

LLOYDS
BANKING
GROUP



Materiality Review 2013

Lloyds Banking Group

Observations and recommendations
prepared for Lloyds Banking Group
by Radley Yeldar
April 2014

The background

What is materiality?

Assessing the relative strategic significance of the issues that a responsible business might choose to manage is being seen as increasingly important. Having a well defined process for determining these 'material' extra-financial issues is a key requirement of sustainability indices and standard setting organisations that include Dow Jones Sustainability Index (DJSI), Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC). It's also seen to be essential to those organisations seeking to differentiate themselves through their responsible business strategies: the most material issues are often most authentically aligned with areas that a company might want to use to campaign about, and consequently enhance their performance and reputation on – often because these issues are most closely aligned to core products and services.

Generally, materiality is defined by assessing the importance of extra-financial issues to stakeholders, balanced with the potential a given issue has to help or harm business success. This offers organisations a sense of which issues are of a higher priority (thus deserving more focus, energy and resources to improve performance, and space in reporting); and which issues are of a lower priority. Best practice dictates that the results of a materiality review are approved by the most senior decision makers within an organisation.

How does assessment of materiality work at LBG?

Lloyds Banking Group (LBG)'s last materiality process was undertaken in February 2012, and a description of the process is included in the Bank's 2011 Responsible Banking Report, published in June 2012.

This year, LBG gathered feedback from a number of stakeholder groups, to help define the extra financial issues that are most material to their business, to deepen their understanding of stakeholder concerns, from both an internal and external perspective and, to identify any gaps in their areas of responsible business focus.

Within LBG responsibility for governance, including assessment of materiality and stakeholder engagement, rests with the Responsible Business Committee, which comprises senior leaders from each and every part of the Group, including members of the Group Executive Committee and the Board. The Committee is chaired by Anita Frew, non-Executive Director, who reports directly to the Board.

This paper, prepared by communications and reporting agency Radley Yeldar, provides an overview of the process and findings from this year's research and was used to inform LBG's 2013 Responsible Business Report.

Executive summary

This year's review included consultation with internal and external stakeholders, drawn from a range of stakeholder groups.

The process of the review included completion of a questionnaire. Respondents applied importance weightings and ranked each issue LBG had reported on historically. These were divided according to LBG's five pillars of responsible business.

A range of materiality exercises were also undertaken including research studies, focus groups, assessment of materiality of LBG's Responsible Business elements, interviews with representative stakeholders, findings from the Ipsos MORI omnibus survey (to get the views of the general public) and mystery shopping. These were used to inform LBG's management of the issues and reporting.

From the materiality review the following issues are considered most material in LBG's overall materiality matrix:

- Colleagues' compliance with our Codes of Responsibility
- Changing our working culture to reflect our Group values
- Working with government and regulators
- Engaging employees in our vision and responsible business activities
- Changing the way we incentivise and reward colleagues to focus on customer outcomes
- Addressing our past mistakes
- Reducing and dealing effectively with customer complaints

Stakeholders involved also provided valuable insights about the issues that matter most to them, highlighting a number of issues as 'high priority'. Their additional 'high priority' concerns were:

- Our support for customers in financial difficulty
- Our approach to risk management
- The way we manage our brand and corporate reputation

The final, full materiality matrix as featured in LBG's 2013 Responsible Business Report and is shown on page 13 of this report.

The process

This year's process invited a range of stakeholders, drawn from specific stakeholder groups, to share their views on which issues they considered to be most material to LBG through the completion of a simple questionnaire.

The stakeholder groups represented were:

- LBG's Responsible Business Committee, which comprises senior leaders from each and every part of the Group, including members of the Group Executive Committee and the Board.
- LBG's independent Stakeholder Panel, which comprises professionals with a wide range of expertise representing the fields of corporate responsibility, sustainability, academia, NGOs, suppliers and investors.
- Representatives from LBG's Employee Stakeholder Panel.
- Representatives from LBG's graduate programme.

The questionnaire asked respondents to apply importance weightings to issues that LBG has reported on historically, along with other issues reported on by major UK peers. These issues were divided according to LBG's five pillars of responsible business, namely:

Customers: Putting customers at the heart of our business

- ▶ Financial accessibility/inclusion
- ▶ Financial crime and anti-money laundering (including cybercrime)
- ▶ Protecting customer data
- ▶ Customer satisfaction
- ▶ Customer complaints
- ▶ Supporting customers in financial difficulties
- ▶ Addressing past mistakes

Colleagues: Building a company that's great to work for

- ▶ Employee remuneration (including executive, equal pay and employment rights)
- ▶ Our work on employee relations
- ▶ Employee objectives – sales vs. service targets
- ▶ Learning and development
- ▶ Health and safety
- ▶ Wellbeing (employee care)
- ▶ Culture and values
- ▶ Engaging employees
- ▶ Diversity and inclusion

Communities: Investing in communities to make them prosper and grow

- ▶ Community investment total (£)
- ▶ Charitable donations (across all regions of the UK)
- ▶ Financial capability (education)
- ▶ Social enterprise
- ▶ Employability
- ▶ Colleague engagement with communities (including volunteering, mentoring etc)
- ▶ Supporting young people
- ▶ High street regeneration
- ▶ Supporting IT literacy – helping people get on-line

Environment: Working continually to reduce environmental impacts

- ▶ Environmental Action Plan (management of our operational footprint)
- ▶ Supporting the transition to low carbon economy
- ▶ Environmental incidents
- ▶ Colleague engagement on Environmental Action Plan
- ▶ Environmental Risk Screening (Credit)
- ▶ Equator Principles

Stakeholders: Working responsibly with our external stakeholders

- ▶ Cross sector collaboration on Responsible Business issues
- ▶ Government (including engagement, political donations etc)
- ▶ Media relations
- ▶ Regulators
- ▶ Tax
- ▶ Supplier management
- ▶ Diversity of suppliers (local, social enterprises etc)
- ▶ Suppliers sustainability practices and policies

THE PROCESS

In addition to the five pillars of responsible business, the questionnaire included issues of Governance:

- ▶ Responsible Business governance forums
- ▶ Risk management
- ▶ Non-financial KPIs
- ▶ Long-term commitments
- ▶ Codes of Responsibility
- ▶ Human rights policy and approach (including colleagues and supply chain)
- ▶ ESE (Environmental, Social and Ethical Policies)
- ▶ Brand and reputation
- ▶ Colleague grievances (including whistleblowing)

Respondents were invited to rank each issue using these classifications:

- **Very high:** This issue is incredibly important to me and I want to rate it as very high as I would expect to see extensive coverage in the report.
- **High:** This issue is of high importance to me and I would expect to see a significant section about this within the report.
- **Medium:** This issue is of medium importance to me and I would expect to see some coverage of this issue in the report.
- **Low:** This issue is of low importance to me and I would expect to see limited coverage of this issue in the report.
- **Not important:** This issue is of no importance to me and I do not believe it should be addressed in the report.

THE PROCESS

The questionnaire instructions also stated that respondents were only permitted to rank three issues per pillar of responsible business as being 'Very high' to help ensure that some degree of balance was present in responses.

The form also included a free text option for each pillar of responsible business – so that respondents could add any additional issues that they felt were missing. From the respondents only the Stakeholder Panel chose to add free text options. Their responses are reported on below.

The responses

This year's process gathered inputs from 23 stakeholders, split by the following four categorisations:

- ▶ Seven responses were received from Lloyds Banking Group's Responsible Business Committee (70 per cent response rate). The Responsible Business Committee can be seen as a proxy for 'the business' in these discussions, given the fact that the Stakeholder Panel is composed of representatives from all major decision makers, and is linked to the Board.
- ▶ Six responses were received from Lloyds Banking Group's Stakeholder Panel (100 per cent response rate). Stakeholder Panel members undertook interviews with a further 11 external stakeholders and 6 colleagues, and, as such, can be seen as a proxy for all external stakeholder groups in these discussions.
- ▶ Two responses were from Lloyds Banking Group Employee panel.
- ▶ Eight responses were from Lloyds Banking Group's Graduate programme.

Responses were gathered between August and November 2013.

The process adopted by the Stakeholder Panel

To enable the Stakeholder Panel to develop views of the 2013 Responsible Business Report, it was provided with several research studies, undertaken by The Virtuous Circle on behalf of the Stakeholder Panel:

- ▶ A review of the 2012 Responsible Business Report, benchmarked against the Responsible Business equivalent reports of LBG's four major UK banking competitors and two overseas banks that have achieved Dow Jones Sustainability Index 'leadership' in their sector.
- ▶ Findings from focus group interviews with LBG colleagues, to assess their perceptions of LBG's Responsible Business.
- ▶ An assessment of the materiality of LBG's Responsible Business elements (both by LBG colleagues and by Stakeholder Panel members).
- ▶ Interviews with representative external stakeholders about their view of LBG's Responsible Business reporting.
- ▶ Findings from the Ipsos MORI omnibus survey sampling the views of the UK general public, featuring comments on LBG's Responsible Business approach.
- ▶ Mystery shopper exercises by the Stakeholder Panel in LBG branches and in those of its main UK competitors.
- ▶ Results for the Responsible Business related questions from LBG's 2013 Colleague Survey.

The materiality exercises were used to inform LBG's management of the issues that should be majored upon in the Responsible Business Report, recognising that the views on materiality will vary depending upon the standpoint of the stakeholder in question (Panel members took a broad external view, whilst colleagues focus on those areas within their role and control).

In addition to receiving input from the research studies referred to above, the Stakeholder Panel held interviews with five members of LBG's Responsible Business Committee, including its chair, Anita Frew, (the non-executive director with board responsibility for Responsible Business). These interviews helped the Stakeholder Panel assess the level of board and senior management commitment to Responsible Business and the Stakeholder Panel welcomed the high level of openness and transparency of the discussions with the Committee members.

THE FINDINGS

By stakeholder group

Here we indicate the top ten issues by each group of respondents:

Responsible Business Committee response:

1. Culture and values
2. Customer satisfaction
3. Regulators
4. Customer complaints
5. Social enterprise
6. Codes of responsibility
7. Addressing past mistakes
8. Employee objectives – sales vs. service targets
9. Engaging employees
10. Employability

In addition, one committee member suggested the reporting ought to reference engagement with stakeholders more clearly, after this issue was raised by a member of the audience at the 2013 AGM.

Colleague focus group response:

1. Customer satisfaction
2. Culture and values
3. Environmental action plan (management of our operational footprint)
4. ESE (Environmental, Social and Ethical policies)
5. Supporting customers in financial difficulties
6. Addressing past mistakes
7. Diversity and inclusion
8. Colleague engagement with communities (including volunteering, mentoring etc)
9. Colleague engagement on Environmental Action Plan
10. Financial accessibility/inclusion

Graduates response:

1. Supporting customers in financial difficulties
2. Customer satisfaction
3. Addressing past mistakes
4. Supporting young people
5. Suppliers sustainability practices and policies
6. Employee remuneration (including executive, equal pay and employment rights)
7. High Street regeneration
8. Brand and reputation
9. Customer complaints
10. Culture and values

Stakeholder Panel response:

1. Culture and values
2. Risk management
3. Codes of Responsibility
4. Financial capability (education)
5. Financial crime and anti-money laundering (including cybercrime)
6. Tax
7. Protecting customer data
8. Addressing past mistakes
9. Employee objectives – sales vs. service targets
10. Engaging employees

In addition, the Stakeholder Panel suggested that the following issues should be highlighted as important:

- Lending to SMEs/support for business growth
- What difference has been made through Lloyds' support for communities? And what is the impact?
- Monitoring of community sector grants
- Metric on supplier payments made on time
- How have Responsible Business considerations been incorporated into strategic decision-making?
- Social Media reviews as a responsible business

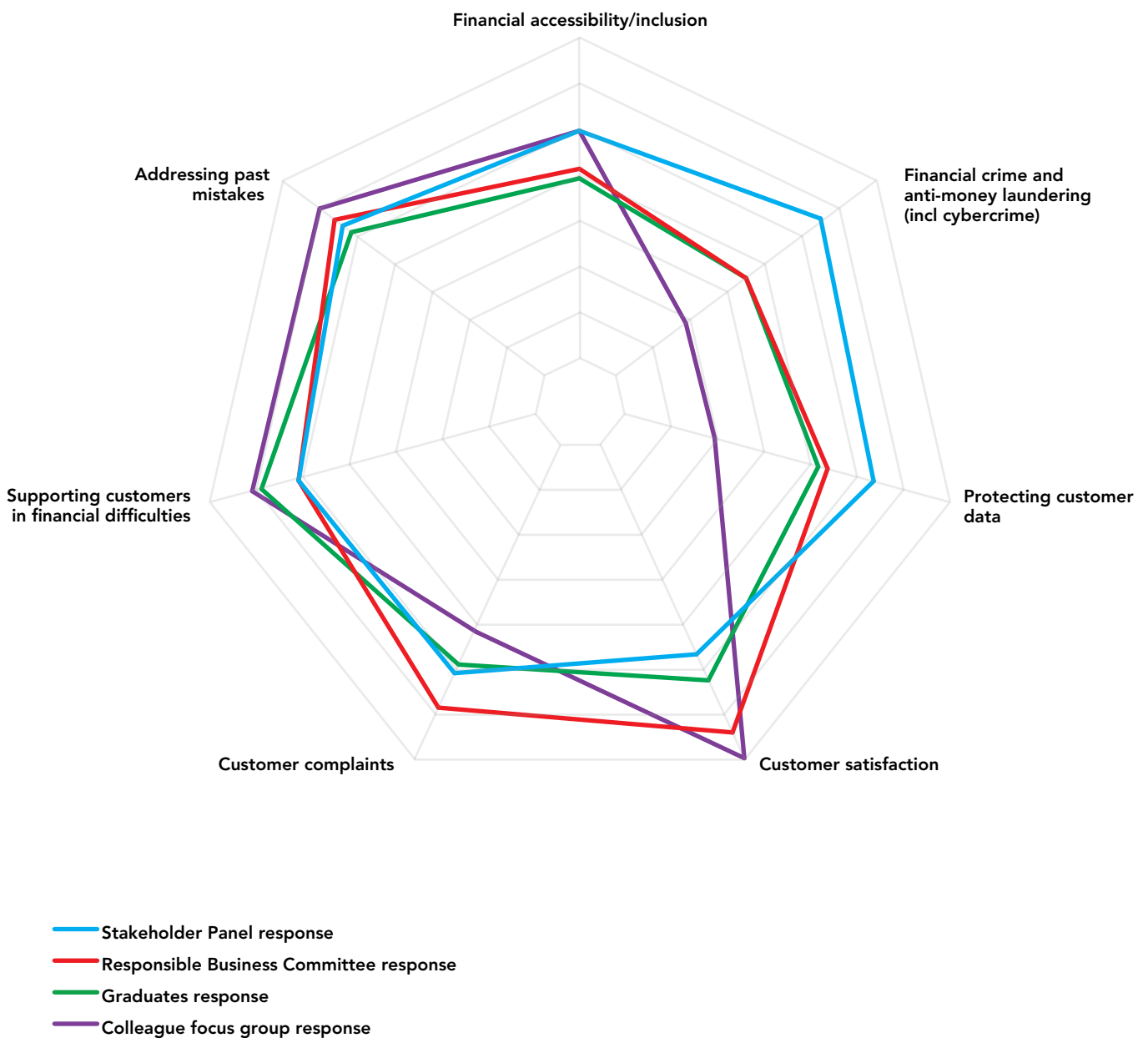
FINDINGS BY THE FIVE PILLARS OF RESPONSIBLE BUSINESS

The following charts indicate the relative responses of stakeholders by pillar of responsible business.

Customers: Putting customers at the heart of our business

Customer satisfaction ranks highest for the Responsible Business Committee and colleagues.

The Stakeholder Panel is more concerned with protecting customer data and focusing on financial crime.



FINDINGS BY PILLAR OF RESPONSIBLE BUSINESS

Colleagues: Building a company that's great to work for

Culture and values are most important across stakeholder groups, except for graduates who rate remuneration just higher.

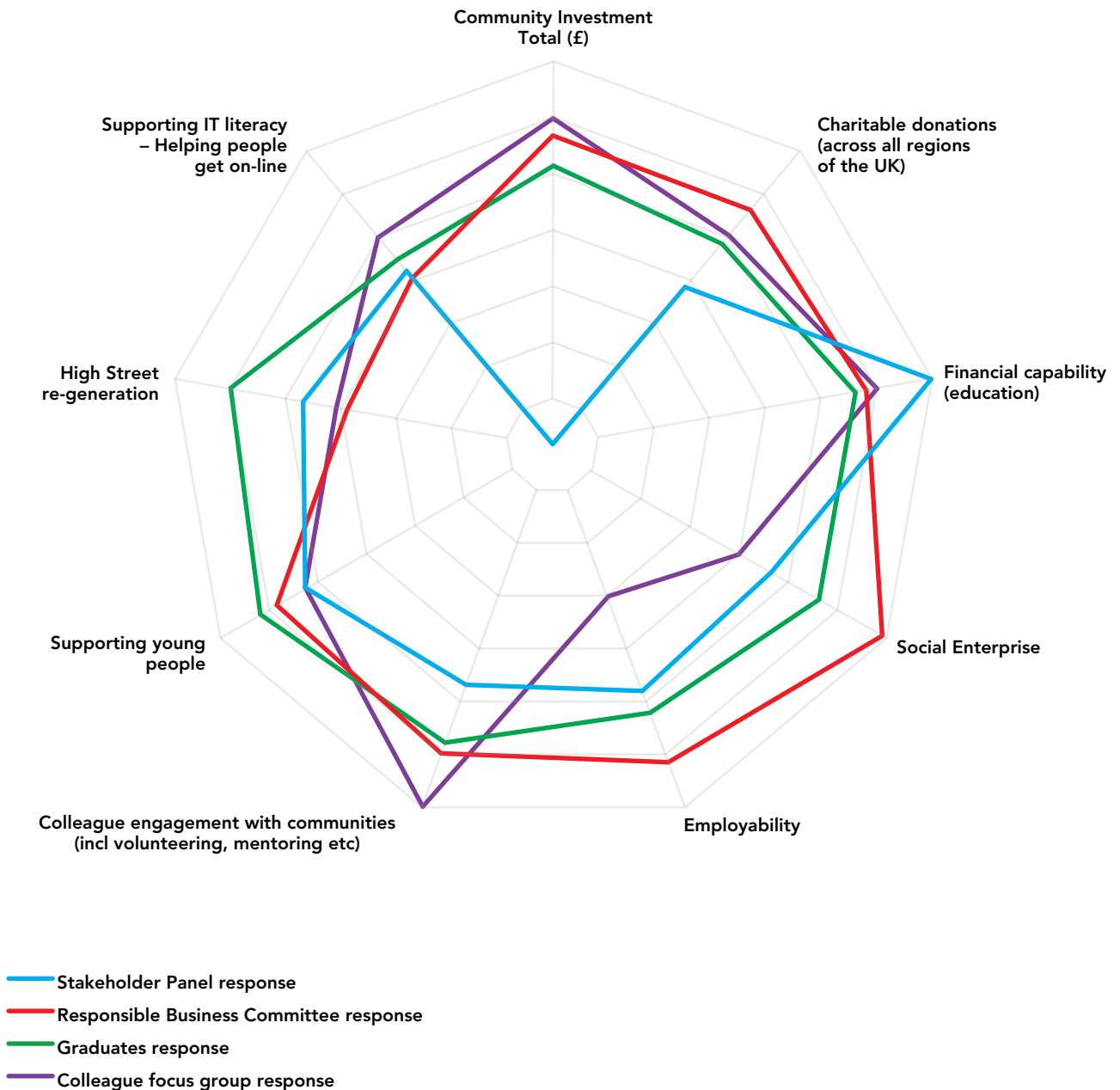


- Stakeholder Panel response
- Responsible Business Committee response
- Graduates response
- Colleague focus group response

FINDINGS BY PILLAR OF RESPONSIBLE BUSINESS

Communities: Investing in communities to make them prosper and grow

There is some variation in how stakeholder groups ranked community issues. Responsible Business Committee respondents saw social enterprise as most important, while colleagues felt strongest about colleague-community engagement. The Stakeholder Panel ranked financial capability and education highest.

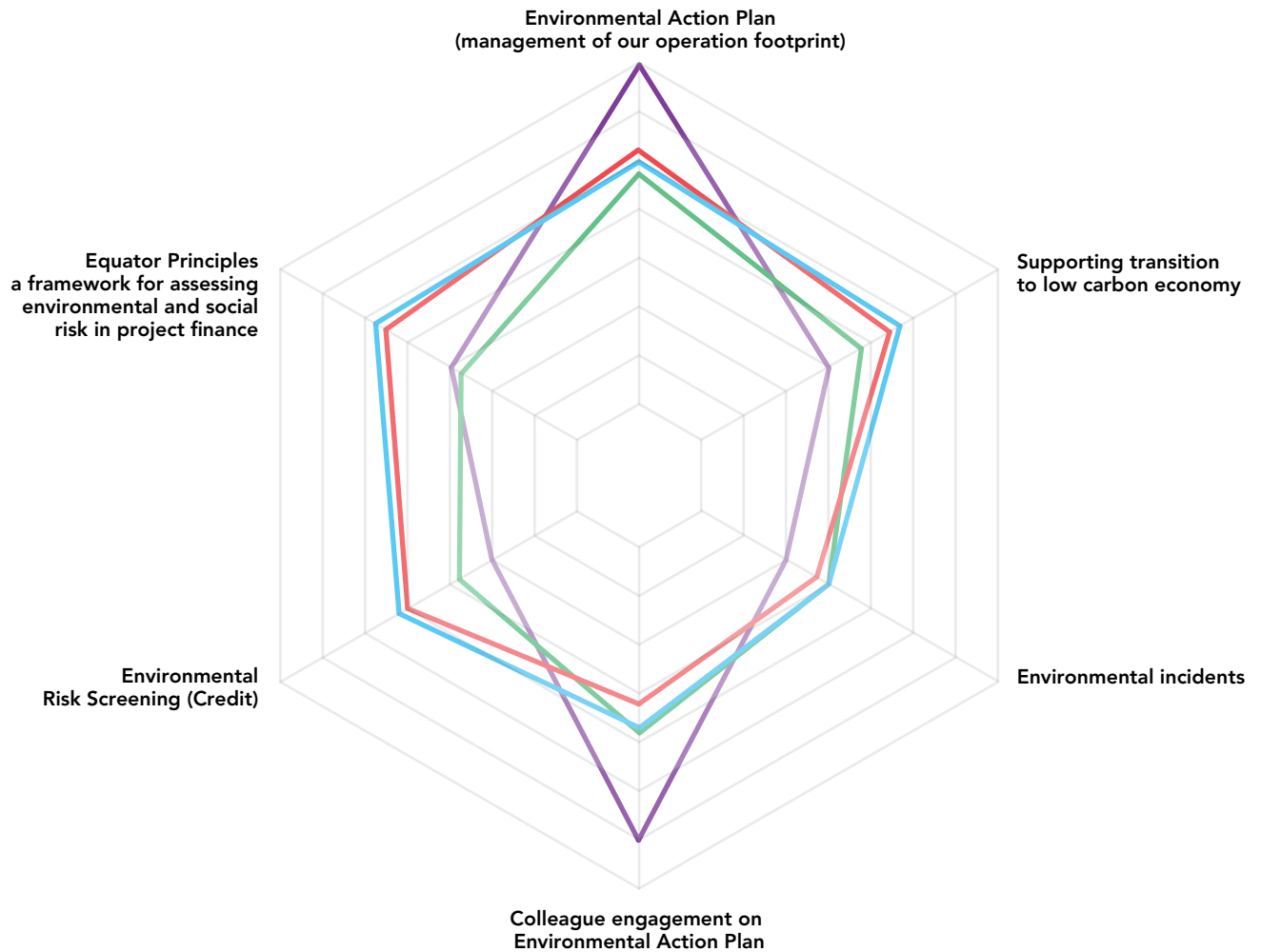


FINDINGS BY PILLAR OF RESPONSIBLE BUSINESS

Environment: Working continually to reduce environmental impacts

The Stakeholder Panel and Responsible Business Committee respondents had very similar focus on the Equator Principles, environmental risk screening, and supporting a low carbon economy.

Colleagues came out with two clear focus areas; the Environmental Action Plan, and colleague engagement on the Plan.

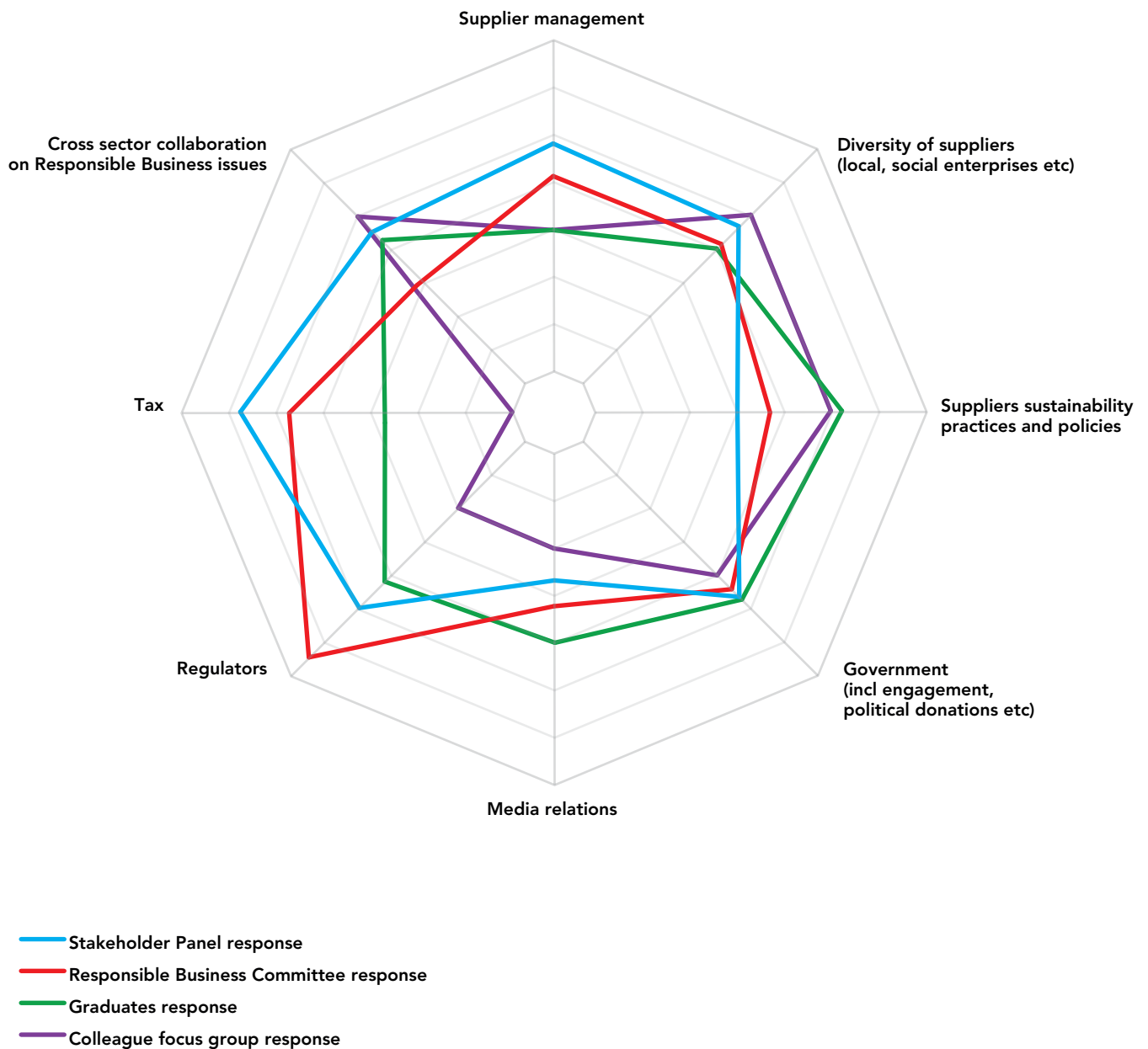


- Stakeholder Panel response
- Responsible Business Committee response
- Graduates response
- Colleague focus group response

FINDINGS BY PILLAR OF RESPONSIBLE BUSINESS

Stakeholders: Working responsibly with our external stakeholders

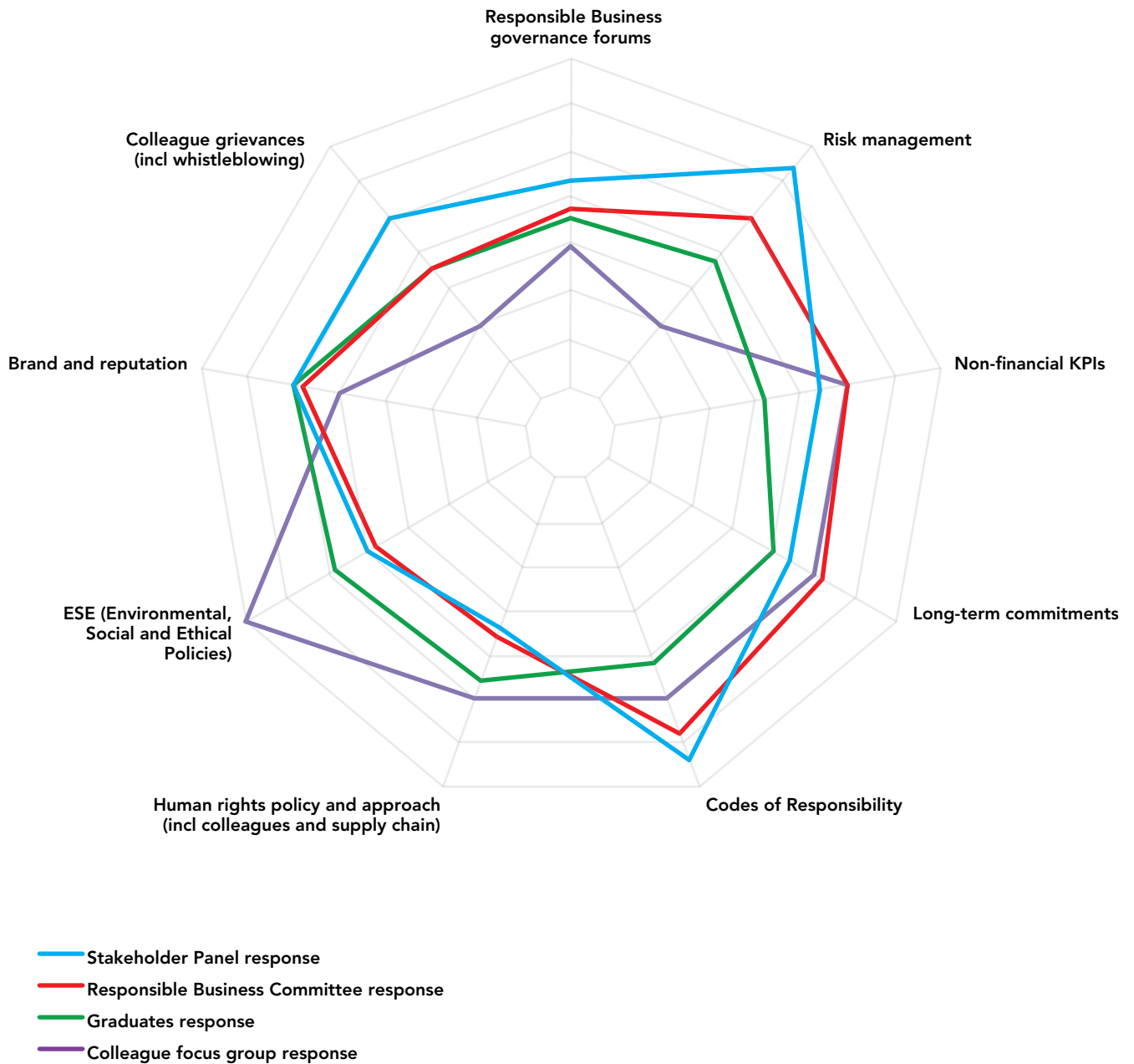
There was quite a lot of disparity in feedback for this pillar of responsible business. The Stakeholder Panel ranked tax the highest, while the Responsible Business Committee ranked regulators most important. Colleague focus was split evenly over supplier diversity, supplier sustainability practices and cross sector collaboration on responsible business issues.



FINDINGS BY MANAGEMENT OF GOVERNANCE

Governance: How we do business responsibly

Colleague respondents found Environmental, Social and Ethical policies (ESE) most important by a fair margin, while Codes of Responsibility were important for the Stakeholder Panel and the Responsible Business Committee.



OTHER INPUTS

While not formally part of the materiality review, some key findings from Ipsos MORI research commissioned by LBG are worth referencing in this report.

Ipsos MORI Sustainable Business Monitor survey¹

Summary findings from this year's research are reproduced below for reference, taken directly from the research summary provided by Ipsos MORI.

Corporate responsibility remains important in the current economic climate

- ▶ Although still the most pressing issue, the perceived importance of the economy to Britain continues to decline. The NHS and race/immigration in contrast are growing concerns.²
- ▶ Confidence in British business remains low, Ipsos MORI has found just one in five of the British public trust the CEOs of large companies to tell the truth.³
- ▶ Companies need to prove that they are taking responsibilities seriously; corporate tax avoidance and executive pay are at the top of the public's consciousness and provide further evidence of corporate irresponsibility.⁴
- ▶ Half don't believe that company profits filter down to help customers, although the vast majority agree that it is possible for companies to be both profitable and responsible.
- ▶ The quality of products and services is growing in influence in terms of how customers judge companies, whilst customer service and honesty and integrity are as important as ever.⁴

If anything, customers are becoming increasingly cynical about the motivations of 'big business'

- ▶ Around two in five don't think Lloyds TSB is taking its responsibility towards society seriously; a six percentage point increase since last year. This appears to be a trend across the whole financial sector as all competitors have seen a significant increase in the proportion reporting they are 'not serious' about their responsibilities and mirrors the long term downward trend of perceptions of the sector's responsibility.
- ▶ All companies tend to gain their strongest scores on responsibility to customers, then society and community and the lowest on responsibility to the environment. The former no doubt having most resonance with respondents.
- ▶ Compared to the rest of the financial sector, both Lloyds TSB and Halifax are performing 'about average' with the exception of the market leader, which clearly outperforms all other organisations on its sustainability ratings.
- ▶ On balance, more people think Lloyds TSB and Halifax don't take their responsibility to society and community seriously than think they do.
- ▶ As for all banks, Lloyds TSB customers are more positive about the organisation (familiarity breeding favourability) nearly half believe that Lloyds TSB is taking its responsibility to customers seriously. Halifax enjoys a similar level of support from customers.

And as such consumers do not think Lloyds TSB is investing enough in its communities

- ▶ Lloyds TSB increasingly struggles to be perceived as an investor in communities or to encourage employees to participate in community volunteering.

- ▶ This is likely to be due to a lack of awareness of Lloyds TSB's existing initiatives – even among customers, around three quarters have never heard of Lloyds TSB's initiatives.
- ▶ Yet, there is evidence to suggest that awareness of these initiatives would increase favourability among a notable group; two in five customers feel more favourably towards Lloyds TSB having been made aware of these initiatives. Although for circa half, these initiatives appear to make little difference to pre-existing impressions of Lloyds TSB.

Supporting small businesses and addressing customer concerns would improve perceptions

- ▶ Across a variety of initiatives, supporting small businesses emerges as the key area Lloyds TSB should be focusing on.
- ▶ Addressing customer concerns around price and quality of customer service by improved 'contact and care' and being more honest and transparent with its customers would help to further improve opinion.

Implications

- ▶ Despite signs of economic recovery, the financial sector appears yet to be forgiven for past events. The public appears to be becoming increasingly cynical about corporate motivations, with media coverage of tax scandals and executive pay adding fuel to the fire. Recent events in the energy and utilities sector are likely to shed a negative halo and exacerbate perceptions that 'big business' in general is not looking after its customers and society as a whole.
- ▶ We would recommend particular focus on initiatives relating to small business, job creation, training, work placements and anything that can demonstrate practical contribution to addressing the country's employment and economic challenges and individual financial pressures.
- ▶ In addition, the impact of touch points that affect customers directly – service and charges/rates, should not be underestimated. These are the most tangible contact that they have with your organisation and as a result, will primarily shape customer perceptions of your degree of responsibility.

Ipsos MORI Issues Index: November 2013⁵:

- When asked 'What do you see as the most important issues facing Britain today?', six out of the top ten responses related to economic issues (Economy; Unemployment; Inflation/prices; Poverty/inequality; Pensions/benefits; Low pay/fair wages).
- The rest of the top ten were composed of issues that are more widely related to the Prosper agenda – and each has an economic dimension (Race relations/immigration; NHS; Education/Schools; Crime/Law and order).

¹ Ipsos MORI's Sustainable Business Monitor runs annually, interviewing c.1,000 members of the GB general public aged 16+ from a nationally representative sample. Most questions are asked online. Data is weighted. NB: The fieldwork for the latest wave took place prior to the separation of TSB from Lloyds Banking Group and therefore all questions were asked in relation to Lloyds TSB.

² Ipsos MORI's Issues Index runs monthly, interviewing c. 1,000 GB adults 18+ each year, asked face-to-face from a nationally representative sample. Data is weighted. This data is from the September 2013 wave.

³ Ipsos MORI Global Advisor Study runs monthly, interviewing c.1,000 adults online panelists, aged 16-64 (18-64 in the US and Canada) across 25 core countries. Data is weighted. This data is from the GB survey, which interviewed c.1,000 British adults aged 16-64 online.

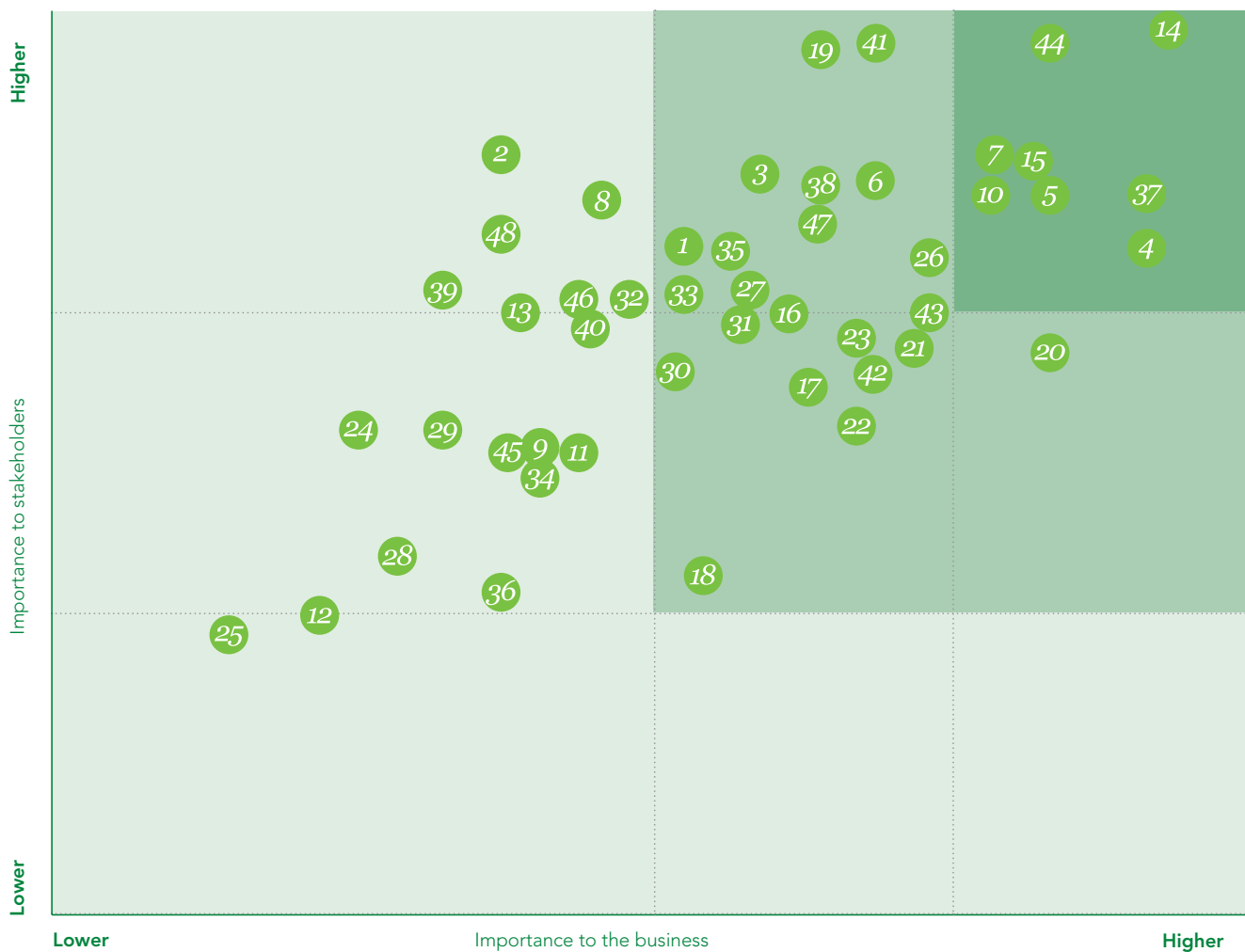
⁴ Ipsos MORI's Sustainable Business Monitor runs annually, interviewing c.1,000 members of the GB general public aged 16+ from a nationally representative sample. Most questions are asked online, but a few key trend questions such as the one shown here are asked face-to-face via our Omnibus study.

⁵ Ipsos MORI's Issues Index runs monthly, interviewing c. 1,000 GB adults 18+ each year, asked face-to-face from a nationally representative sample. Data is weighted. This data is from the November 2013 wave.

OVERALL FINDINGS

Plotting the views of the Stakeholder Panel against the views of the Responsible Business Committee

The chart below is indicative of a conventional materiality matrix. It combines the views of the Stakeholder Panel* with employees and graduates to offer the stakeholder perspective and the views of the Responsible Business Committee to demonstrate the priorities of the business.



The most material issues, shown in the top right hand quadrant, are:

- Customer satisfaction (4)
- Culture and values (14)
- Codes of responsibility (44)
- Regulators (37)
- Addressing past mistakes (7)
- Employee objectives – sales vs. targets (10)
- Employee engagement (15)
- Customer complaints (5)

*The Stakeholder Panel responses are weighted to account for the various groups represented within that grouping.

OVERALL FINDINGS

A full list of issues and number is provided here:

1	Financial accessibility/inclusion	25	Supporting IT literacy – helping people get on line
2	Financial crime and anti-money laundering (incl cyber crime)	26	Environmental Action Plan (management of our operational footprint)
3	Protecting customer data	27	Supporting transition to low carbon economy
4	Customer satisfaction	28	Environmental incidents
5	Customer complaints	29	Colleague engagement on Environmental Action Plan
6	Supporting customers in financial difficulties	30	Environmental Risk Screening (Credit)
7	Addressing past mistakes	31	Equator Principles – a framework for assessing environmental and social risk in project finance
8	Employee remuneration (incl exec, equal pay and employment rights)	32	Supplier management
9	Our work on employee relations	33	Diversity of suppliers (local, social enterprises etc)
10	Employee objectives – sales vs. service targets	34	Suppliers sustainability practices and policies
11	Learning and development	35	Government (incl engagement, political donations etc)
12	Health and safety	36	Media relations
13	Wellbeing (employee care)	37	Regulators
14	Culture and values	38	Tax
15	Engaging employees	39	Cross sector collaboration on Responsible Business issues
16	Diversity and inclusion	40	Responsible Business Governance forums
17	Community investment total (£)	41	Risk management
18	Charitable donations (across all regions of the UK)	42	Non-financial KPIs
19	Financial capability (education)	43	Long-term commitments
20	Social enterprise	44	Codes of Responsibility
21	Employability	45	Human rights policy and approach (incl colleagues and supply chain)
22	Colleague engagement with communities (incl volunteering, mentoring etc)	46	ESE (Environmental, Social and Ethical Policies)
23	Supporting young people	47	Brand and Reputation
24	High Street regeneration	48	Colleague grievances (incl whistle blowing)