BLACK HORSE RIDE

THE INSIDE STORY OF LLOYDS AND THE BANKING CRISIS

IVAN FALLON

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PREFACE

IT WAS JUST before eight on the evening of Monday 15 September 2008 when Sir Victor Blank arrived at Spencer House, ancestral home of Princess Diana, in London's St James's Place. He was late for a pre-dinner drinks reception and as the tall, patrician chairman of the Lloyds TSB banking group climbed the stairs to the gilded Great Room on the first floor, he could already hear the excited hum of a dozen conversations all discussing the same subject. Lehman Brothers, one of Wall Street's biggest and oldest banks, had spectacularly gone bankrupt overnight, threatening the entire global banking system with collapse and with it the fortunes of almost everyone in the room that night.

The reception was hosted by Sir Win Bischoff, chairman of the New York-based Citigroup, who had just presided over a two-day board meeting which turned out to be one of the gloomiest in the long history of the American bank, then ranked as the seventh biggest in the world. Bank shares that day had collapsed, with Citigroup's own shares down 40 per cent in a single session and no financial institution, including Lloyds, had escaped the market mayhem. What had been intended as a social

evening for his Citigroup board to meet some of the leading figures in Britain's banking and financial communities had been overwhelmed by the events of the past twenty-four hours.

Bischoff was anxiously glancing at his watch when Blank finally appeared. A few minutes earlier he had checked with the organiser to see if everyone was present so they could cut off the interminable drinks session and go next door to dinner. 'All, except for one person,' she answered. 'We're still waiting for Sir Victor Blank.'

'We'll give him five more minutes,' Bischoff decided. 'The Prime Minister wants to disappear but he wants to talk to him first.'

At that moment the Prime Minister, Gordon Brown, was standing a few feet away, deep in conversation with Bob Rubin, a former co-chairman of Goldman Sachs and Treasury Secretary under Bill Clinton who now served on the Citigroup board. Brown knew him well from his days as Chancellor of the Exchequer, and the two of them were animatedly debating the urgent actions their respective governments should be taking to head off financial Armageddon.

The Citibank event had been in Brown's diary for months but he had cancelled the dinner and had come along to the cocktail party to hear what the bankers had to say – and to lend an air of reassurance that the government was staying calm. The atmosphere in the room was anything but calm. Words such as 'scary', 'terrifying' and 'meltdown' could be heard above the hubbub and the word 'Lehman' was on everyone's lips. The events over the weekend were unprecedented in financial history and no one had any illusions about the fall-out, which was going to affect all of them profoundly.

Blank, not a man to panic easily, was as concerned as any of them. He had woken up that morning to the news that Lehman was filing for bankruptcy, the biggest banking failure ever and America's largest bankruptcy. And that was not all: the mighty Merrill Lynch, the legendary

'Thundering Herd' and the largest brokerage house on earth, had suffered such massive losses on its mortgage portfolio that it had to be bailed out by Bank of America before the markets opened. At close of business on Friday there had been four major investment banks on Wall Street: Merrill's, Lehman, Morgan Stanley and Goldman Sachs. By Monday there were two: Morgan Stanley and Goldmans – and even they looked perilously close to the brink too.

Just as seriously, the global insurance giant AIG (American International Group, Inc.) was in deep trouble, desperately trying to scrape together an emergency injection of $50 billion to keep it afloat after its shares fell by 72 per cent in one day. Its collapse, which seemed imminent, threatened the entire world insurance system as well as the banks, whose loans it insured.

Blank had spent the day talking to his executives and board, trying to get a handle on the impact on Lloyds of these momentous, unimaginable events. Lloyds, like every bank, did business with Lehman and he knew there would be a write-off, possibly running into the hundreds of millions. Until twenty-four hours before, Lehman had also been Lloyds's lead stockbroker (Citi was another one) and would have to be replaced at a time when it was needed the most.

As he arrived at the Citigroup reception, Blank was still trying to absorb the fact that the brash, irrepressible Lehman, which was founded in 1850 and had weathered the American Civil War, the Great Depression, two world wars and countless financial crises, was no more, its doors closed forever. Earlier in the day he had watched the TV coverage of disconsolate Lehman employees, among the highest earners in the City just a week before, carrying all that remained of their glittering careers in cardboard boxes out onto the street in Canary Wharf. That stark, unforgettable scene, more than any other, symbolised better than anything the end of the longest and biggest banking boom in history – and presaged the biggest crash which was now under way.

The Lloyds chairman made straight for Bischoff, who tactfully steered Rubin away to leave Brown alone with Blank, out of earshot of the rest of the room. The Prime Minister didn't waste time on pleasantries and went straight to the matter on hand. 'I haven't forgotten that conversation we had on the plane about Halifax Bank of Scotland,' he began, oblivious to the quizzical looks cast in their direction. 'We have been thinking quite hard about it – and we'll do everything we can to help.'

This was momentous news, which Blank had been waiting to hear since he and the Prime Minister talked on a plane coming back from Israel six weeks before. But he hadn't expected to get it at a cocktail party. For two years Lloyds and HBOS, Britain's fifth and fourth biggest banks respectively, had been trying to find ways to merge but had never been able to get past the competition issues involved. In July, with HBOS in serious trouble, Blank had suggested to Brown that the government help clear the way for the merger on the grounds that, unless HBOS was rescued by Lloyds, it would either go bust or have to be nationalised, both equally unpalatable for the Prime Minister. Now he listened, half stunned, as Brown finally gave him his decision.

'We recognise your argument that you could not go through the competitions process, particularly if there was a full review,' the Prime Minister said. 'Halifax Bank of Scotland could not survive it, so if you still want to do it, you should get on with it quickly.' He had, he said, scheduled a meeting the next morning with the new Chancellor, Alistair Darling, and Mervyn King, Governor of the Bank of England, and he would start the process immediately. After once more urging Blank to move fast and keep Downing Street informed, the Prime Minister turned away and, saying his goodbyes, left the room. He was expecting a long evening back at the office.

It took the normally quick-witted Blank a moment to take in the significance of what he had just heard. In effect, he had been given the green light for Lloyds TSB to proceed with the acquisition of HBOS,

which at that moment seemed to be heading the same way as Northern Rock, the high-flying mortgage bank which had collapsed the previous year after the first bank run in Britain for more than a century. That day alone the HBOS share price had fallen by 18 per cent, deposits were flowing out at a terrifying rate and the view in the Lloyds boardroom, shared by some of those in Spencer House, was that without government help, or a takeover from a stronger bank, it might not survive the week. With 15 million investors, 5 million mortgage-holders, 2 million shareholders and assets in excess of the annual UK GDP, its collapse could bring down the whole British banking system, turning the developing recession into the deepest depression since the 1930s.

The Prime Minister was aware that, behind the scenes, Lloyds and HBOS had been in merger discussions for months, but he didn't know the details. In fact, they were a long way down the road, and two months earlier the two banks had informally agreed on a basic structure whereby Lloyds, marginally the smaller of the two but with a stronger balance sheet, would take over HBOS. It would be an all-paper deal, a swap of Lloyds's shares for HBOS's, designed to protect every pound in precious capital the two banks could muster between them. Blank would be chairman of the new group and his American-born chief executive, Eric Daniels, would retain executive control. In a single bound, Lloyds, long seen as the staidest and most old-fashioned of all the high street banks, would vault to first place among domestic British banks, a position it had not enjoyed for a decade, the leader in all the major banking retail markets.

To the 65-year-old Blank, in his third year as non-executive chairman, HBOS was 'the big prize', the acquisition which, from the moment he arrived at Lloyds in 2006, he and the board had believed was the best solution to Lloyds's strategic problems. Both HBOS and Lloyds, he had long concluded, were 'marooned', stuck as two mid-sized financial institutions focusing on a mature UK banking market which had barely grown

in five years. A decade of trying to expand through cross-border mergers in Europe had taken Lloyds nowhere and for some time Blank and Daniels had been focused on a merger with HBOS as their best way to break out of their strategic straitjacket. The financial crisis, and HBOS's looming problems, gave them their window, the one brief moment when the competition rules could be relaxed long enough to let them through, but they had to move fast before it closed again. HBOS, after a period of wild and overaggressive expansion, needed rescue and Lloyds was the only bank around that could bail it out.

Watching the Prime Minister's back recede through the door, Blank caught the eye of his chief executive, who had been observing his interaction with Brown from across the room, and he gestured for him to follow him outside. Daniels was an obsessive smoker and was delighted to be in the open air where they stood on the steps directly underneath Rupert Murdoch's London apartment and facing (Lord) Jacob Rothschild's headquarters (also at the party).

'Eric, you're not going to believe this,' Blank began as Daniels lit up. He then related the conversation he had just had and its implications. 'It's as firm an assurance as he can give,' concluded Blank.

While Blank went back into the dinner, Daniels wheeled into action, calling his opposite number at HBOS, Andy Hornby, to pass on the news and ask him to assemble his executive team for a meeting first thing in the morning. Later in the evening Blank got hold of the HBOS chairman, (Lord) Dennis Stevenson, to tell him: 'Dennis, we've got the go-ahead from Gordon Brown on the competition issue. But we need to move fast.' Stevenson, contemplating the collapse of his bank and an inglorious end to his career, needed no urging.

The biggest banking merger in British history was under way.