

LLOYDS BANK

HELPING BRITAIN PROSPER

ESG BOND FRAMEWORK

Based on the Helping Britain Prosper Responsible Business Plan
June 30th, 2014

Key ESG Highlights:

Environmental

- Lending to agricultural enterprises to finance small-scale renewable energy projects
- Avoidance of areas that ESG investors consider to have negative environmental impacts

Social

- SME financing in economically disadvantaged areas (extra emphasis on healthcare)
- UK's Regional Growth Fund
- Avoidance of areas that ESG investors consider to have negative social impacts

Governance

- Compliance with Lloyds' Code of Business Responsibility and SME Charter
- Robust and transparent investor reporting framework



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1. PREFACE

Sustainalytics has been hired by Lloyds Bank plc (“Lloyds”) to support the creation of a framework that Lloyds can use to issue bonds that provide both financial and social returns. As part of this engagement Sustainalytics met with Lloyds senior management, reviewed relevant internal documents and worked with stakeholders from different departments to create a robust framework covering the Environmental, Social and Governance (“ESG”) aspects of the bond issue. In the following pages we outline the framework, rationale and ESG analysis in more detail.

2. INTRODUCTION

In March 2014, Lloyds launched the Helping Britain Prosper (“HBP”) Plan, a corporate responsibility strategy designed to address the significant issues facing the bank’s clients. Lloyds is working towards the issuance of a bond underpinned by the HBP Plan, the proceeds of which will be used to invest in specific loans to UK small and medium-sized enterprises (“SMEs”) that deliver positive social and environmental benefits. The bond is geared towards the mainstream institutional investor market and particularly to investors with an ESG focus. The bonds will be offered under Lloyds’ existing MTN programme, providing similar expected financial returns with the added dimension of a positive social impact. The bond will incorporate ESG features and be the first large scale bond issued by a mainstream UK bank with primarily a social focus.

The HBP Plan lays out Lloyds’ strategy to ensure that it contributes to societal value in the areas most closely connected to its products and services. The HBP Plan is simple yet ambitious. It sets out seven key commitments and over 20 independently verified ‘prosper metrics’ that cover the areas in which Lloyds can have the greatest positive impact, focusing on UK households, businesses and communities.

The seven key commitments are as follows:¹

1. Lloyds will help more customers get on the housing ladder – and more customers to climb up it,
2. Lloyds will help their customers plan and save for later life,
3. Lloyds will take a lead in financial inclusion to enable all individuals to access, and benefit from, the products and services they need to make the most of their money,
4. Lloyds will help businesses to start up and scale up, and will procure responsibly,
5. Lloyds will help businesses and individuals succeed with expert mentoring and training,
6. Lloyds will be the banking group that brings communities closer together and help them thrive,
7. Lloyds will better represent the diversity of their customer base and our communities at all levels of the Group.

¹ Lloyds Banking Group, Helping Britain Prosper Responsible Business Report 2013

3. CONTEXT

Lloyds has a history of sustainability practices and lending in line with the goals of the ESG bond. These practices indicate a strong alignment between the desired ESG impacts of the bond and Lloyds' overall Responsible Business Plan. This section outlines Lloyds' overall ESG performance, provides an overview of SME lending in the UK, describes Lloyds' SME and agricultural lending approach and finally provides Lloyds' approach to environmental risk and reputational impact assessment.

3.1 Sustainalytics ESG Benchmark Assessment of Lloyds Bank

With the objective of providing a clear indication of Lloyds' long-term commitment to the ESG areas supported by the ESG bond, Sustainalytics conducted an ESG benchmarking assessment of the bank, comparing Lloyds' performance to the ESG performance of three of the bank's closest peers in the UK. Lloyds' performance was assessed across indicators specific to the banking industry and compared against three UK-based peers of similar market size.

Sustainalytics findings determined that Lloyds has strong social and governance performance compared to its closest peers in the UK market, and particularly strong performance and commitments in areas that are closely aligned with the key impact areas of the ESG Bond.

Commitment three of the HBP Plan is to take a lead in financial inclusion and enable people to access and benefit from the products and services they need to make the most out of their money. Of particular note is Lloyds' clear outperformance on the key indicator of Financial Inclusion. The company has a strong and detailed programme to promote financial inclusion and performs better on this indicator than all three of the assessed peers. Lloyds states on its website that it is committed to reach "those who are financially excluded and equips them with the confidence and capability to manage their money effectively".

In 2013, Lloyds had more than 22,000 active small business customers in low-income areas across Britain and increased its loan facility for business customers in these areas from £524 million in December 2012 to £633 million in December 2013. In addition, Lloyds has disclosed targets and priorities for 2014-2017 that demonstrate best practices for this indicator.

Overall, Lloyds' strong social and governance performance compared to its peers in the UK and its strong commitments to financial inclusion are aligned well with the social impact objectives of the ESG bond.

3.2 SME Lending in the UK

The essential role that small and medium-sized enterprises continue to play in the UK's economic recovery is undeniable. As of 2013, there were an estimated 5 million SMEs operating in the UK, providing almost 60% of private sector jobs. According to the UK Department for Business and Innovation, this represents

an increase of 102,000 businesses since the start of 2012 and an estimated combined annual turnover of £3,300 billion.

Although these figures communicate a positive story, SMEs continue to face challenges in starting up and scaling up their businesses in the UK. In their report “Adapting in tough times: The growing resilience of UK SMEs” the Economist Intelligence Unit outlines that the past five years of economic stagnation have forced UK SMEs to adapt more strategic approaches to risk and financial planning. In their survey of 500 UK SMEs, “poor access to finance” was named as one of the top five challenges facing SMEs today, and one of three challenges that pose a greater threat to business than they did two years ago. In 2014, research carried out by Populus, a UK-based research and strategy consultancy, polled senior managers at 301 UK SMEs and asked them to disclose the difference between the amount of money requested in their last loan application and the amount actually awarded. The study identified a significant funding gap of £4.3 billion between loans requested and loans received. This research further highlights the concern that banks are not providing SMEs the financing they require to thrive.

Supporting the growth of UK SMEs outside of urban centres is particularly important. For Britain to truly prosper in the decades to come, economic growth must be fostered not only in traditionally advantaged areas but also in rural and disadvantaged areas as a significant portion of UK SMEs are located in rural areas with a history of unemployment. The UK Department of Environment, Food, and Rural Affairs estimates England’s rural economy to be worth approximately £205 billion, or about one fifth of the national total. In sparse hamlets and villages, the agriculture, forestry, and fishing-based enterprises make up between 30-40% of total enterprises, therefore the overall positive economic impacts of lending to agricultural-based enterprises is considerable.

3.3 Lloyds’ Approach to SME and Agricultural Lending

Lloyds’ strong commitment to SME lending is articulated in its SME Charter and supported by its Code of Business Responsibility. The Code of Business Responsibility outlines the bank’s commitment to “supporting the economy by providing households and businesses with access to affordable and responsible credit.” The bank’s HBP Plan commits Lloyds to growing net lending to SMEs by £1 billion and increasing the maximum amount senior managers can authorize locally when renewing loans to £1 million, with the aim to deliver faster local service. In addition to this, the bank has committed to offer discounted lending and capped arrangement fees for SMEs. In terms of support, the bank commits to providing access to business mentors, increasing the network of enterprise mentors from 400 to 600 in the HBP Plan.

Lloyds recognizes that agricultural SMEs are an important part of the SME economy and provides specialized support and services through three separate brands: Lloyds, Bank of Scotland and the Agricultural Mortgage Corporation (“AMC”). In 2013 Lloyds and Bank of Scotland achieved a 16 per cent increase, providing new loans worth a total of £438 million. The AMC provided new loans of £370 million, achieving growth of 7%. Since inception in April 2012, £60 million has been lent to finance small-scale renewable energy projects across the three brands.

As noted above, Lloyds' HBP Plan contains seven commitments, two of which are also reflected in the SME Growth Charter and directly relate to the ESG Bond, which are "4. We'll help businesses to start up and scale up, and we will procure responsibly" and "5. We'll help businesses and individuals succeed with expert mentoring and training". The HBP Plan has been integrated into Lloyds' core business through board-level oversight, ties to executive remuneration, and disclosure of performance. The development of the Plan also aligns to best practices in sustainability strategy, including robust stakeholder strategy, identification of material issues to stakeholders, and accountability through clear targets and goals set up to measure performance.

3.4 Lloyds' Approach to Environmental Risk and Reputational Impact

Lloyds launched its Code of Business Responsibility and Code of Personal Code of Responsibility in 2012. These codes underpin the Group's Ethics Policy and lay common foundations for responsible behaviour across the Group.

The codes state that, to safeguard the Group's business and reputation, Lloyds must manage risks effectively and responsibly. When Lloyds becomes aware of customer operations that may give rise to adverse impact, it must respond swiftly and effectively. All Commercial Banking businesses consider reputational impact when:

- On-boarding any banking relationship, including issues impacting separate legal entities within a customer group that may not hold a banking relationship with the Group (Know Your Business and Know Your Customer protocols)
- Account opening for clients with an existing banking relationship (Know Your Business and Know Your Customer protocols)
- Reviewing all new, renewal or revised application for credit facilities
- Taking any action against a customer including (but not limited to) legal or enforcement action
- All account and / or sector planning
- Documenting credit policy

The Group has specific sector policies and processes to manage such risks. These policies and processes cover a wide range of sectors.

Lloyds' Environmental Risk & Reputational Impact team provides advice and guidance to Lloyds' employees enabling them to assess level of environmental and reputational impact associated with a particular customer. This team also assists in providing tailored questions for all customers, including those not subject to a specific sector policy, where reputational issues feature. Within Commercial Banking any transaction or business activity that presents or could present a significant reputational risk to the Group is referred to an executive committee for a decision.

Environmental Risk Screening

Since 2011, the Group has used its Environmental Risk Screening Tool (ERST) as the primary mechanism for environmental risk assessment. ERST uses risk weightings derived from industry sector data and the geographical location of security in the UK. The Group's specialist Environmental Risk team focuses on

transactions that ERST identifies with heightened environmental risk. The Group's panel of environmental consultants provides further support.

Lloyds' Environmental sector briefings provide environmental risk and legislative overview for particular sectors. Shared with clients, these briefings support compliance with legislation and regulation.

Equator Principles

The Group is a signatory to the Equator Principles (EPs). Updated in 2013, the EPs provide a structured risk management framework for assessment and management of environmental and social issues in Project Finance transactions, Project-Related Corporate Loans and Bridge Loans (intended for refinance by Project Finance or Project-Related Corporate Loans).

4. METHODOLOGY AND GUIDANCE

4.1 Use of Proceeds

Upon issue the ESG bond proceeds will be invested in eligible liquid assets. The ESG bond proceeds will then be allocated to eligible assets which are new loans made to SMEs and to agricultural enterprises that meet the following three criteria:

1. Tier 1 Criteria consist of Exclusionary Criteria intended to ensure the eligibility of the bond for major ethical and socially responsible investors. Any assets that do not meet these criteria will not be considered Eligible Assets.
2. Tier 2 Criteria are intended to assure that all lending is subject to Lloyds' internal policies committing to fairness and transparency in providing access to finance.
3. Tier 3 Criteria consist of thematic criteria that will insure the bond proceeds are channelled towards areas related to the HBP Plan, adhering to commitment 4: We'll help businesses to start up and scale up, and we will procure responsibly.

Tier 1: Exclusionary Criteria

SMEs whose primary business activity sits within any of the following areas will not be eligible for loans under the ESG Bond:

- Alcohol
- Gambling
- Tobacco
- Military weapons
- Payday lending
- Fossil fuels
- Palm oil

Sustainalytics has identified a list of SIC codes that will be used to identify these SMEs (see Appendix A).

Tier 2: Governance Criteria (Responsible Lending)

Lending to SMEs or agricultural enterprises that meet Tier 1 criteria will have to abide by Tier 2 responsible lending criteria:

- Lending and transactions must be in compliance with Lloyds' Code of Business Responsibility; and
- Lending and transactions must be in compliance with Lloyds' SME Charter.

Tier 3: Environmental and Social Criteria

SMEs or agricultural enterprises that pass through Tiers 1 and 2 criteria will qualify for the proceeds of the ESG bond if they fulfil one or more of the following criteria:

- Enterprise is part of UK's Regional Growth Fund (see Appendix B for eligibility criteria);
- Small-scale renewable energy projects, projects that increase energy efficiency or climate change resilience (including flood recovery) of operations;
- SME located in the 30% most economically disadvantaged areas of the UK;
- Healthcare provider located in the 30% most economically disadvantaged areas of the UK.

4.2 Assessment and Reporting Process

In order to ensure transparency and traceability of the use of proceeds, Lloyds has committed to the following assessment and reporting process:

Management Oversight of the Use of Proceeds (Internal)

- Lloyds has elected executive sponsors internally from within Commercial Banking Finance and the SME business to ensure that the assessment and reporting process is robust.
- On a monthly basis, Commercial Banking Finance will produce an internal report attesting to what proceeds have been allocated to the qualifying assets (per eligibility criteria) versus held in eligible liquid assets. Commercial Banking Finance will be fully responsible for the completeness, accuracy and validity of all reports produced. There will be appropriate preparer and reviewer segregation of duties and final sign off will be undertaken by a senior finance executive.
- Sustainalytics has met with the elected executive sponsors, and can verify that Lloyds has put adequate processes in place to ensure that the bond proceeds are tracked through the business and the 'eligible assets' selected sufficiently meet all eligibility criteria.

Assessment and Reporting (External)

All reports will be made publically available in the Investor Relations section of Lloyds' website.

A. Quarterly Use of Proceeds Report

- Lloyds will provide a quarterly Use of Proceeds report (up until proceeds have been allocated in full to 'eligible assets') produced by the elected Lloyds Finance team.
- This report will provide a summary of the proceeds that have been allocated to the qualifying assets (per eligibility criteria) versus held in eligible liquid assets and provide investors with a breakdown of amounts lent into each of the eligibility criteria. This will be reviewed and endorsed by Lloyds' external auditors.

B. Final Allocation Report

- Once the bond proceeds have been allocated in full to 'eligible assets' Lloyds will communicate the final use of proceeds to investors via a Final Allocation Report, which will be reviewed and endorsed by a third party. The report will summarise the allocation of bond proceeds as well as providing selected examples of individual loans (subject to borrower consent).

C. Annual Compliance Report

- Following the issuance of the Final Allocation Report, Lloyds will produce an Annual Compliance Report which will mirror the Quarterly Investor Report and be reviewed and endorsed by Lloyds' external auditor attesting that Lloyds has maintained a balance of 'Eligible Assets' at least equal to the bond proceeds.

APPENDICES

Appendix A: SIC 2007 CODES for Exclusionary Criteria

Exclusionary Criteria	SIC 2007 CODE	Description
Alcohol	46342	•Wholesale of wine, beer, spirits and other alcoholic beverages
	11010	•Distilling, rectifying and blending of spirits
Gambling	92000	•Gambling and betting activities
Tobacco	01150	•Growing of tobacco
	12000	•Manufacture of tobacco products
	46350	•Wholesale of tobacco products
	47260	•Retail sale of tobacco products in specialized stores
Military Weapons	30400	•Manufacture of military fighting vehicles
	25400	•Manufacture of weapons and ammunition
Payday lending	64999	•Financial Intermediation
	64929	•Other Credit Granting
	64929	•Specialist consumer credit grantors
Fossil Fuels	05101	•Deep coal mines
	05102	•Open cast coal mines
	05200	•Mining of lignite
	06100	•Extraction of crude petroleum
	06200	•Extraction of natural gas
	08920	•Extraction of peat
	20110	•Manufacture of industrial gases
	19100	•Manufacture of coke oven products
	35210	•Manufacture of gas
Palm Oil	01260	•Oil Palm Growing
	10410	•Palm Oil Production / Refining

Payday lenders are categorised as Financial and Insurance activities by Lloyds, this means that a business of this nature would not sit within the SME business. To ensure that no Payday Lender is inadvertently financed by the bond proceeds, Lloyds has agreed to add SIC codes for Financial and Insurance activities to the exclusionary criteria.

Appendix B: Lloyds Bank Regional Growth Fund Criteria

The following criteria are used to determine eligibility for the Lloyds Regional Growth Fund.

Eligibility

Your business may be eligible if:²

- You are looking to purchase an asset which will be located in England in an area outside of London (restrictions apply in the South East)
- You need bank finance but lack a sufficient deposit to meet conventional lending requirements
- You are able to commit to creating and retaining jobs for a minimum of 12 months, or protecting jobs that would otherwise have been lost within 12 months
- You are an SME employing less than 250 people and have a turnover of more than £500,000 and less than £50million
- You are not operating in an ineligible or excluded sector
- You have not/ will not receive any other State Aid in support of the asset purchase (any amount received must be deducted from the maximum possible grant)
- Your business or any of its Group Companies, in aggregate, has not previously received more than £500,000 of grants under the Regional Growth Fund from Lloyds Banking Group
- Your business is not in financial difficulty, the subject of insolvency proceedings, or subject to an outstanding recovery order in relation to State Aid
- Your business meets normal viability criteria to qualify for a grant (viability will be considered in relation to historic and future trading expectations and business plans); more information is available at www.lloydsbankbusiness.com/finance/lendingapplicationprocess.asp

Excluded Sectors

Principal exclusions relate to the purchase of equipment in the following sectors:

- Land or property for residential and/or commercial property investment or development
- Air transport means and equipment
- Road freight transport vehicles for the purpose of road freight transport, hire or reward
- Fishery and aquaculture
- Activities in the primary production, processing and marketing of agricultural products
- Coal
- Export related activities, meaning export aid or aid favouring domestic over imported products

² Lloyds Bank Regional Growth Fund, Assisted Asset Purchase Scheme