LLOYDS BANKING GROUP

# Rights Issue and Capital Enhancement Proposals

**3 November 2009**

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# Introduction

## Sir Winfried Bischoff

**Chairman**

# Key Highlights

## Eric Daniels

**Group Chief Executive**

# TODAY'S PROPOSALS
## A market-based solution to Lloyds' capital needs

- **At least £21 billion core[1] capital generation: proceeds fully underwritten**
  - £13.5 billion rights issue[2]
  - £7.5+ billion exchange offers into enhanced capital notes (ECNs) and equity[3]
- **HMT/UKFI will fully subscribe to rights issue**
- **Good momentum in 2009Q3 results**

**Proposals structured to:**

- **Create a higher quality, more efficient capital structure**
- **Reinforce capital ratios in stress conditions**
- **Secure less onerous EU remedies than GAPS**
- **Deliver superior economic value compared to GAPS**

**POSITIONING LLOYDS BANKING GROUP FOR FUTURE GROWTH**

1 Core tier 1 and contingent core tier 1 capital
2 Before expenses
3 In limited circumstances, cash or additional ECNs (Non-US Exchange Offer)

# SUPERIOR ECONOMIC VALUE TO GAPS

| | CAPITAL AND VALUE | INSURANCE PROVIDED |
|---|---|---|
| **GAPS** | ▪ £15.6 billion cost with marginal benefit<br>▪ Public shareholders potentially diluted from 57% to 38% for limited value<br>▪ Excess initial capital, excess medium term leverage as GAPS fee amortises<br>▪ Adverse operational and commercial impact | ▪ No net GAPS claims under Group central case<br>▪ Even under FSA stress test net claims less than £15.6 billion fee<br>▪ Coverage limited to GAPS assets |
| **PROPOSALS** | ▪ £13.5 billion[1] immediate cash and core tier 1 capital<br>▪ GAPS payment of £2.5 billion<br>▪ Lower dilution[2]<br>▪ EPS and RoE enhancing relative to GAPS | ▪ £7.5 billion of contingent core tier 1 capital[3]<br>▪ Converts into core tier 1 capital in times of severe stress<br>▪ Coverage extends to all Group's assets |

1 Before expenses
2 Assumes no conversion of ECNs
3 Based on fully underwritten exchange offers

# A COMPELLING INVESTMENT PROPOSITION

LLOYDS BANKING GROUP

| | |
|---|---|
| **BUILDING POSITIVE MOMENTUM** | ▪ UK economic outlook beginning to stabilise<br>▪ Stabilising margins<br>▪ Overall impairments peaked |
| **HIGH QUALITY, EFFICIENT CAPITAL STRUCTURE** | ▪ Core tier 1 ratio increases to 8.6%[1]<br>▪ Liability management exercise creates contingent core tier 1 buffer of 1.6%[2]<br>▪ Meets FSA stress test requirements |
| **PROGRESS ON STATE AID REMEDIES** | ▪ Significantly less onerous expected remedies than GAPS<br>▪ Cost synergy target unchanged |
| **COMPELLING INVESTMENT PROPOSITION** | ▪ Leading market positions<br>▪ Breadth of revenue opportunities<br>▪ Significant cost synergies<br>▪ Rigorous risk management<br>▪ Lower asset intensity<br>▪ Excellent long term earnings and returns potential |

1 Pro-forma at 30 June 2009, excludes impact of any equity generated as part of exchange offers and after expenses and GAPS payment

2 Pro-forma at 30 June 2009, based on fully underwritten exchange offers

# BUILDING POSITIVE MOMENTUM
## Performing in line with recent guidance

| | RECENT GUIDANCE | Q3 TREND |
|---|---|---|
| REVENUE GROWTH | High single digit growth within 2 years | ✓ |
| MARGINS | Lower in 2009H2, rising in 2010 | ✓ |
| COST:INCOME RATIO | c.200 p.a. basis points improvement | ✓ |
| INTEGRATION BENEFITS | >£1.5 billion savings p.a. by end 2011 | ✓ |
| IMPAIRMENTS | Overall impairments peaked in 2009H1 | ✓ |
| REDUCTION IN BALANCE SHEET ASSETS | £200 billion asset reduction over 5 years | ✓ |

Business trending in line with recent guidance

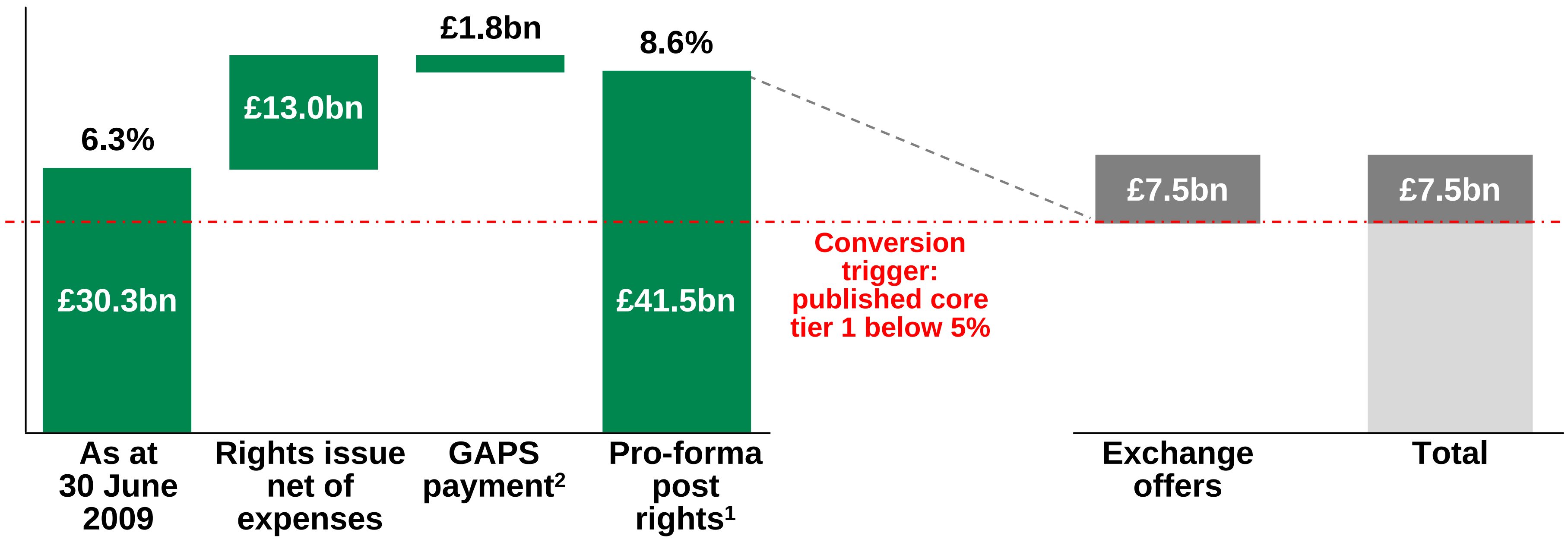
# HIGH QUALITY, EFFICIENT CAPITAL STRUCTURE

## STRONG CORE TIER 1 CAPITAL

- **Immediate 230bps increase in core tier 1 capital ratio to 8.6%**
- **Appropriate and efficient core tier 1 capital base**

## EFFECTIVE DOWNSIDE PROTECTION

- **160bps contingent core tier 1 capital buffer**
- **ECNs convert to core tier 1 if published core tier 1 ratio falls below 5%**
- **Downside protection in severe stress**




1 Pro-forma at 30 June 2009, excludes impact of any equity generated as part of exchange offers
2 Net of tax

**STATE AID**

## No materially negative impact on the Group's business

- **c.£180 billion asset reduction**
- **Divestment of retail banking business with at least 600 branches, a 4.6% personal current account market share and approximately 19% of the Group's mortgage book, to include:**
  - C&G savings accounts and all C&G branch-based mortgages, all branches but not the brand
  - Lloyds TSB Scotland, including all branch-based customers, but not the brand
  - TSB brand
  - Some Lloyds TSB branches in England and Wales[1]
  - Intelligent Finance
- **2 year prohibition on discretionary coupon payments/calls on existing hybrids; no restriction on new issuance**
  - Consequent prohibition on ordinary share dividend payments for a similar period
- **Prohibition on making certain acquisitions for approximately 3 to 4 years**

**CONTINUE TO EXPECT COST SYNERGIES OF OVER £1.5 BILLION PER ANNUM BY 2011**

[1] Together with their branch-based customers

# A LEADING UK FINANCIAL SERVICES COMPANY

LLOYDS BANKING GROUP

**LEADING MARKET POSITIONS**

- A leading provider of banking products and services
- 35 million retail and nearly 1 million commercial customers
- Focused on most attractive segments in retail and wholesale

**POWERFUL BRAND PRESENCE**

Lloyds TSB
BANK OF SCOTLAND
clerical medical
HALIFAX
SCOTTISH WIDOWS

**WINNING BUSINESS MODEL**

- Deep and enduring customer relationships
- Strong operational efficiency
- Prudent risk disciplines
- Capital disciplines

**EXCELLENT EARNINGS AND RETURNS POTENTIAL**

| | | | |
|---|---|---|---|
| Income growth (high single digit within 2 years) | 2% p.a. cost:income ratio improvement (higher in earlier years) | On track to achieve £1.5 billion cost savings p.a. | Run off / redeploy £200 billion of assets; core tier 1 ratio target of >7% |

# Proposal Structure and Third Quarter Update

**Tim Tookey**

**Group Finance Director**

# £21 BILLION OF CORE TIER 1 AND CONTINGENT CORE TIER 1 CAPITAL GENERATED

| | |
|---|---|
| **RIGHTS ISSUE £13.5bn[1]** | ▪ **£13.5 billion of new core tier 1 capital**<br>▪ **Fully underwritten**<br>▪ **HMT / UKFI will fully subscribe** |
| **EXCHANGE OFFERS AT LEAST £7.5bn** | ▪ **£7.5 billion exchange offers into enhanced capital notes (ECNs) and new ordinary shares[2]**<br>▪ **£7.5 billion fully underwritten** |

[1] Before expenses
[2] Or in limited circumstances, cash or additional ECNs (Non-US Exchange Offer)

# EXCHANGE OFFERS
## Overview

- **Offers to eligible holders of £16 billion Existing Securities (tier 1/upper tier 2 capital securities) to exchange into either of:**
  - Enhanced Capital Notes (ECNs) on a par for par basis with enhanced coupon; or
  - Ordinary shares[1] at a discount to the par value of Existing Securities exchanged
    - maximum value of ordinary shares issued capped at £1.5 billion
    - maximum ordinary shares equal to £1.5 billion divided by 75% of ECN conversion price
- **New ECNs treated as lower tier 2 at issue and convert into ordinary shares if Group's published core tier 1 ratio falls below 5%**
  - ECN conversion price is the higher of (i) 5 day VWAP[2] or (ii) 90% of the closing price as at 17 November 2009 (adjusted for the bonus element of the Rights Issue)
- **£7.5 billion underwriting of Exchange Offers provided by investment banks**
- **Lloyds may limit quantum of Existing Securities accepted in Exchange Offers**

1 In limited circumstances, cash or additional ECNs
2 Volume weighted average price

# BENEFITS OF EXCHANGE OFFERS

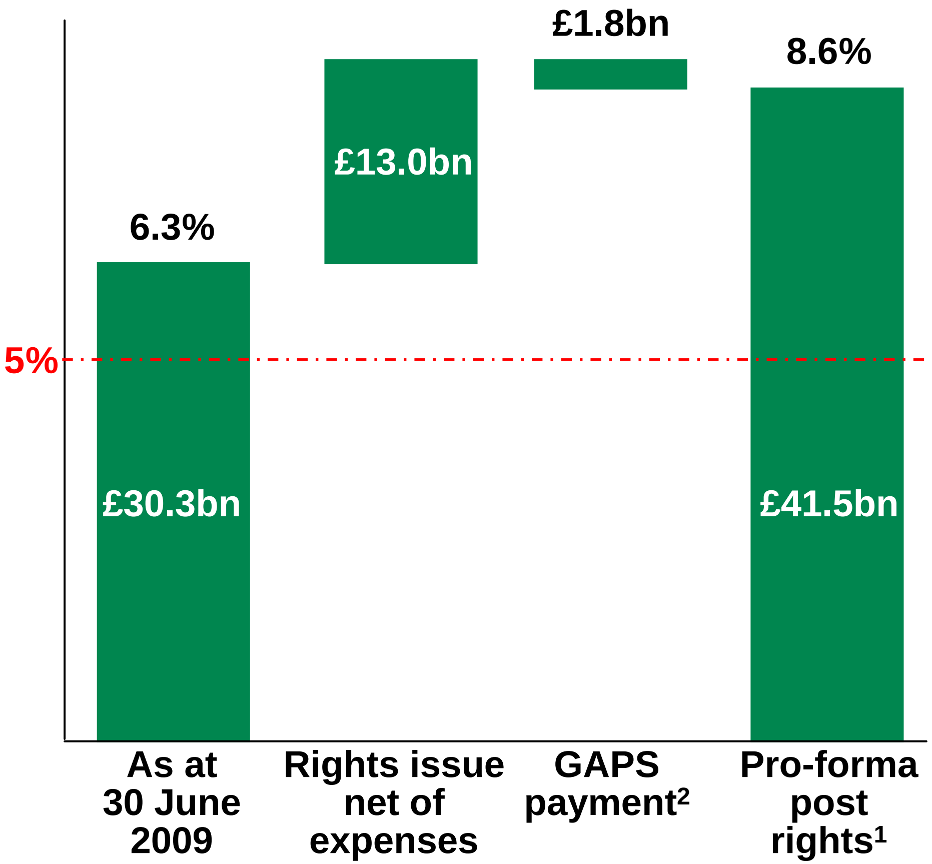
## An attractive proposition for eligible holders

- **Benefits to ordinary shareholders**
  - Limited upfront dilution[1]
  - Provides protection against severe downside
  - Modest additional coupon cost
- **Investors exchanging into ECNs will benefit from**
  - Par for par exchange
  - Certainty of coupon payments: many Existing Securities subject to deferral/suspension of coupon payments required by EU
  - Fixed maturity date: ECNs are lower tier 2 bonds with fixed maturity date
- **Investors exchanging into ordinary shares will benefit from**
  - Greater liquidity in ordinary shares
  - Premium to prevailing market price of their Existing Securities

[1] Assumes no conversion of ECNs. Up to a maximum number of ordinary shares being equal to £1.5 billion divided by 75% of ECN conversion price.

# ROBUST CAPITAL RATIOS
## Significant increase in capital strength

### CORE TIER 1 CAPITAL

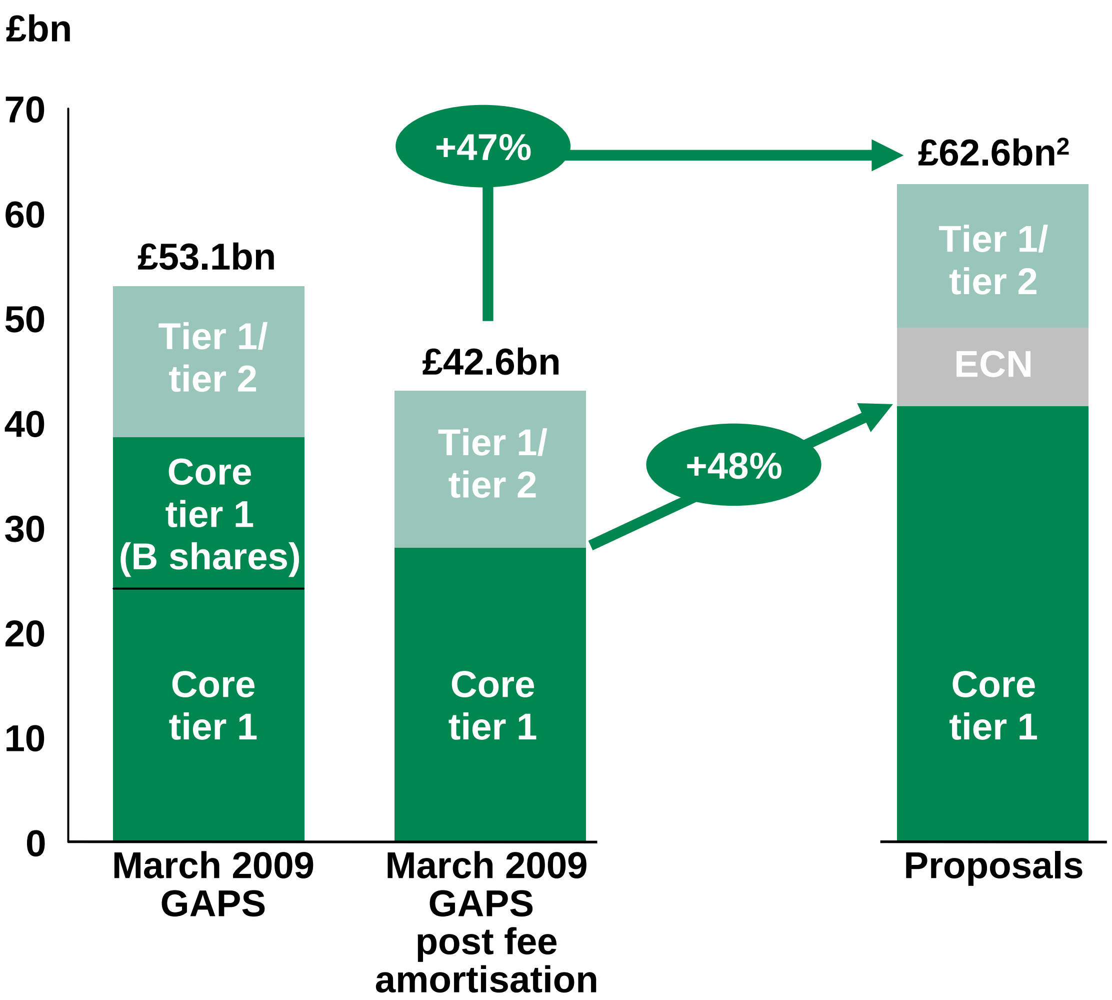



- **Significant increase in core tier 1 capital**
- **Non-amortising capital versus GAPS, reducing future Group leverage**
- **Target core tier 1 ratio of >7%**
- **Anticipated future strengthening of core tier 1 ratio from:**
  - £200 billion asset run down (consistent with half year announcement)
  - Any equity take up in the non-US exchange offers
  - Retained earnings

1 Pro-forma at 30 June 2009, excludes impact of any equity generated as part of exchange offers
2 Net of tax

# HIGH QUALITY CAPITAL BASE[1]

## Improving quantity and quality of capital base




- If Exchange Offers not fully taken up, additional tier 1/ tier 2 capital (maximum £7.5 billion)
- £7.5 billion capital buffer available for severe stress
- Core tier 1 + contingent core tier 1 represents 78% of total capital (vs 66% under GAPS) post fee amortisation

1 As at 30 June 2009
2 Excludes value of tier 1 and upper tier 2 notes that could be exchanged into ECNs or equity

# HIGH QUALITY CAPITAL BASE

## A more sustainable capital position (as at 30 June 2009)

### March 2009 GAPS participation: contribution to core tier 1[2]

| | Immediate | After 7 years |
|---|---|---|
| Net capital ('B' shares) | 3.2% | 3.2% |
| Reduced RWAs | 4.6% | 0.0%[3] |
| Amortising GAPS fee | -0.2% | -2.3% |
| 50% of first loss deduction | -2.0% | 0.0% |
| **Total** | **5.6%** | **0.9%** |

- **GAPS RWA relief reduces as assets run-off**
- **Capital reduced as GAPS fee amortises**
- **Reversal of first loss deduction**

### November 2009 proposals: contribution to core tier 1[2]

| | Immediate | After 7 years | Core tier 1 below 5% |
|---|---|---|---|
| Right issue (net of expenses/GAPS payment) | 2.3% | 2.3% | 2.3% |
| Liability management[1] | – | – | 1.6% |
| **Total** | **2.3%** | **2.3%** | **3.9%** |

- **Higher quality new core tier 1 capital**
- **ECNs convert if published core tier 1 ratio falls below 5%**

1 Assumes full £7.5bn of ECNs issued through underwriting
2 Assumes constant RWAs unless otherwise specified and takes no account of retained earnings or losses
3 Assumes GAPS assets fully run-off over 7 years

# KEY FACTORS IMPACTING INCOME STATEMENT

LLOYDS BANKING GROUP

| | | GAPS | PROPOSALS |
|---|---|---|---|
| CHARGES | Amortisation on £15.6 billion GAPS fee (over 7 years) | ✗✗✗ | ✓ ✓ ✓ none |
| | GAPS payment | none | ✗ (one off payment) |
| | Coupon on B shares (until conversion)[1] | ✗✗ | ✓ ✓ none |
| | Coupon on ECNs | none | ✗ modest |
| | Annual GAPS administration charge | ✗ | ✓ none |
| CREDITS | Coupon suspension on tier 1/tier 2 securities | ✓ | ✗ depends on take up |
| | GAPS claims (central case)[2] | none | none |
| | Rights issue funds @ overnight rate | ✗ | ✓ |
| | No onerous operational issues | ✗ | ✓ |

[1] 13.6 billion shares issued on conversion of B shares if share price rises

[2] For Lloyds central case assumptions see Appendix. In FSA stress test conditions, GAPS claims expected to be significantly less than the GAPS fee

# EU STATE AID

## No materially negative impact on the Group's business

### 'NON-CORE' ASSET REDUCTION

- **Consistent with half-year communication**
- **Committed to reduce c.£180 billion over 5 years**

### GAPS PAYMENT FEE

- **£2.5 billion before tax**

### BANKING DIVESTMENTS (2008)[1]

- **Total income: c.£1.4 billion**
- **Costs: c.£600 million**
- **Profit before tax: c.£500 million**
- **Customer lending: c.£70 billion**
- **Customer deposits: c.£30 billion**

**CONTINUE TO EXPECT COST SYNERGIES OF OVER £1.5 BILLION PER ANNUM BY 2011**

[1] Subject to final State Aid decision and based on initial high level estimates only. Figures likely to change when final shape of banking divestments is agreed

# Third Quarter Update

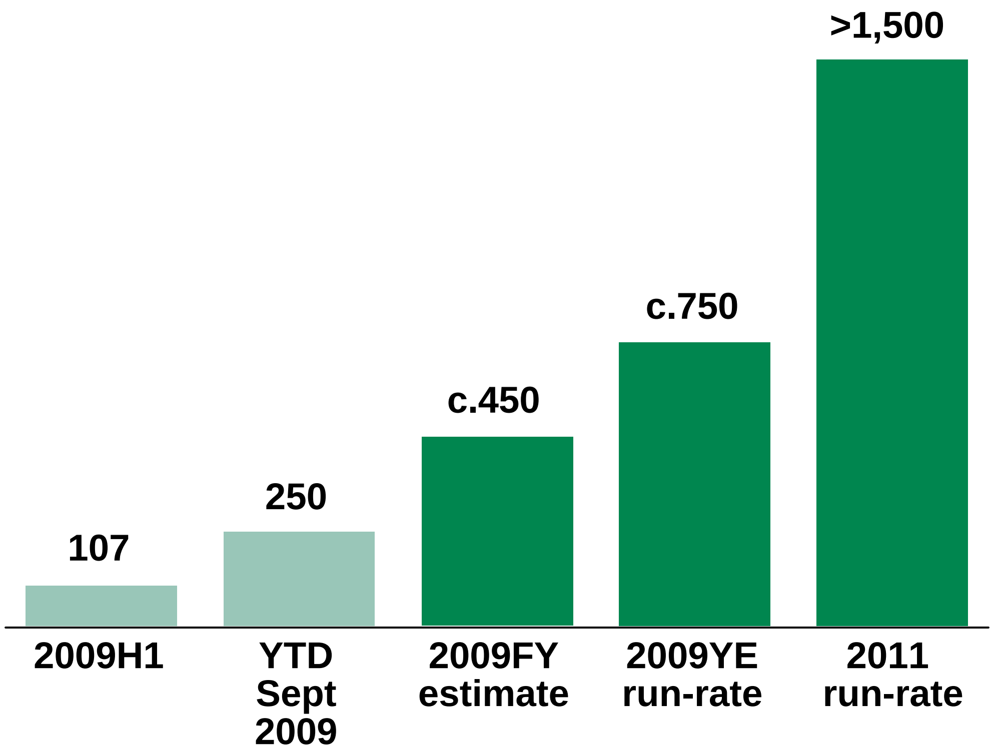
# THIRD QUARTER UPDATE
## Building positive momentum

- **Continued to deliver good revenue performance in 2009Q3**
- **Banking net interest margin flat in 2009Q3 compared to 2009H1**
- **Costs continue to be well controlled: 2% lower compared to 9 months to 30 September 2008**
- **Excellent progress on integration: £50 million higher run-rate of cost synergies than previously announced**
- **Overall impairments on improving trend, 2009Q3 £5.2 billion compared to 2009H1 £13.4 billion:**
  - Overall run-rate has improved, particularly in Wholesale
  - Ireland remains a concern
  - We expect overall impairments to fall significantly in 2009H2

# INTEGRATION UPDATE

## Cost synergy delivery ahead of schedule

### SYNERGY DELIVERY AS AT 3Q IMS (£m)



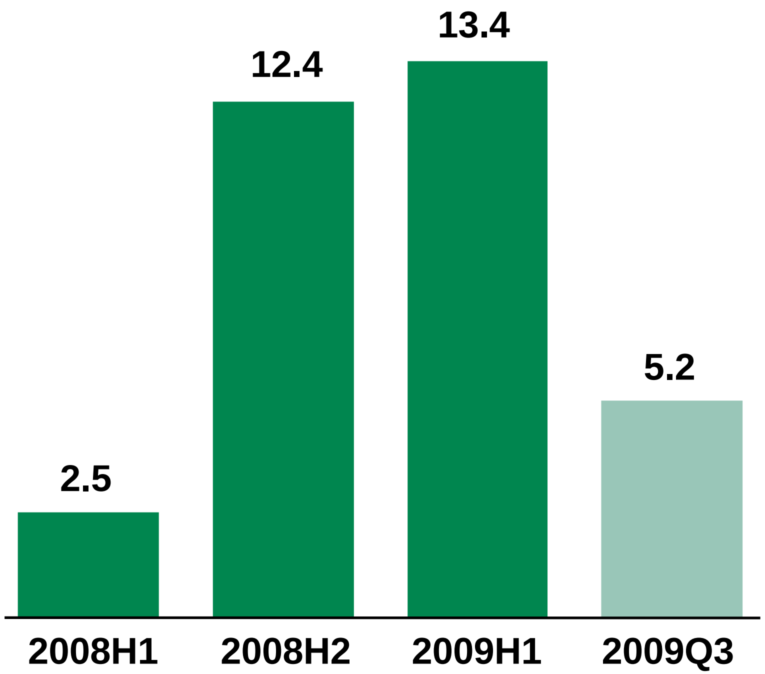

- Integration benefits continue to run ahead of schedule
- Integration savings in first 9 months of 2009 of £250 million
- Increased estimates for synergy delivery in 2009: year end run-rate of c.£750 million (up from £700 million)
- Continue to expect over £1.5 billion of cost synergies per annum by end 2011 despite expected State Aid remedies

# IMPAIRMENTS TRENDS

## Overall Group impairments have peaked

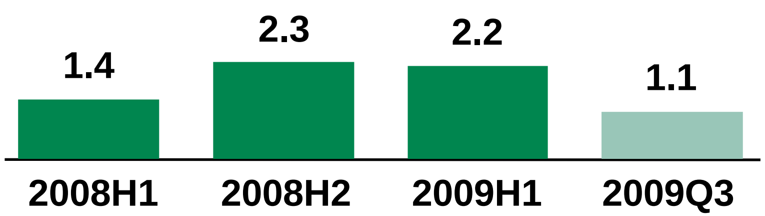
### GROUP IMPAIRMENT CHARGES (£bn)

- Run-rate of impairments has slowed in 2009Q3
- Continue to expect 2009H2 charge to be significantly lower than 2009H1 charge




### RETAIL IMPAIRMENT CHARGES (£bn)

- Significant reduction in mortgage impairment run-rate
- Better house price index performance than expected
- Mortgage arrears trends improving
- Unsecured lending portfolio impacted by rising unemployment as expected

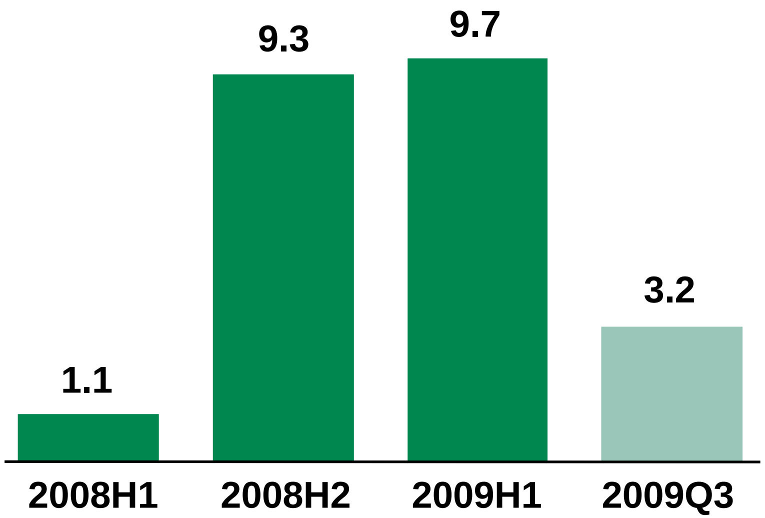


# IMPAIRMENTS TRENDS

## Overall Group impairments have peaked

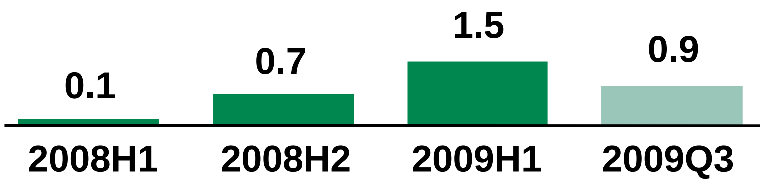
### WHOLESALE IMPAIRMENT CHARGES (£bn)

- Significant reduction in impairment charge run-rate as expected
- Reduction driven by sharp fall in commercial real estate impairments
- 2009H2 charge expected to be significantly lower than that in 2009H1




### WEALTH & INT'L IMPAIRMENT CHARGES (£bn)

- High level of impairments in 2009H1 continued into 2009Q3
- Two thirds of 2009Q3 charge related to Irish exposures
- Outlook for Irish economy continues to be difficult, and expect high levels of impairments to continue through 2009

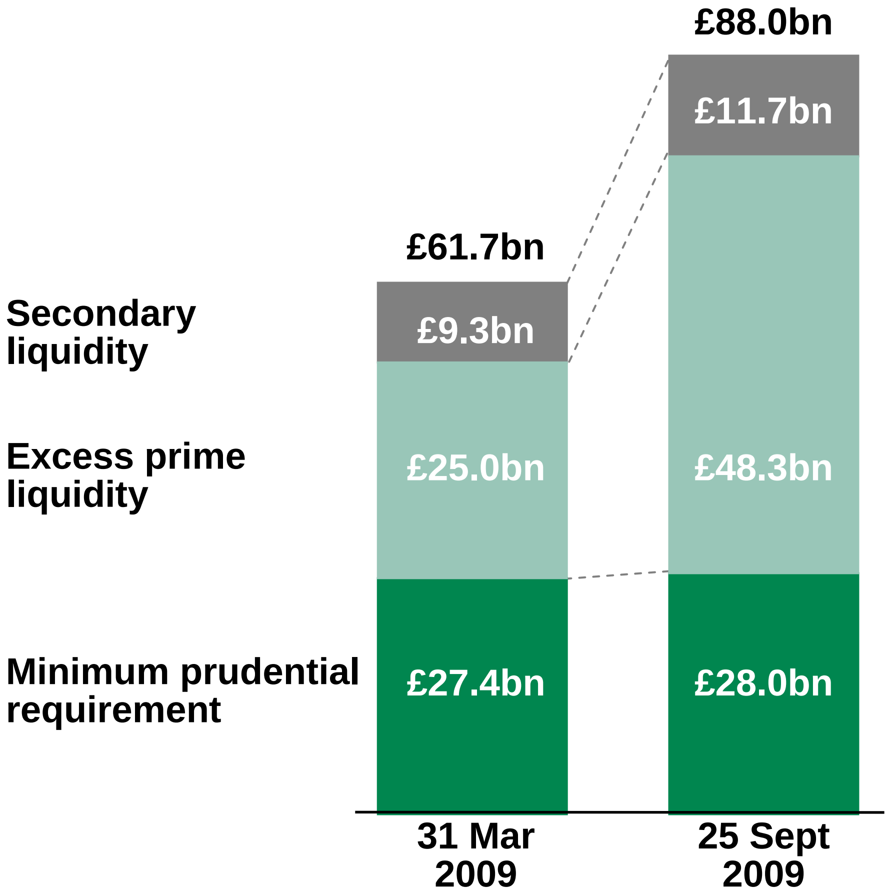


# IMPAIRMENT GUIDANCE

## Overall impairments expected to have peaked in 2009H1

| | RECENT GUIDANCE | Q3 PERFORMANCE |
|---|---|---|
| GROUP | Expected to have peaked in 2009H1 | Lower than H1<br>Guidance unchanged |
| RETAIL | Expected to peak in 2009H2 | Lower than H1<br>Guidance unchanged |
| WHOLESALE | Expected to be significantly lower in 2009H2 | Significantly lower than H1<br>Guidance unchanged |
| WEALTH & INTERNATIONAL | Expected to be significantly lower in 2009H2<br>Concern over Irish exposures | Ongoing concerns with Irish economy. High level of impairments to continue throughout 2009 |

# HIGH QUALITY LIQUID ASSET BUFFER
## Material increase in liquidity buffer




- Liquidity buffer in excess of 8% of total assets
- A multiple of current regulatory requirements
- Lloyds Banking Group already planning to use expected new FSA liquidity requirements

**Definitions:**
**Minimum prudential requirement = minimum FSA liquid asset holding**
**Excess prime liquidity = eligible liquidity per FSA PS09/16 definition, i.e. G7 government debt**
**Secondary liquidity = unencumbered CB eligible debt (post haircuts)**

# A compelling investment proposition

- ✓ Significant improvement in quality and quantity of core tier 1 capital
- ✓ Significant capital buffer from new contingent core tier 1 capital
- ✓ Meets FSA stress test requirements
- ✓ Not entering GAPS in favour of a market-based solution is a superior economic alternative for shareholders
- ✓ Business performance and impairment trends continue to improve

**PROPOSALS UNDERPIN THE GROUP'S LONG-TERM EARNINGS POTENTIAL**

# Appendix

# CAPITAL GENERATION STRUCTURE
## Timetable

- Each element of transaction on approval by shareholders of all other elements
- HMT / UKFI can vote on all resolutions to approve transaction other than relating to GAPS payment

| | |
|---|---|
| **General meeting** | 26 November 2009 |
| **Rights issue** | |
| – Rights issue terms announced | 24 November 2009 |
| – Dealing in nil-paids commences | 27 November 2009 |
| – Last date for acceptance/payment | 11 December 2009 |
| – New ordinary shares start trading fully paid | 14 December 2009 |
| **Liability management** | |
| – Announce results of exchange offers (Non-US and early bird US) | 23 November 2009 |
| – Announce results of US exchange offer | 9 December 2009 |

# ECONOMIC FORECASTS

| | 2009 FORECAST | | 2010 FORECAST | |
|---|---|---|---|---|
| | FSA Stress Test[1] | Lloyds Central Case[2] | FSA Stress Test[1] | Lloyds Central Case[2] |
| **% change year-on-year** | | | | |
| – GDP | -3.8 | -4.0 | -2.0 | +1.8 |
| – House prices[3] | -24.7 | 0.0 | -20.4 | 0.0 |
| – Commercial real estate[3] | -30.3 | -15.0 | -16.1 | 0.0 |
| **Unemployment (%)** | 8.1 | 8.2 | 10.4 | 10.1 |

1 Forecast for year. Source FSA May 2009
2 Lloyds internal forecasts
3 Year to Q4

# Rights Issue and Capital Enhancement Proposals

**3 November 2009**