

LLOYDS  
BANKING  
GROUP



# **THE FINANCIAL CRISIS: KEY QUESTIONS, REALITY AND RESPONSES**

**BANK OF AMERICA MERRILL LYNCH CONFERENCE**

London

4 October 2011

**António Horta-Osório**

Group Chief Executive

# AGENDA

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**KEY QUESTIONS ON THE FINANCIAL CRISIS**

**EFFECTS OF THE FINANCIAL CRISIS AND LESSONS LEARNT**

**OUR STRATEGY AND ACTION PLAN**

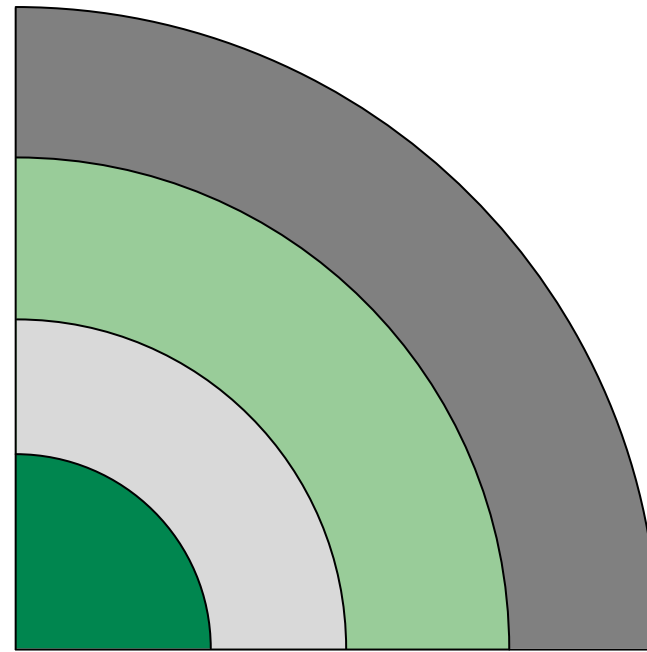
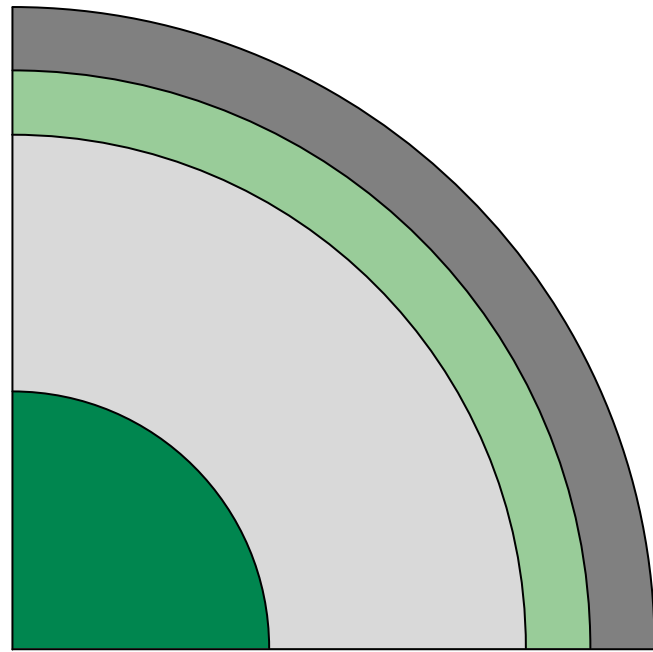
# QUESTION I: WAS THE 2008 CRISIS EVER OVER?

The crisis is still evolving



**2008**  
Primarily a credit and banking crisis

**2011**  
Primarily a sovereign and political crisis

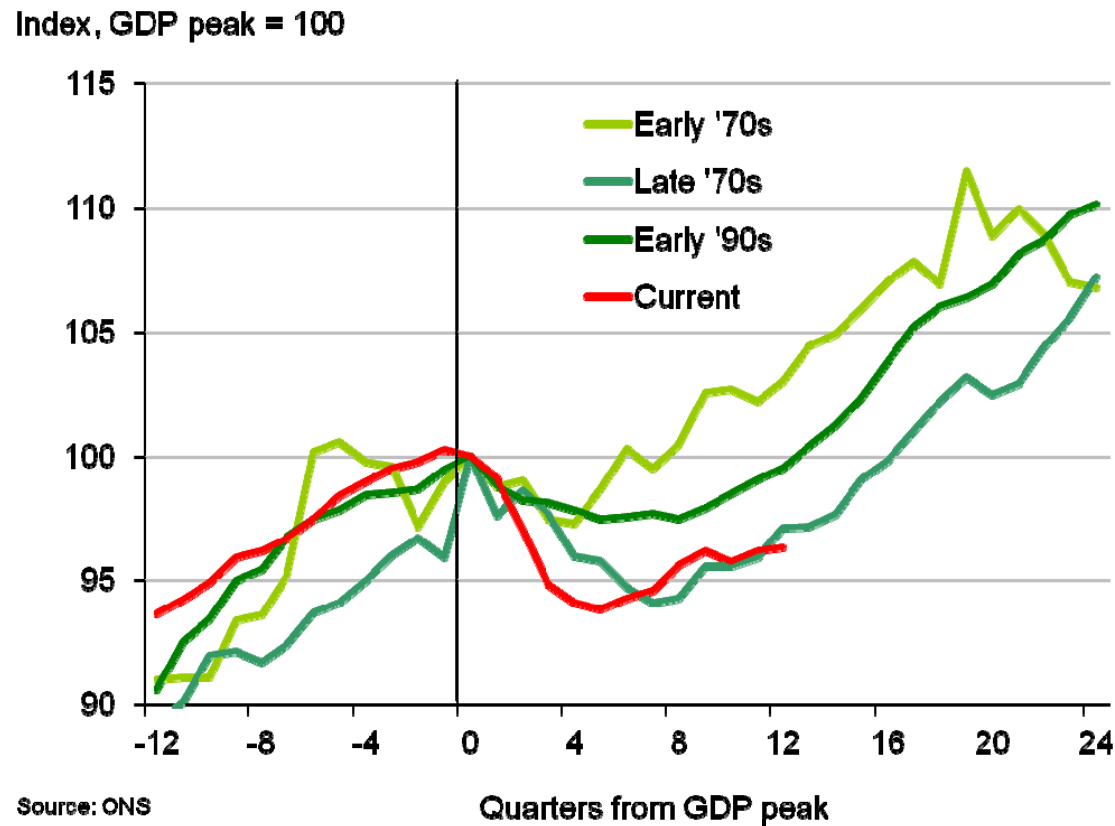


Personal and corporate leverage    Banking    Sovereign concerns    Political issues

**CRISIS MOVING INTO POLITICAL AND SOVEREIGN PHASE**

# QUESTION II: ARE THE ECONOMIC EFFECTS UNPRECEDENTED?

Thus far similar trends to previous severe recessions in the UK but recovery likely to be weaker



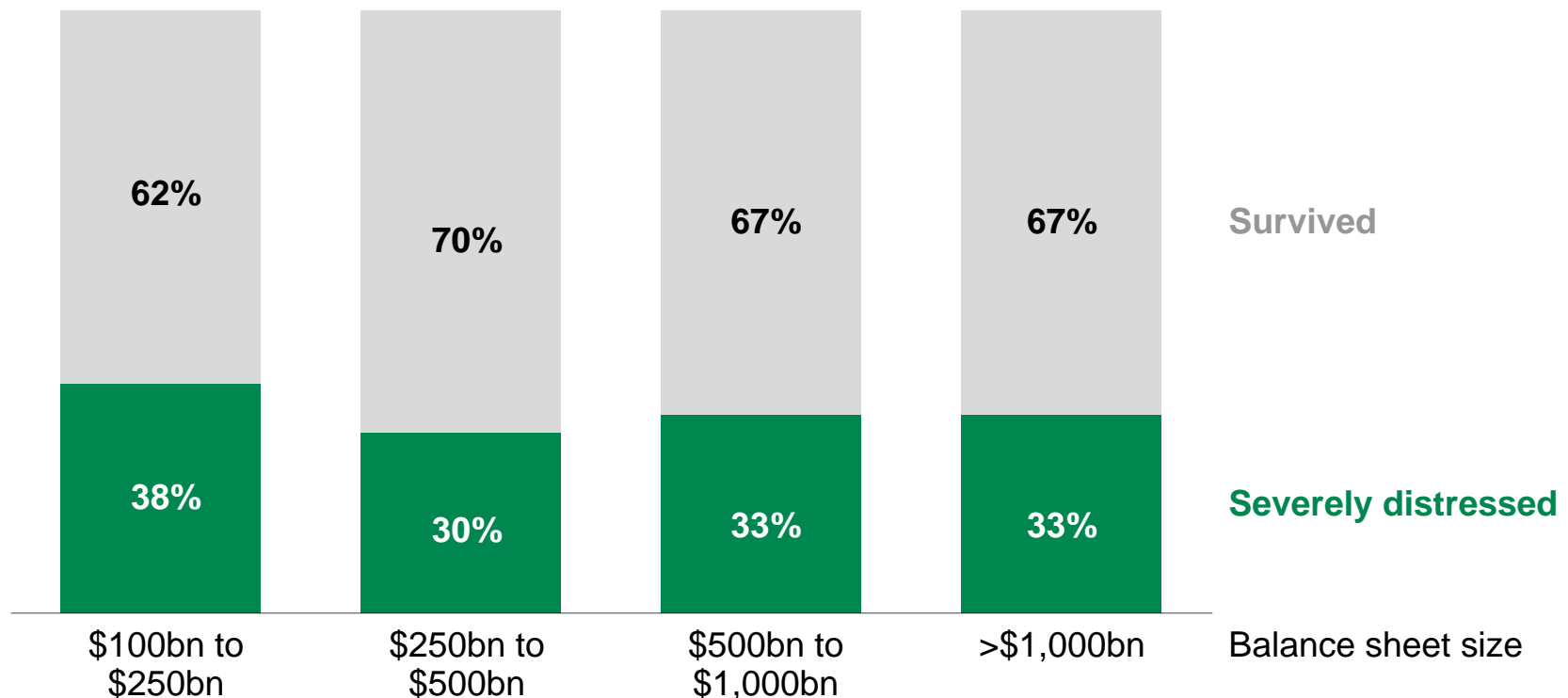
**SLOW RECOVERY EXPECTED, WITH SUSTAINED RESTRUCTURING AND DELEVERAGING**

# QUESTION III: WERE LARGE BANKS MORE LIKELY TO FAIL?

## Size was not the driver of failure



Percentage of banks failed or rescued in the UK, Italy, Spain & Germany since 2007  
(by number of institutions)



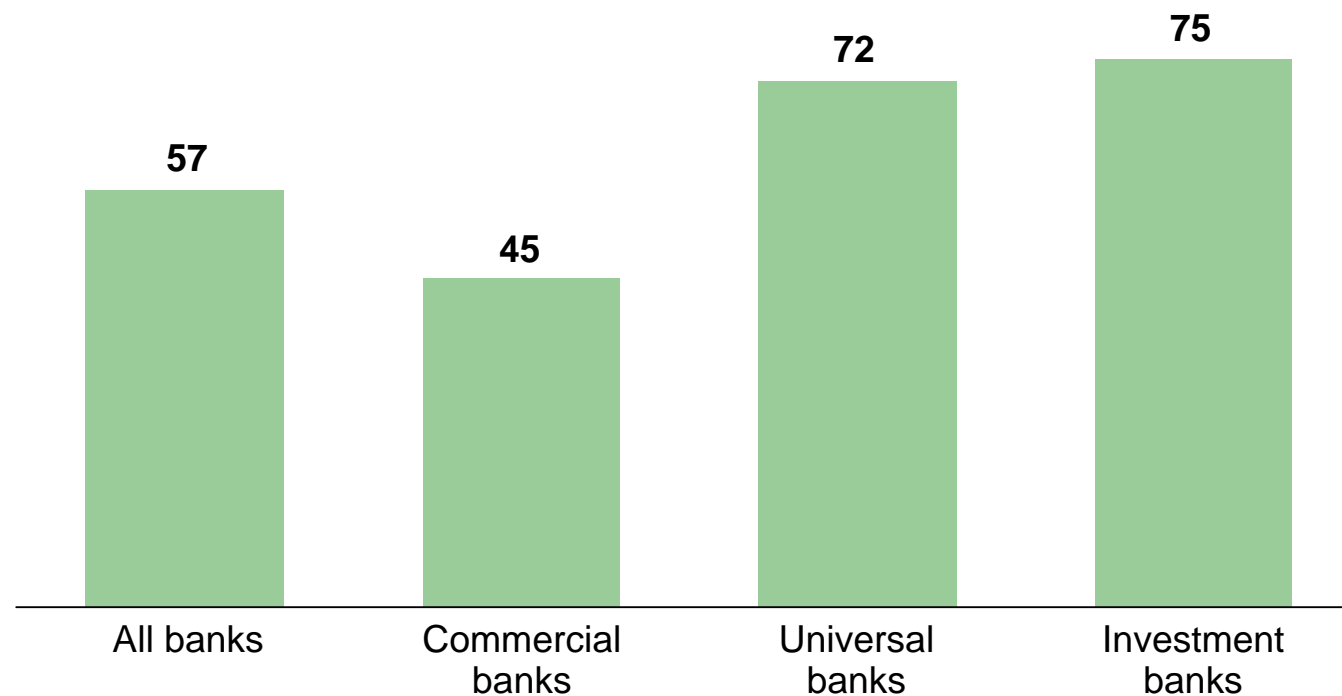
Sources: CECA, AEB, UACC, FSA, ECB, UK TSC reports, The Banker, Bankscope, Die Bank, SoFFin, press search. Bank failure or rescue is defined as bankruptcy, nationalisation, capital injection from government, issuance of government guaranteed debt, or takeover by rival due to financial distress

# QUESTION IV: WERE UNIVERSAL BANKS PROTECTED BY THEIR DIVERSIFIED MODEL?

Commercial banks performed better



Frequency of distress (%)



**COMMERCIAL BANKS HAD THE LOWEST FREQUENCY OF DISTRESS**

Source: I Ötker-Robe, A Narain, A Ilyina and J Surti, 'The too-important-to-fail conundrum: impossible to ignore and difficult to resolve', IMF, Staff Discussion Note, May 2011

**QUESTION V: WAS THE CRISIS A FAILURE OF REGULATION?**  
**Business model and poor management were also contributors**

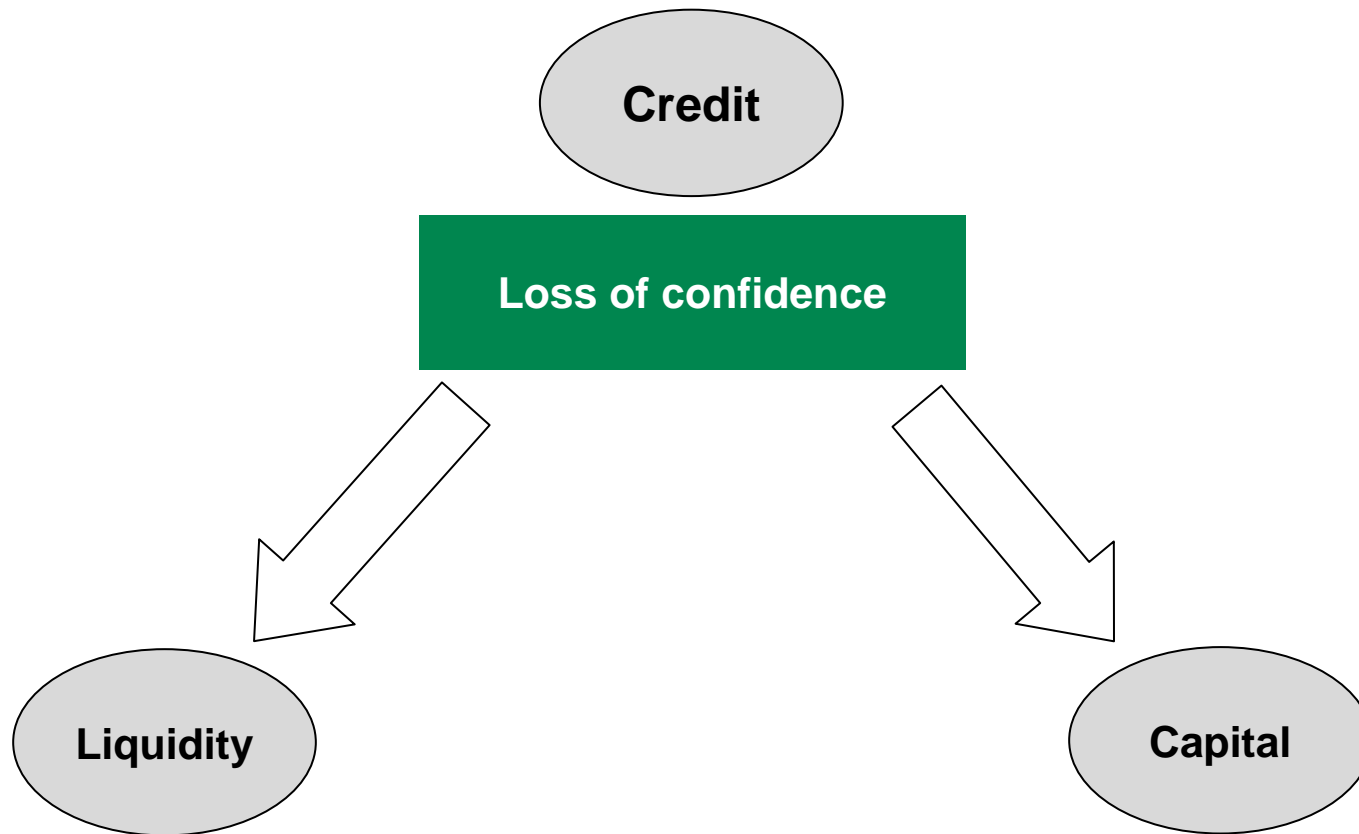


	Successful banks	Rescued banks
<b>Strategy</b>	Willing to make choices, exit	Keep up with others
<b>Focus</b>	Risk-adjusted return	Return at any cost
<b>Management</b>	Extensive line experience	Less experience, especially in risk
<b>Structure</b>	Risk reporting direct to CEO/Board	Risk reporting to business
<b>Style</b>	Challenge, debate	Complacency

**STRONGER RISK MANAGEMENT AND SUPERVISION ARE KEY FOR SUCCESSFUL BANKS**

## QUESTION VI: WAS IT LARGELY A CRISIS OF CAPITAL?

The crisis of confidence stemmed from credit concerns and affected both liquidity and capital



CONFIDENCE RESTORED BY LIQUIDITY AND CAPITAL INJECTIONS



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# EFFECTS OF THE FINANCIAL CRISIS

## The rebalancing will continue



Research indicates banking crises preceded by credit bubbles are typically followed by prolonged deleveraging

- Average deleveraging period: 5–6 years<sup>(1)</sup>
- Deleveraging typically starts 2 years after onset of financial crisis<sup>(1)</sup>
- Average deleveraging of 40% in 5 years post crisis<sup>(2)</sup>

Deleveraging since crisis has been modest to date

	Peak private sector debt/ GDP	% points decrease since peak
UK	203%	-15%
US	177%	-12%
Spain	234%	-9%
Sweden	177%	-6%
France	160%	-1%

<sup>(1)</sup> McKinsey 'Episodes of Deleveraging' analysis

<sup>(2)</sup> BIS analysis of 17 country banking crises which were preceded by credit booms (1981–2002)

# EFFECTS OF THE FINANCIAL CRISIS

## Implications for the banking industry

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### ECONOMIC ENVIRONMENT

- Recession followed by weak economic recoveries
- Uncertainty from austerity impacts
- European peripheral crisis

### REGULATORY ENVIRONMENT

- Inconsistency of regulatory responses
- Closer regulatory scrutiny
- Higher capital/liquidity requirements
- New regulatory initiatives

### CUSTOMERS AND COMPETITION

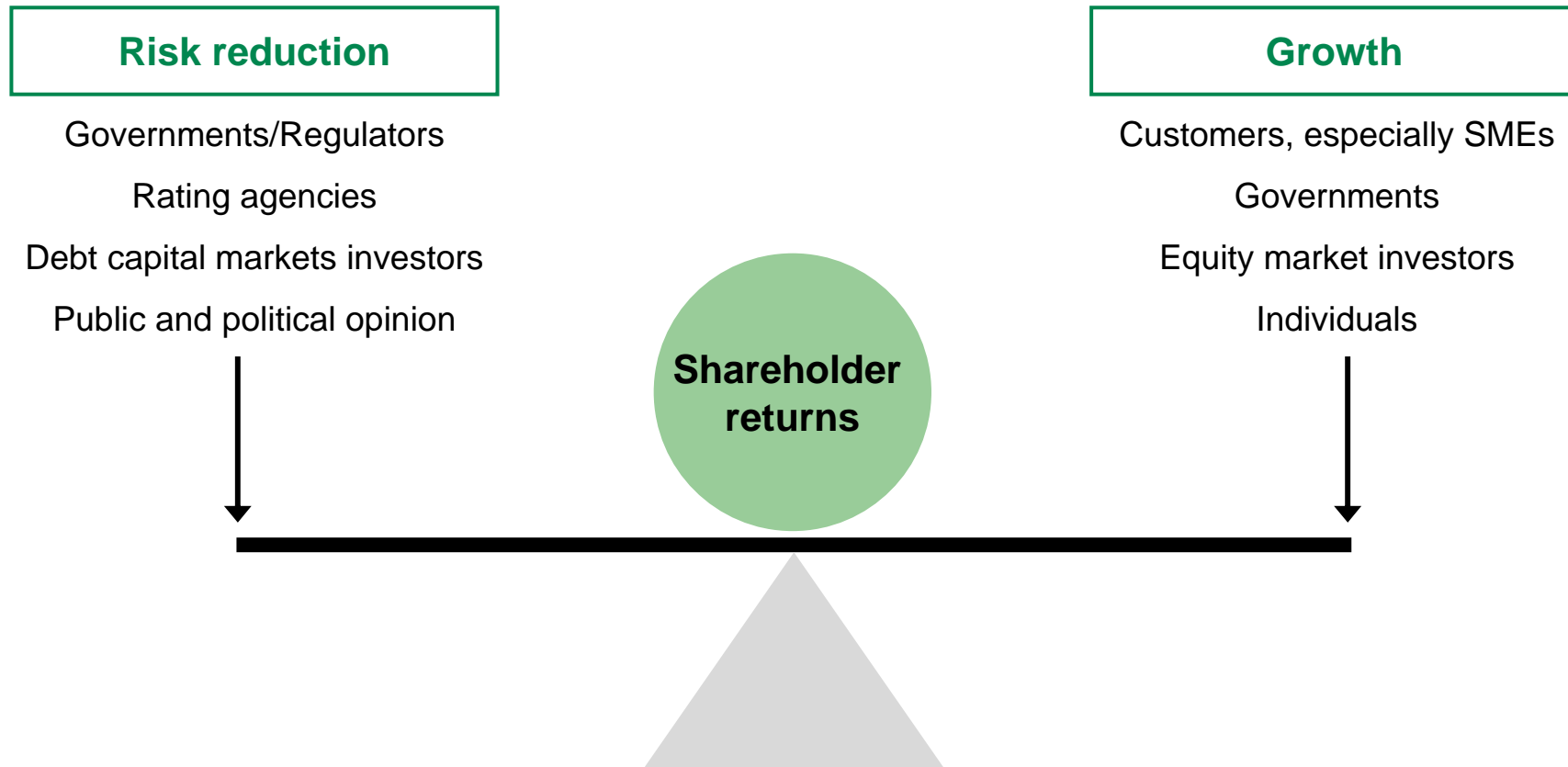
- Deleveraging by individuals and corporates
- Increasing customer expectations
- Lack of trust in industry
- Increasingly competitive markets
- Real incomes falling

### EQUITY AND FUNDING MARKETS

- Government ownership and funding support
- Depressed equity prices
- Challenging deposit market growth
- Higher funding costs

# EFFECTS OF THE FINANCIAL CRISIS

## Balancing the conflicting demands of risk and growth



**TO DELIVER APPROPRIATE SHAREHOLDER RETURNS THE INDUSTRY MUST BALANCE CONFLICTING REQUIREMENTS**

# LESSONS LEARNT FROM THE FINANCIAL CRISIS

## The conflicting demands of risk and growth will lower industry returns



### Income statement challenges

- Revenue growth difficult to find
- Net interest margins under pressure
- Cost base not aligned to new world
- Impairments still elevated

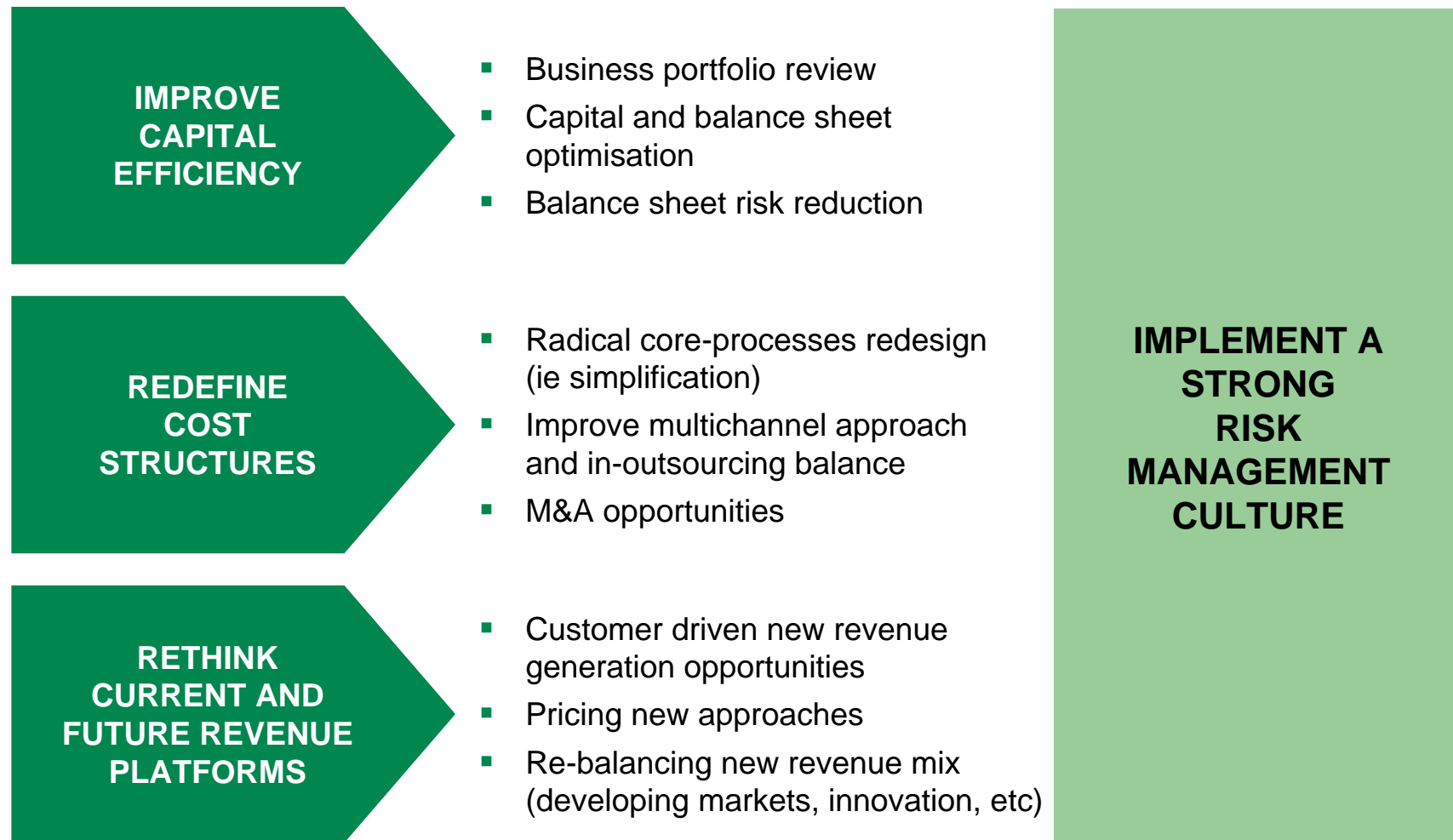
### Balance sheet challenges

- Higher capital
- Higher liquidity
- Improved funding positions
- Lower leverage
- Reduce higher-risk assets

**LOWER INDUSTRY RETURNS ON EQUITY THAN PRE-CRISIS**

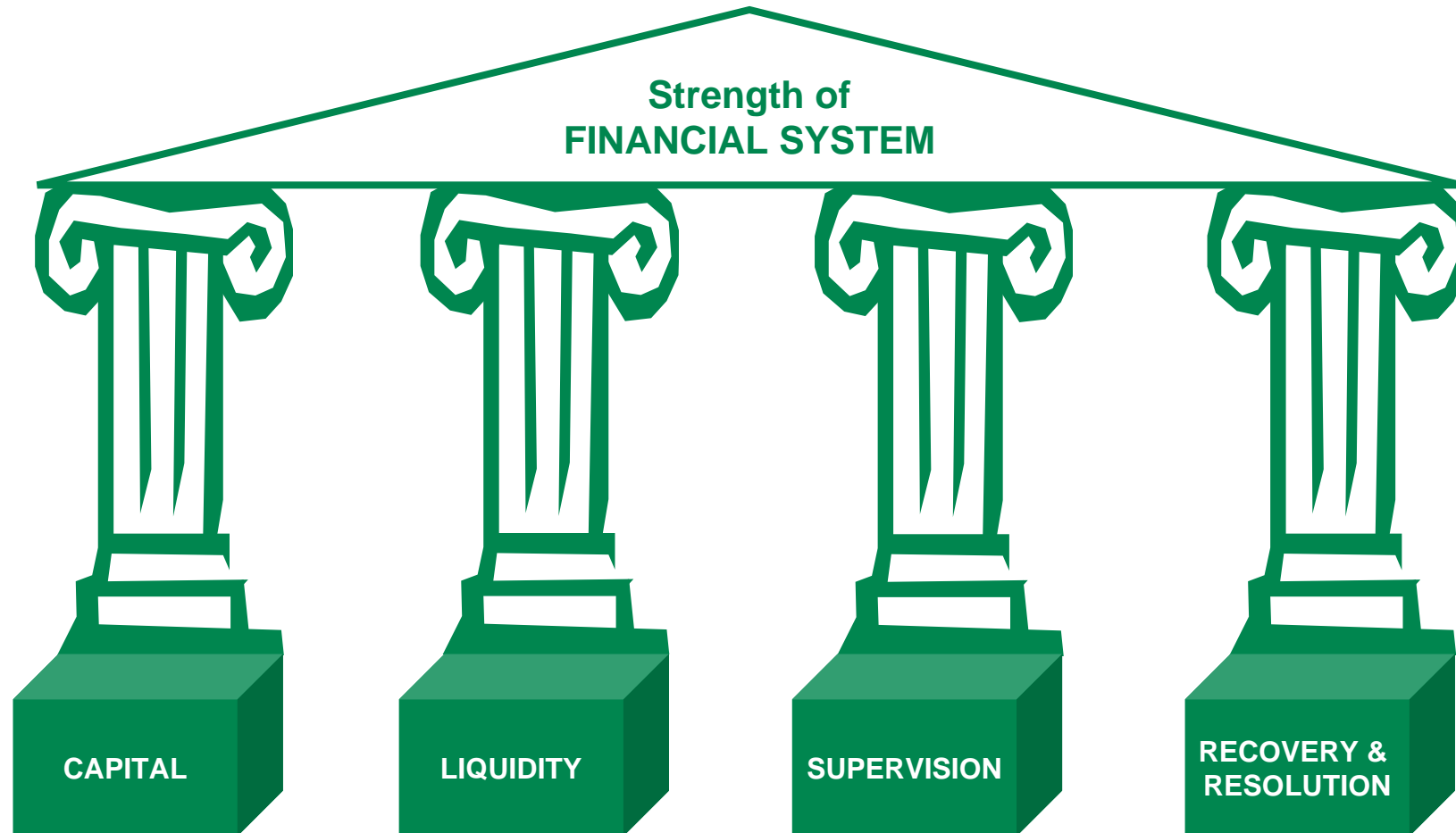
# LESSONS LEARNT FROM THE FINANCIAL CRISIS

Future winners will be the ones that are able to transform their business models by acting decisively to...



# LESSONS LEARNT FROM THE FINANCIAL CRISIS

...while taking account of the evolving regulatory environment in their business model



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# STRATEGY

Strategy reflects our integral role in supporting the UK economy

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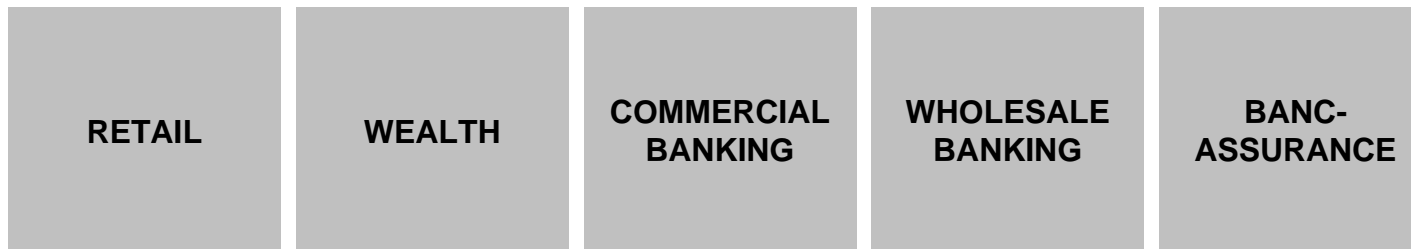
## THE BEST BANK FOR CUSTOMERS



## THE BEST BANK FOR SHAREHOLDERS

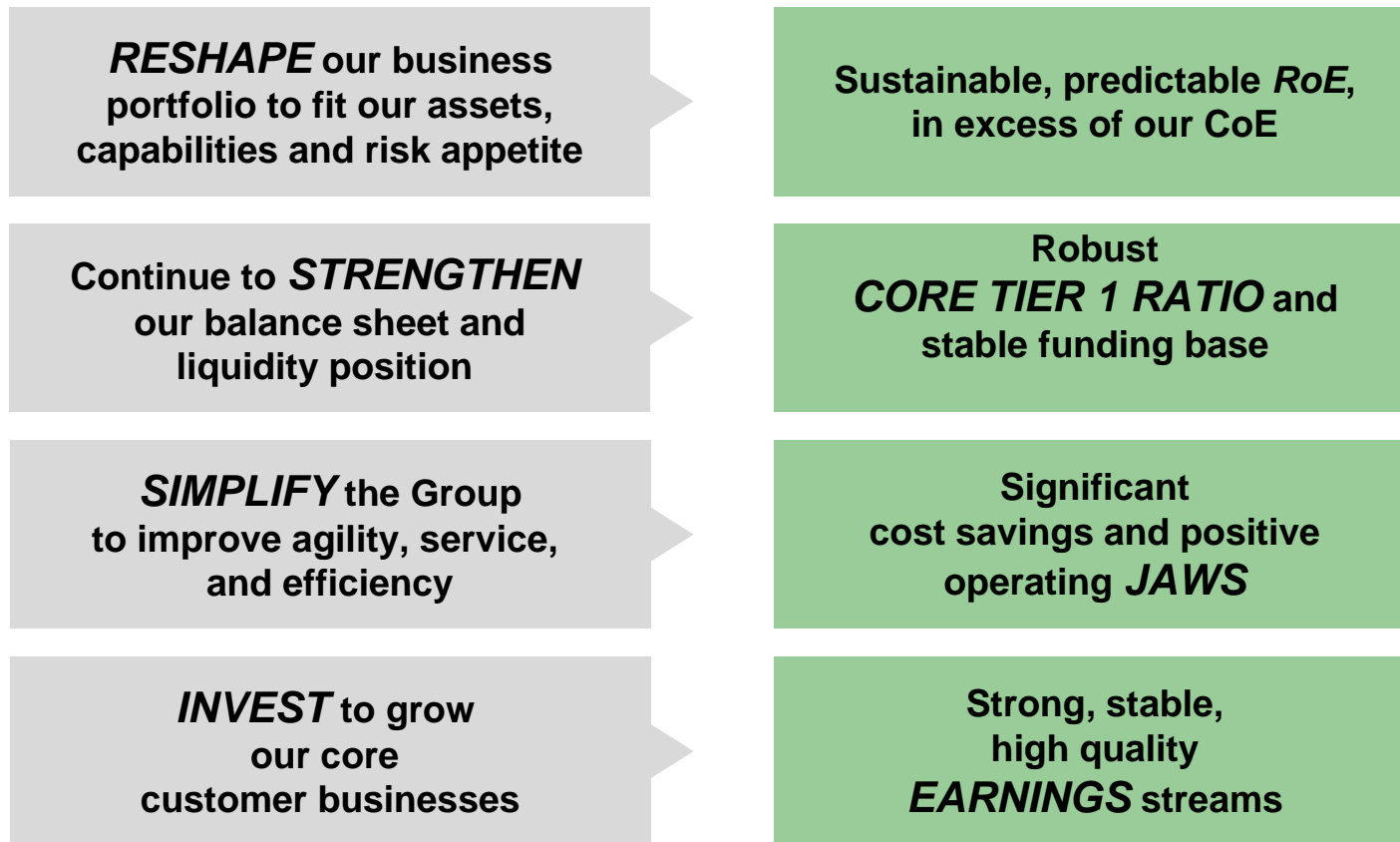


## APPROPRIATE BUSINESS FOCUS FOR NEW, DE-RISKED AND DELEVERED ENVIRONMENT



# OUR ACTION PLAN

Action plan targets strong, stable returns for our shareholders



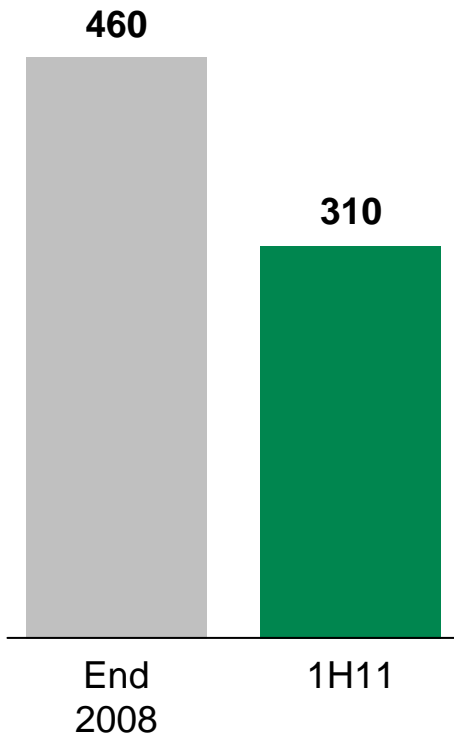
**FLEXIBLE STRATEGY FOR CHANGING ECONOMIC ENVIRONMENT**

# WE HAVE TRANSFORMED OUR BALANCE SHEET

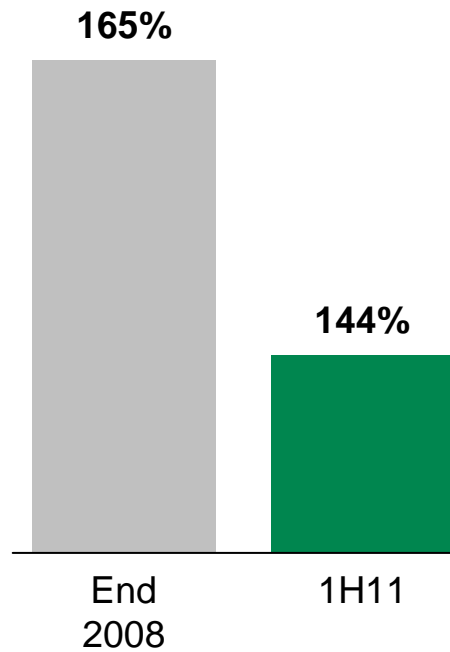
## Strategy builds on significant recent Balance Sheet progress



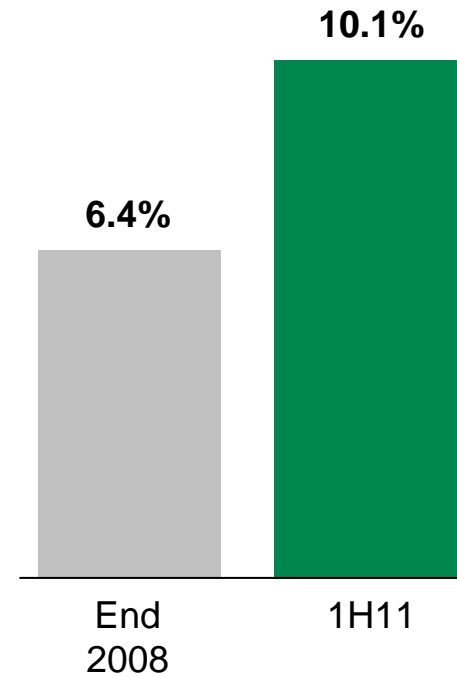
### Wholesale funding<sup>(1)</sup> (£bn)



### LTD ratio (%)



### Core tier 1 capital (%)



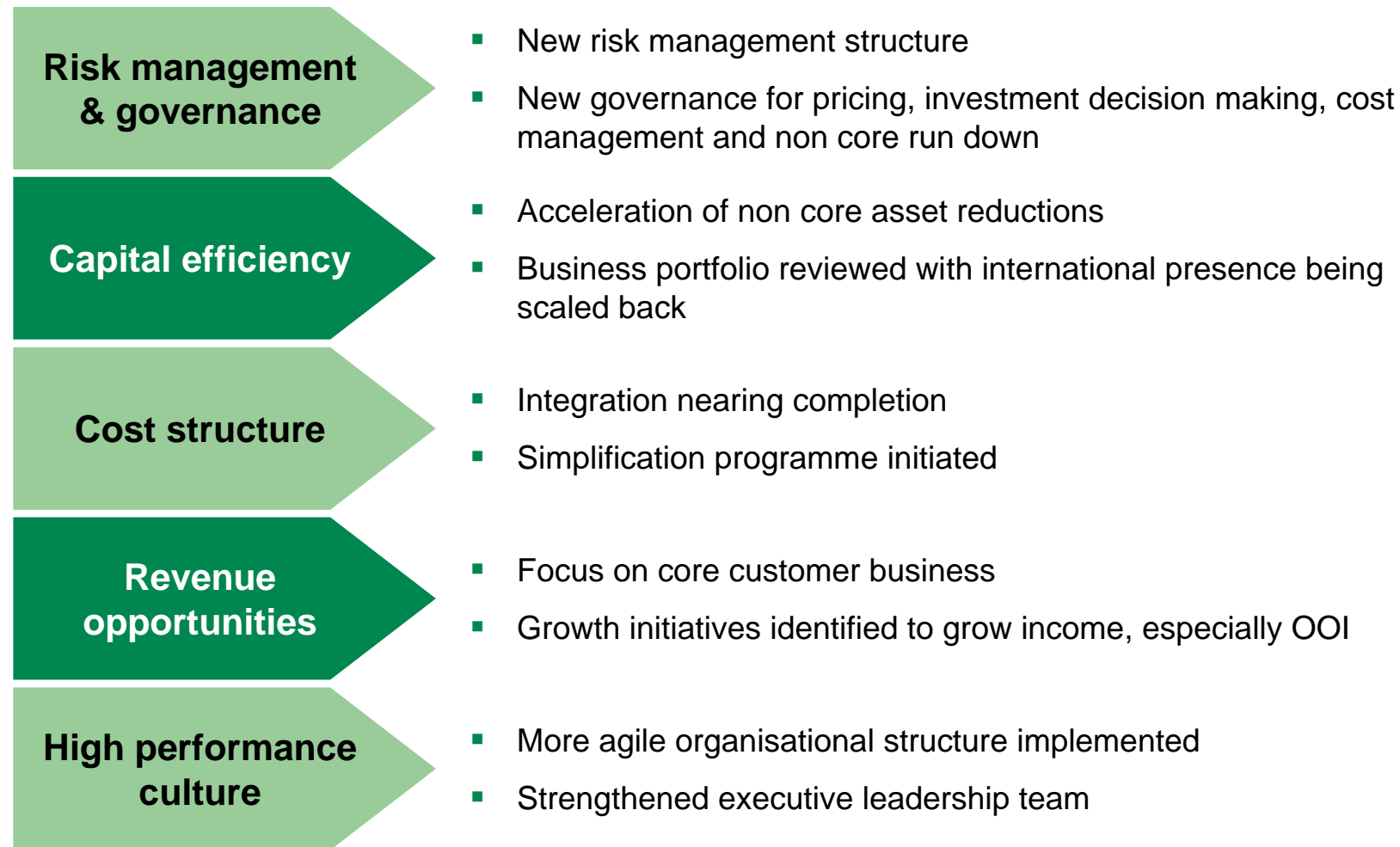
**WE WILL CONTINUE TO FURTHER STENGTHEN OUR CAPITAL AND FUNDING POSITION**

<sup>(1)</sup> Aggregate of wholesale and repo funding

# THE CREATION OF A HIGH PERFORMANCE ORGANISATION

## A number of actions have already been implemented to create a high performance organisation

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# CONCLUSIONS

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- **Many questions surround the recent crisis but it is clear it is not over**
- **Characteristics of future winners and losers in the banking sector are emerging**
- **Our strategy reflects the lessons learnt from the crisis and the operating environment**
- **We are targeting strong, stable and sustainable returns for shareholders over time**

# FORWARD LOOKING STATEMENTS AND BASIS OF PRESENTATION

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## FORWARD LOOKING STATEMENTS

This announcement contains forward looking statements with respect to the business, strategy and plans of the Lloyds Banking Group, its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group or the Group's management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. The Group's actual future business, strategy, plans and/or results may differ materially from those expressed or implied in these forward looking statements as a result of a variety of risks, uncertainties and other factors, including, without limitation, UK domestic and global economic and business conditions; the ability to derive cost savings and other benefits, as well as the ability to integrate successfully the acquisition of HBOS; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; risks concerning borrower or counterparty credit quality; instability in the global financial markets; changing demographic and market related trends; changes in customer preferences; changes to regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements; the policies and actions of governmental or regulatory authorities in the UK, the European Union, or jurisdictions outside the UK, including other European countries and the US; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU state aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations; exposure to regulatory scrutiny, legal proceedings or complaints, actions of competitors and other factors. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of such factors together with examples of forward looking statements. The forward looking statements contained in this announcement are made as at the date of this announcement, and the Group undertakes no obligation to update any of its forward looking statements.

## BASIS OF PRESENTATION

The results of the Group and its business are presented in this presentation on a combined businesses basis and include certain income statement, balance sheet and regulatory capital analysis between core and non-core portfolios to enable a better understanding of the Group's core business trends and outlook. Please refer to the Basis of Presentation in the 2011 Half-Year Results News Release which sets out the principles adopted in the preparation of the combined businesses basis of reporting as well as certain factors and methodologies regarding the allocation of income, expenses, assets and liabilities in respect of the Group's core and non-core portfolios.

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