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17 April 2015

Dear Mr Bailey

Lloyds Banking Group
Enhanced Capital Notes (ECNs) and stress testing

We act for BNY Mellon Corporate Trustee Services Limited (the **Trustee**), which is the trustee for the holders of the ECNs issued by entities in the Lloyds Banking Group (**LBG**) in 2009.

We refer to the ECNs and to your open letter dated 17 March 2015 in relation to the ECNs and the stress test carried out in relation to LBG in 2014.

You stated in your letter:

"*LBG remained above the 4.5% CET1 threshold in the stress testing exercise and also remained above the ECN conversion trigger level. The changes to LBG's financial position in the stress scenario were not projected to trigger the conversion of the ECNs. Therefore, the ECNs counted towards LBG's projected total capital ratio (which includes Tier 2 capital) in the stress, but did not count towards LBG's projected CET1 capital ratio in the stress.*

LBG did not include any increase in the accounting value of the embedded derivative constituted by the conversion clause in the ECN's in its CET1 capital ratio as modelled through the stress and we did not adjust this approach."

We understand from this that the reason the ECNs were not counted towards LBG's projected CET1 capital ratio in the stress scenario was that, in simple terms, LBG's capital position was sufficiently robust so as not to result in the conversion of the ECNs into shares. We do not understand this to mean that if they were to convert in the stress scenario, the resulting additional CET1 capital constituted by the shares would not be taken into account.

You went on to state that:

"For the above reasons, the question of whether the ECN's would have converted before the 4.5% CET1 threshold did not arise in the 2014 stress test. However, we note that as a result of the differences between the definitions of CT1 and CET1 capital, it is likely the ECN's would only reach the contractual conversion trigger at a point materially below 4.5% CET1."

It is unclear to us from this passage whether you are: (a) commenting as to the likelihood of the ECNs counting towards projected CET1 capital in a future stress test; or (b) suggesting that they are now disqualified from counting towards projected CET1 capital, so that even if they were to convert in the stress scenario, the resulting additional CET1 capital constituted by the shares would not be taken into account.

If the latter, we would be grateful if you could explain whether this is a result of a change in law, regulation or policy since the ECNs were issued in 2009 and, if so, the nature of that change.

We would be grateful if you could provide a response to this letter as soon as possible, and in any event no later than Friday 24 April.

We look forward to hearing from you.

Yours sincerely

Allen & Overy

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