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LBG Enhanced Capital Notes (ECNs) and stress testing

Further to your interest in LBG ECNs, I am sharing with you information that is being provided in response to enquiries from other investors about the LBG ECNs and stress testing, to ensure that all interested parties have received the same information.

2014 stress test

The Bank of England's 2014 stress test involved an assessment of how LBG would perform against current regulatory capital requirements and expectations through a hypothetical stress scenario.

In April 2014, we provided guidance on the stress test for participating firms. This set out, amongst other things, that firms should model the impact of the stress including any triggers of contingent capital instruments. We also confirmed that a key threshold for the test was set at 4.5% of risk-weighted assets (RWAs), to be met with Common Equity Tier 1 (CET1) capital using a CRD IV end-point definition of CET1 resources in line with the UK implementation of CRD IV.

As stated in the guidance, there was a "strong presumption" that if a firm's CET1 ratio fell below 4.5% of RWAs in the stress the PRA would require the firm to take action to strengthen its capital position.

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.

Other observations

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.

Yours Sincerely,

A handwritten signature in black ink that reads "Andrew Bailey". The signature is written in a cursive style with a prominent initial "A" and a long, sweeping underline.

Andrew Bailey

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