

To Bank Shareholders

4 April 2009

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## Bank Investors Campaign – Update No. 11

### Lloyds

There is now a dedicated page of the UKSA web site for Lloyds Banking Group and our campaign on this company – see [www.uksa.org.uk/Lloyds.htm](http://www.uksa.org.uk/Lloyds.htm). There is an additional page that covers the “key issues” in terms of past and current events for shareholders which is at: [www.uksa.org.uk/Lloyds\\_Key\\_Issues.htm](http://www.uksa.org.uk/Lloyds_Key_Issues.htm). We are in the process of taking some legal advice on those issues and will report further on this as soon as the picture is clearer – the legal issues are somewhat complex.

On the 26<sup>th</sup> March, I and two colleagues from the committee formed to progress our “Bank Campaign” met with Sir Victor Blank, the Chairman of Lloyds. It was a reasonably cordial meeting, but we certainly emphasised that we thought the takeover of HBOS by LloydsTSB was an absolute mistake. The only justification we really got was that they were buying the assets of HBOS very cheaply and in essence knew what they were getting into. HBOS was an opportunity to grow the LloydsTSB business when there were few other options.

HBOS’s estimates of required provisions on their loans was £2.4bn, whereas LloydsTSB had estimated it at £8bn at the time of the merger, but it subsequently turned out to be £9.6bn. This was partly due however to the unexpected acceleration in the decline in the economy and property prices.

We raised the issue of whether adequate due diligence had been done, and Michael Oliver (Lloyds Investor Relations) stated that Eric Daniels had been misrepresented. But we left the meeting no wiser as to exactly how. But Sir Victor did affirm that he thought sufficient due diligence had been done and Eric Daniels has also said to a Lords Committee that “we conducted very thorough diligence”. Certainly 5,000 man days (for that is definitely the claimed figure) is not a small amount.

The merits of the Asset Protection Scheme were then discussed and what the likely impact would be in terms of the ultimate stake by the Government in the business (and hence the dilution suffered by other shareholders). It was made clear that the FSA was really “calling the shots” because the need for this scheme (and the associated strengthening of the Lloyds balance sheet) was determined by the FSA’s views on adequate capital ratios for Lloyds. Their insistence on a Core Tier 1 ratio of 14.4% (higher than any other bank), was apparently based on their “stress tests”, ie. how vulnerable Lloyds was to various scenarios.

Why is the demanded capital ratio so much higher than other banks such as Barclays (see below)? A question I posed but did not get a straight answer to. My deduction is that it is because the assets that Lloyds acquired from HBOS are particularly sensitive to default if the general economy and housing markets worsen!

This rather reinforces the main point that the merger was a mistake for LloydsTSB shareholders, because the assets acquired are of such questionable quality.

In reality, some people have argued that the assets being covered by the Asset Protection Scheme are so poor in quality (and 83% came from HBOS), that the insurance being provided by the Government is actually quite cheap.

Anyway from the comments of Sir Victor Blank it would seem that no other serious option was considered to avoid the necessity of involvement in this scheme, and they thought it was a good deal in most respects. It was suggested that it would provide a secure base for Lloyds Banking Group to prosper in the future with the prospect of dividends being resumed in due course (but obviously no specific commitments were made in that regard).

As regards the question of the likely Government stake, these are the points to bear in mind:

1. If non-Government shareholders (e.g. institutions) take up their full entitlement to the new shares, then the Government stake in the company would in the short term remain unchanged at 43%. It seems likely that there will be a good take up of the new shares because the recent market price of the company's shares has been very much higher than the 38p offer price for the new shares.

2. However, the Government is also taking up some "B" shares which will be convertible to ordinary shares in due course. In that case the Government stake could rise to 62%.

Sir Victor did emphasise that the Government was keen to dispose of their shareholding in due course but that was more a medium to long term objective than a short term possibility given the current market appetite for bank shares.

I made the point strongly in the meeting that whether the stake was 43% or 62%, this effectively meant that the company was under the control of the Government and this would deter investors and generally depress the share price. Major stakes of this nature by one shareholder are usually seen as prejudicial to other shareholders' interests.

No date has yet been fixed for the AGM (which will include a shareholder vote on the Asset Protection Scheme) – technical reasons are delaying it, but it will be held in Scotland. We requested a live web cast be done to enable shareholders in other parts of the country to see it, and that would be considered.

We will advise at a later date and once we have seen the full offer document as to whether shareholders should support the Asset Protection Scheme and take up the open offer.

Note that we are likely to produce a separate newsletter for Lloyds shareholders, and raise funds separately for that campaign, in due course. However there is a lot of overlap among shareholders in terms of holdings of these major UK banks (many shareholders held shares in more than one of them), so we will continue joint coverage for the present.

### **Royal Bank of Scotland**

An independent Shareholder Action Group has been formed to represent Royal Bank of Scotland shareholders and to look at some of the legal questions associated with the company (particularly at the "rights issue"). See their new web site at [www.rbosaction.org](http://www.rbosaction.org) . Note that this Group has been formed by a number of concerned shareholders and has been separately incorporated as a limited company.

It has no legal connection with UKSA and therefore any RBS shareholder who wishes to support them will need to register separately with them (you might like to wait a couple of weeks before doing so as they have not yet got the administrative infrastructure in place to cope with large volumes of inquiries).

UKSA suggests that this is the appropriate channel to seek redress for RBS shareholders and we will therefore be actively supporting this initiative.

A report on the General Meetings of RBS held on the 3<sup>rd</sup> April is present in this document issued by the RBOS Shareholders Action Group: [www.rbosaction.org/RBOS\\_Update\\_1.pdf](http://www.rbosaction.org/RBOS_Update_1.pdf) . This is the first of no doubt regular newsletters from that Group.

RBS is also facing an inquiry by the FSA into allegations of "intimidation" of non-executive directors under the past regime. Lord Foulkes, a former Minister for Scotland, has written to the FSA demanding an investigation after talking to some of the former "non-execs". There are suggestions that they were led to believe that they might not be re-appointed if they continued to ask searching questions.

## **Barclays**

Barclays reported that the FSA viewed its capital as adequate after undertaking detailed "stress tests". Soon after it also reported that it would not participate in the Government's Asset Protection Scheme, but they are likely to sell the iShares unit which would raise significant capital to strengthen its balance sheet. The lack of participation in the Government scheme would seem to be a positive sign in that it suggests the company does not have a worry about the quality of its assets and surely staying out of the tentacles of the Government is a good thing, but the market seemed to react negatively to the news.

## **General Bank Campaign**

We now have a group of about a dozen people who have expressed interest in the committee formed to progress this matter. One of them, David Kaye, has agreed to take responsibility for it and he is likely to be elected to the UKSA main board at our forthcoming AGM.

## **Other News**

One interesting item of news that was disclosed recently was that banks are now holding more UK Government Bonds (Gilts) than at any time since 1986. They now hold £18bn of gilts when often they have held none in the recent past. As we have pointed out before, one obvious consequence of the FSA raising the Tier One capital ratios for banks is that it almost forces them to purchase more Government debt. So one branch of the Government is ensuring a healthy demand for the debt issued by another branch.

The Government also has other possible motives in raising these capital ratios in that it has enabled it to take effective control of two of the major UK banks (Royal Bank of Scotland and Lloyds Banking Group), and it now probably has a very substantial share of the mortgage lending market in the UK (counting in its ownership of Northern Rock and Bradford and Bingley in addition). **Effective nationalisation of this sector has taken place without any public debate, at minimal cost to the Government and without any fair compensation being paid to the shareholders who have suffered confiscation and dilution of their shareholdings.**

## Donations

As mentioned in our last newsletter, we are now accepting donations to support the work of this group which you can donate to on-line at [www.uksa.org.uk/AppealBankInvestors.htm](http://www.uksa.org.uk/AppealBankInvestors.htm) (by credit/debit card or by printing out the page and sending a cheque). Please donate if you are able to do so as these campaigns do take considerable resources if they are to be successful. For example, there are 3 million shareholders in Lloyds Banking Group and just writing to the larger ones will cost a considerable sum of money. Thanks to those who contributed, but we really do need more funds to progress these issues, particularly our campaign on Lloyds Banking Group.

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*Note that all previous information issued by UKSA in respect of our campaign on banks is present on the following web site page: [www.uksa.org.uk/Bank\\_Investors\\_Campaign.htm](http://www.uksa.org.uk/Bank_Investors_Campaign.htm)*