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To Bank Shareholders

16 May 2009

Bank Investors Campaign – Update No. 15 – Lloyds Voting Recommendations

Introduction

All three banks that we have been reporting on, Barclays, Lloyds and RBS, all recently issued "Interim Management Statements" covering their results for the first quarter of the year. There was a mixed impact on their share prices. But the subsequent realisation of the amount of capital that US banks would need to raise and several reports that banks were still generally under-capitalised and that there may be more enormous write-offs in the banking sector over the coming year, called a halt to the general upward trend in bank share prices seen in recent weeks.

Although "green shoots" of economic recovery are being reported left, right and centre, and stock markets in general have perked up of late, there is a still a lack of confidence in banks and the major problem is that bank accounts are still very opaque. This issue was highlighted by a presentation by Prof. Paul Klumpes at the UKSA national conference recently in Bournemouth where he argued that new accounting standards need to be imposed on banks, so everyone had a clearer picture on their cash flows and the extent of their leverage. Unless investors can judge the risks banks are running, they are deterred from investing in them.

Previously investors in UK banks relied on the Government as regulator to ensure they did not take unreasonable risks – which was clearly a mistake. Likewise they relied to some extent on the Bank of England acting as "Lender of Last Resort" if they ran out of cash, which likewise proved to be unwise. Investors thought that banks were bullet proof because the Government wouldn't let them go bust, but now they have realised that the UK Government will solve any problems by measures that are likely to wipe out shareholders.

As a result of these factors, and the insistence by the FSA on raising capital ratios, plus the forecast impact of the recession on loan defaults, banks have adopted a much more conservative lending strategy. Likewise foreign investors and lenders have decided to steer clear of the UK, cutting the funding and liquidity available. This has compounded the financial credit crisis and led to Government policies actually being self defeating.

Lloyds

Lloyds Banking Group Interim Statement reported rising impairments on corporate loans. Most of them relate to assets that are planned to be included in the Asset Protection Scheme – in effect they mainly came from HBOS. They also expect retail impairment levels to rise significantly in 2009. Most analysts saw this as more bad news, although a lot of it was signposted in previous announcements.

Among the recent failures in the HBOS loan book was property company Mountgrange which went into administration with £74m of debt owing to HBOS and the assets are expected to realise very little. An associated company also going into administration was Mountgrange Stud which owned race horses, which are now being sold off if anyone fancies a bargain. What HBOS was doing investing in such a business is beyond any sensible explanation.

Sir Victor Blank's Position

Several newspapers took the opportunity of the publication of the interim report to comment on the situation of Lloyds and the role taken by the Chairman, Sir Victor Blank, in the troubles of the company.

The Lex column in the FT suggested that John Kingman, new head of UKFI which controls the Government stake in Lloyds, should make amends for the Governments financial incontinence by sacking both Victor Blank and Eric Daniels. The writer said it was a foolhardy decision to acquire HBOS, which has done severe damage to this former paragon of conservative banking. He suggested that the two must pay for their recklessness and they have "blown up their own bank" and also said there is only one reason they are still there – the Government does not want even more attention to its own role in Lloyds implosion.

Likewise Anthony Hilton, of the London Evening Standard said "*there are tens of thousands of people who invested in Lloyds TSB because it was a conservative bank which paid a mouth-watering dividend. All this was squandered when it rescued HBOS*". He suggests they should have asked the Government to cover the risk of losses from HBOS before going through with the deal. Shareholders have been impoverished and Lloyds reputation destroyed. He called on Sir Victor Blank to go before he was pushed.

Lloyds AGM and Voting Recommendations

Now it just so happens that **Sir Victor Blank** is coming up for re-election at the Lloyds AGM on the 5th June. As we agree with the comments above, **we recommend you vote against his re-election**. Eric Daniels is not up for re-election this year and there seems less of a unified view on his removal among shareholders. However, in reality all directors who were on the board at the time of the decision to acquire HBOS should of course take responsibility for the decision so you may care to vote against the re-election of the other directors who were present with that in mind.

Remuneration Report

You may also wish to consider voting against the remuneration report. For example, do you consider it reasonable that Sir Victor Blank collected £669,000 in total remuneration for 2008 (slightly up on the previous year), when his actions have resulted in the collapse of the Lloyds share price and the total impoverishment of some shareholders.

The structure of the remuneration of the executive directors is also still much too highly geared towards bonuses with the resulting emphasis on performance which encourages risky strategies. Base salary is only "expected" to be about 33% of total pay, with 33% coming from long-term incentive schemes (LTIPs) and 33% from short-term incentive schemes. They make some token gestures to cutting excessive pay by only permitting LTIP awards to be 200 per cent of base salary (down from 400 per cent), but it still a grossly distorting incentive arrangement and much of it depends on earnings per share and economic profit which banks seem to have no difficulty in manipulating.

This means for example that Eric Daniels could be in line for a £4 million share award. Some shareholders believe he should not benefit from any such awards unless he gets the Lloyds share price back above what it was before the HBOS takeover!

The "economic profit" measure has replaced Total Shareholder Return in the calculations, which needless to say has fallen with the collapse of the share price. As with all such incentive schemes, if the selected measures don't produce the goods, it's best to change the yardstick – or am I just being cynical?

In addition, much of the award is now going to be dependent on non-financial measures of performance such as a "balanced scorecard" system. Again when the financial results are likely to be poor going forward, the scheme is changed to reduce reliance on them.

Other Resolutions

You may also care to vote against resolution 10 (authorising ordinary share buy-backs), which many commentators are now opposed to as a matter of principle for public companies, and against resolution 13 permitting a shorter notice period for general meetings – something that private shareholders are generally unhappy with.

The changes to the Articles of the company seem unremarkable however.

Please ensure you vote whether you can attend the meeting in Glasgow or not. If you are in a nominee account, you need to contact your nominee operator (typically your stockbroker) to see how you can vote. If they are unwilling to permit you to do this, you may wish to consider transferring your shareholding to another broker who does. Good stockbrokers now enfranchise their beneficial shareholders as is possible by the provisions of the new Companies Act (and Lloyds cannot stop them doing so – if any broker suggests it is beyond their capability to give you a vote, they are wrong).

Royal Bank of Scotland

The RBoS Shareholders Action Group has issued their latest newsletter concerning the Interim Management Statement and other news – see www.rbosaction.org/RBOS_Update_4.pdf .

IMPORTANT: If you are an RBS shareholder but have not yet registered your interest in that group then it is important to do so as soon as possible. This independent group is now issuing their own newsletters to supporters and we will be dropping coverage of RBS from this newsletter very soon. If you wish to support the prospective legal action being pursued by the RBoS Shareholders Action Group then you need to become a member – this can be done by using the form obtainable from this page of their web site: www.rbosaction.org/Membership.htm or by telephoning 020-8467-2686.

Barclays

Barclays Interim Report was more positive with total income up 42% and profit up 12%, although earnings per share fell because of the extra equity issuance. Impairment charges did significantly increase however.

More recently it has been reported that Barclays may sell the entire Global Investors division for $10bn. The sale of the iShares division which is part of Global Investors had already been agreed for $4.2bn but the deal included a provision enabling Barclays to stay open to other offers.

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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