UKSA

Press Release

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Dismay on Details of Bank Support Terms and the Question of the LloydsTSB/HBOS Merger

Summary

- UKSA criticises the terms of the Government support for banks, and the impact it will have on dividends and the views of long-term investors.
- UKSA questions the merits of the Lloyds/HBOS merger, particularly for LloydsTSB shareholders.

Banking Sector Support

The UK Shareholders Association (UKSA) previously expressed support for the Government's steps to improve the capitalisation and liquidity of the banking sector. However, the detailed terms imposed by the Government are in our view enormously damaging to many people who rely for their income on dividends from the affected companies.

Dividends from banks such as LloydsTSB, Royal Bank of Scotland and HBOS will not be payable for five years and until the preference shares issued to the Government have been repaid. This is a very long time in stock market terms and especially so for those people in their seventies and eighties with limited life expectancy. UKSA director Roger Lawson had this to say: *"I have received many emails and telephone calls from people who are very distressed about these proposals as they rely on the dividends from these banks for day-to-day living expenses. What do they live on for the next five years? They cannot sell the shares and switch to other investments because they are already showing a massive capital loss and would not get similar income from other investment grade stocks. These are typically retired folks who thought they had made reasonable provision for their old age, but now find the rules redrawn to undermine that".*

Compare the terms imposed by the UK Government with those in the USA on similar "recapitalisations", where dividends can continue to be paid although not increased. In addition the interest rate imposed on the preference shares is a penal 12% in the UK whereas it is only 5% rising to 9% in the USA. The high coupon on the preference shares will erode the value of the businesses and is a serious deterrent for investors. The large equity stakes that effectively give the UK Government control of several banks, and which will discourage many investors from holding bank shares, are of course an unavoidable consequence of Government support. The situation would be much improved if the preference shares were redeemable at the option of the companies, when funds become available.

Clearly the banks have already destroyed mind-boggling amounts of value between them, and the main losers are pension funds and individual retired investors who relied on them for income. The removal of the ability to pay dividends will further reduce the attractiveness of the affected banks to pension funds and cause many fund managers who need to hold "income" stocks to move out of these stocks. This is likely to keep the share prices lower than they otherwise would be. It would be far better to permit the banks to pay dividends again once their "new" boards conclude it is prudent to do so. We note that there have still been virtually no apologies from the "old" boards.

Those investors who took up the large rights issues in Royal Bank of Scotland and HBOS, and who relied on information provided by the companies to conclude that they were still investible companies at the time, and would even get future dividends from them, have also been mislead and are therefore particularly irate. This same point applies to Bradford and Bingley, of course.

We suggest that the Government needs to reconsider the terms applied to these recapitalisations and take a more enlightened view on why people invest in stocks and shares. Most stock market investors are not simply those who are out to make a fast buck from risky speculations, but have invested for the long term dividend income and long term capital growth. If the Government undermines this basic premise by rash interventions, then they undermine the whole capitalist economy and discourage the prudence shown by people in saving for their retirement via stock market investment, to the long term detriment of our whole society. In our view it simply was not necessary to impose such harsh terms on these companies and on their shareholders.

LloydsTSB / HBOS Merger

The impact on the LloydsTSB/HBOS merger of these new financing proposals also needs to be examined carefully, particularly by LloydsTSB shareholders. It would appear to us that although LloydsTSB may be picking up some substantial assets at a relatively low cost by acquiring HBOS, the deal has several negative aspects:

1. It increases the risk profile of the company substantially because HBOS is much more exposed to the UK housing mortgage sector than LloydsTSB. If HBOS turns out to be a "bad bank" as a result, the current shareholders of HBOS and LloydsTSB would be better off if they stay separate.

2. The requirement to strengthen the balance sheet means no dividends for five years, expensive preference share issue, and a large issue of equity to the Government (assuming few other investors take up the equity as seems likely). The latter will of course mean massive dilution of earnings, and hence reduced potential future dividends.

3. With probably the Government ending up with more than 40% of the company, they could well be the "elephant in the room" and have a negative influence on the activities of the company and future strategic decisions.

We therefore suggest that whereas the original LloydsTSB/HBOS merger proposals may have looked attractive to the shareholders in both companies at the time, the latest deal now looks more questionable. Could LloydsTSB shareholders escape those onerous obligations (as Barclays intends to do) by not going through with the deal? LloydsTSB shareholders should consider carefully the above issues before voting in favour we suggest.

HBOS shareholders should also consider carefully because the new merger proposals do not offer them much in value, although clearly their continued independence may be difficult. Only the Government seems to gain clearly from the current merger proposals, not the shareholders in either company.

UKSA is not authorised to give investment advice. All we have done here is to raise questions. What shareholders of each company really need is an understandable assessment of the situation and the options available from their respective boards of directors. We hope they will deliver this.

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About the UK Shareholders Association (UKSA)

UKSA is the leading independent organisation which represents the interests of private shareholders in the United Kingdom. We campaign to protect the rights of shareholders in public companies, and to promote improved standards of corporate governance. Our educational activities, regular regional meetings, company "analyst" meetings and the resources of our web site, help to inform the public on investment management. UKSA is a "not for profit" organisation which is financially supported primarily by its individual members.