	Erste Bank	EBKOF	EBS AV	Alastair Ryan
	Erste Bank	EBKDY	EBKDY US	Alastair Ryan
	HSBC	XHSBF	5 HK	Alastair Ryan
	HSBC	HBCYF	HSBA LN	Alastair Ryan
	HSBC -A	HSBC	HSBC US	Alastair Ryan
	Intesa Sanpaolo	IITSF	ISP IM	Antonio Reale
	Intesa Sanpaolo	ISNPY	ISNPY US	Antonio Reale
	KBC Group	KBCSF	KBC BB	Tarik El Mejjad
	KBC Group NV	KBCSY	KBCSY US	Tarik El Mejjad
	NatWest Group	RBSPF	NWG LN	Rohith Chandra-Rajan
	Natwest Group PLC	NWG	NWG US	Rohith Chandra-Rajan
	Nordea	NBNKF	NDA FH	Tarik El Mejjad
	Nordea	XSABF	NDA SS	Tarik El Mejjad
	Nordea Bank Abp	NRDBY	NRDBY US	Tarik El Mejjad
	Santander	SAN	SAN US	Antonio Reale
	Santander	BCDRF	SAN SQ	Antonio Reale
	Societe Generale	SCGLF	GLE FP	Tarik El Mejjad
	Societe Generale	SCGLY	SCGLY US	Tarik El Mejjad
	Unicredit	UNCFE	UCG IM	Antonio Reale
	Unicredit	UNCRY	UNCRY US	Antonio Reale
<b>NEUTRAL</b>				
	ABN AMRO	ABMRF	ABN NA	Tarik El Mejjad
	Banco Bilbao Vizcaya Argentaria	BBVA	BBVA US	Antonio Reale
	Banco BPM	BNCZF	BAMI IM	Antonio Reale
	Bankinter	BKIMF	BKT SQ	Antonio Reale
	BBVA	BBVXF	BBVA SQ	Antonio Reale
	Commerzbank	CRZBF	CBK GY	Rohith Chandra-Rajan
	Handelsbanken	SVNLF	SHBA SS	Tarik El Mejjad
	ING Groep NV	ING	ING US	Tarik El Mejjad
	ING Groep NV	INGVF	INGA NA	Tarik El Mejjad
	Lloyds Banking Group	LLDTF	LLOY LN	Rohith Chandra-Rajan
	Lloyds Banking Group	LYG	LYG US	Rohith Chandra-Rajan
	Monte dei Paschi	BMDPF	BMPS IM	Antonio Reale
	Raiffeisen Bank International	RAIFF	RBI AV	Alastair Ryan
	StanChart	SCBFF	STAN LN	Alastair Ryan
	StanChart	XCHBF	2888 HK	Alastair Ryan
	Svenska Handelsbanke	SVNLY	SVNLY US	Tarik El Mejjad
	UBS	XUJHF	UBSG SW	Alastair Ryan
	UBS	UBS	UBS US	Alastair Ryan
<b>UNDERPERFORM</b>				
	Banco Sabadell	BNDSE	SAB SQ	Antonio Reale
	Barclays	BCLYF	BARCLN	Rohith Chandra-Rajan
	Barclays	BCS	BCS US	Rohith Chandra-Rajan
	Deutsche Bank	DB	DB US	Rohith Chandra-Rajan
	Deutsche Bank	XDUSF	DBK GY	Rohith Chandra-Rajan
	DNB	DNBBF	DNB NO	Tarik El Mejjad
	DNB ASA	DNBBY	DNBBY US	Tarik El Mejjad
	Mediobanca	MDIBF	MB IM	Antonio Reale
	Permanent TSB	ILPMF	PTSB ID	Alastair Ryan
	Poste Italiane	PITAF	PST IM	Antonio Reale
	SEB	SVKEF	SEBA SS	Tarik El Mejjad
	Swedbank	SWDBF	SWEDA SS	Tarik El Mejjad
	Swedbank AB	SWDBY	SWDBY US	Tarik El Mejjad
	Virgin Money UK PLC	CBBYF	VMUK LN	Rohith Chandra-Rajan
	Virgin Money UK PLC	CYBBF	VUK AU	Rohith Chandra-Rajan



## EMEA - Banks Coverage Cluster

Investment rating

Company

BofA Ticker

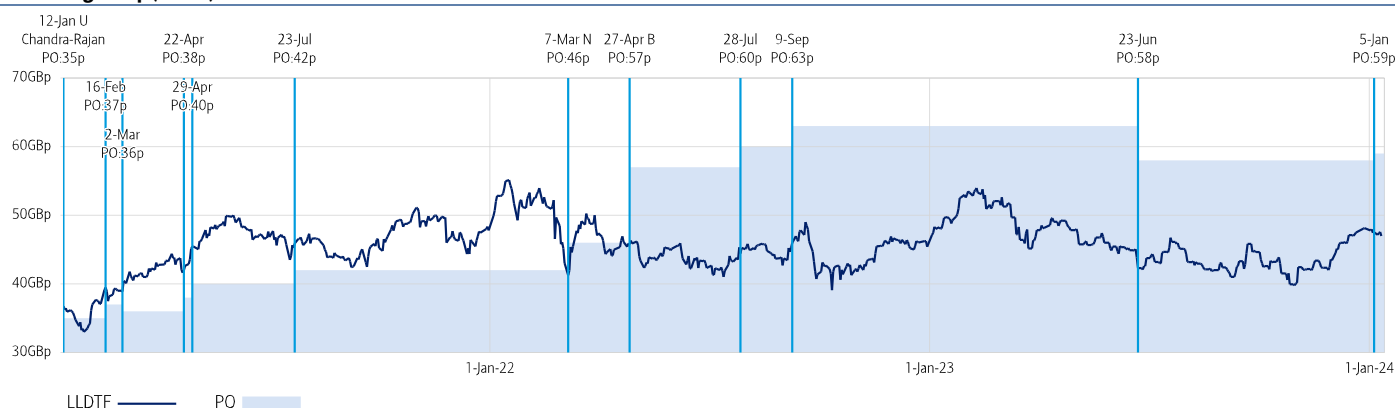
Bloomberg symbol

Analyst

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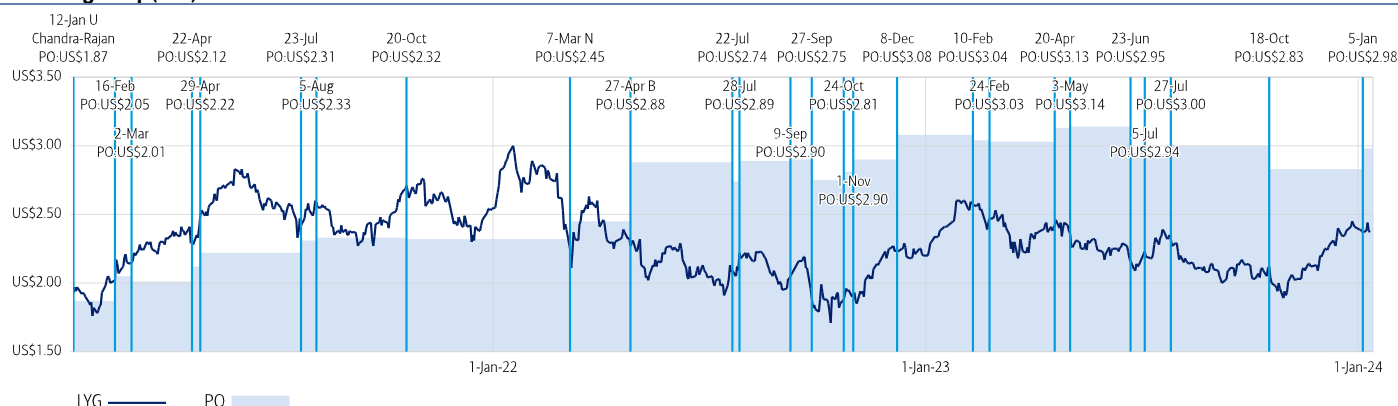
## Lloyds Banking Group (LLDTF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

## Lloyds Banking Group (LYG) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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## Equity Investment Rating Distribution: Banks Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	100	49.75%	Buy	84	84.00%
Hold	54	26.87%	Hold	41	75.93%
Sell	47	23.38%	Sell	35	74.47%

## Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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