

UK Financial Investments Ltd

**UK STEWARDSHIP CODE
SEPTEMBER 2016**

PRINCIPLE 1: INSTITUTIONAL INVESTORS SHOULD PUBLICLY DISCLOSE THEIR POLICY ON HOW THEY WILL DISCHARGE THEIR STEWARDSHIP RESPONSIBILITIES.

The overarching objective of UK Financial Investments (“UKFI”) in relation to listed companies is to manage the government’s shareholding in The Royal Bank of Scotland Group plc and Lloyds Banking Group plc (our investee companies) commercially to create and protect value for the taxpayer as shareholder and provider of financial support, with due regard to financial stability and competition, and to devise and execute a strategy for disposing of the government’s investments in an orderly and active way over time.

UKFI’s stewardship responsibilities are focussed on how and when to dispose of shares in a timely manner, with no mandate for any new investments.

In managing the government’s investments for value, UKFI is an active and engaged shareholder and our actions are guided by two key documents in place between UKFI, UK Government Investments (“UKGI”, our parent company) and HM Treasury.

First, the Shareholder Relationship Framework Document sets out the objectives for UKFI and the framework within which UKFI will pursue them. The Framework Document gives a clear mandate to UKFI to manage the investments commercially with a view to achieving an exit. It also makes clear that UKFI will not intervene in the day-to-day management decisions of the investee companies.

Secondly, the Investment Mandate describes the scope of UKFI’s decision-making responsibilities with respect to its management of the investments in the investee companies; and the extent to which decisions require the prior approval of HM Treasury before being taken or implemented.

In line with the principles set out in these two documents, UKFI has extensive engagement with the investee companies throughout the year on a range of issues such as governance, strategy, financial performance, board composition and remuneration. Appropriate to the level of holdings we have in our investee companies, we expect to be consulted on strategic decisions in a timely manner. This engagement assists UKFI in delivering on its objectives and provides UKFI with the opportunity to give feedback to the investee companies.

Given the nature of UKFI’s mandate, the UKFI Board spends a significant proportion of its time focusing on stewardship duties, which are all carried out by UKFI staff, rather than being outsourced. UKFI does, from time to time, procure advisors to provide the UKFI Board and Executive Management team with specialist advice. In 2013, UKFI established a framework for appointing advisors (Framework for Specialist Financial Services) to help facilitate our objectives.

Both the Shareholder Relationship Framework Document and the Investment Mandate are available on our website at: <http://www.ukfi.co.uk/publications/>.

PRINCIPLE 2: INSTITUTIONAL INVESTORS SHOULD HAVE A ROBUST POLICY ON MANAGING CONFLICTS OF INTEREST IN RELATION TO STEWARDSHIP WHICH SHOULD BE PUBLICLY DISCLOSED.

UKFI is not a typical institutional investor as we have a single client, HM Treasury, which through UKGI, is also our sole shareholder. UKFI is independent of HM Treasury, and while UKFI will always try and align our objectives with our shareholder, it is possible this may not always happen. The Framework Document sets out how UKFI will approach circumstances in which the views of our shareholder diverge from those of UKFI – with our policy being to take any unresolved issues to our Board for further discussion.

UKFI takes the issue of conflicts of interest very seriously, and the Framework Document outlines the procedures UKFI must adopt for managing conflicts. UKFI has established Board procedures and compliance policies to manage conflicts:

- UKFI has a compliance manual which sets out how UKFI staff should manage conflicts, and UKFI staff complete an annual compliance return.
- The Framework Document outlines how UKFI will ensure preservation of the independence of the investee companies – this covers cross-directorships, handling of commercial information, and having procedures which between do not result in a prevention, restriction, distortion or significant lessening or impediment of effective competition.
- UKFI has developed a rigorous control framework with respect to governance, compliance and risk procedures. Appropriate account of best practice has been taken; for instance, although UKFI’s activities do not require regulatory authorisation, the Board has decided that UKFI should adopt policies and procedures that would meet the standard expected of a wholesale-market firm operating in the financial services market.
- The UKFI Board has responsibility for maintaining a sound system of internal controls that supports UKFI’s policies and the achievements of its objectives, whilst safeguarding the public funds and assets for which the Board is collectively responsible. The Audit and Risk Committee has responsibility for oversight of UKFI’s governance, internal control, risk management processes and behaviours. It also has responsibility for agreeing internal and external audit work programmes and overseeing the reports associated with these programmes.

PRINCIPLE 3: INSTITUTIONAL INVESTORS SHOULD MONITOR THEIR INVESTEE COMPANIES.

UKFI takes a commercial and active approach to managing these investments, including dialogue with other investors with an interest in the investee companies. UKFI’s role as an engaged shareholder is to ensure that the banks have sound long-term strategies, and that they are effectively managed and properly governed.

As the body representing the taxpayer’s interest in these companies stewardship is of critical importance to the work of UKFI and is at the heart of how we conduct our business –

ultimately UKFI's performance as an organisation will be judged on the success of our stewardship and disposals programme.

UKFI maintains an active and regular dialogue with our investee companies' boards and senior management. UKFI meets with the senior executive management team on a monthly basis, in addition to ad-hoc meetings when required. Should we have concerns, for instance about strategy, operational performance, acquisitions, or disposals, we will discuss with the investee company at the appropriate executive level.

UKFI also interacts with the investee companies' board, through regular contact with the Chairs and heads of board committees. Although UKFI does not get involved with individual appointments, we discuss with the Chairs and relevant board members recruitment in light of the balance of skills on the board.

UKFI conducts thorough and regular valuations on what our investee companies are worth, and this work is shared with our Board. The Framework Document and our Annual Report and Accounts sets out additional and specific monitoring, reporting and engagement activities which UKFI undertakes.

UKFI recognises that the Corporate Governance Code is intended to set out best practice rather than operate as formulative rules. While we generally expect to see compliance with the principles of the Corporate Governance Code by our investee companies, we will consider explanations for why a firm has chosen not to comply. Any decision to depart from the principles of the Corporate Governance Code must be accompanied by a clear and reasoned explanation and UKFI will challenge a decision where we feel a suitable explanation has not been given.

UKFI has privileged access to sensitive information including information received under non-disclosure agreements with other entities. UKFI's Framework Document sets out how we will manage inside information. There will be times, where we may agree to be taken inside for a temporary period, and where required we have established protocols with our investee companies on how to manage this process. Receiving this information is a considered decision undertaken by UKFI in order to perform its responsibilities under the Framework Document. For example it can arise where UKFI is engaging with an investee company to enable a full understanding of the effects of a strategic decision.

In such circumstances, UKFI will make a decision as to whether it considers it necessary to receive the non-public information. We ensure confidential information is treated appropriately, and consideration is given to the timeframe over which such information will remain non-public.

PRINCIPLE 4: INVESTORS SHOULD ESTABLISH CLEAR GUIDELINES ON WHEN AND HOW THEY WILL ESCALATE THEIR STEWARDSHIP ACTIVITIES.

As set out in principle 3, UKFI has a regular dialogue with our investee companies, with engagement undertaken at many levels and dependent on the topic. For example, it is

common to meet with newly appointed company directors and senior management outside of our regular meetings with the investee companies. UKFI's position allows for access to the board and senior management team when escalation is required. In the first instance discussion is undertaken with senior management of the investee company; following this if an issue needs to be escalated to the board then this will happen either with the Chair of the board, the senior independent director (SID) or the Chairs of the board committees.

Topics which are likely to trigger any potential intervention by UKFI would be those in relation to the objectives set out in the Framework Document – these might be in relation to the investee company's overall strategy, including major disposals and/or acquisitions.

PRINCIPLE 5: INSTITUTIONAL INVESTORS SHOULD BE WILLING TO ACT COLLECTIVELY WITH OTHER INVESTORS WHERE APPROPRIATE.

In respect of RBS and Lloyds, UKFI takes a commercial and active approach to managing these investments, working alongside other investors with an interest in these companies.

Since UKFI's inception in November 2008 we have maintained an active and continuous dialogue with other institutional shareholders – both existing and prospective. Our aims through this dialogue include: emphasising our remit and explaining the arm's-length nature of our relationship with government; ensuring investors are clear that the companies are being run on a commercial basis; and hearing other investors' views, so that we are aware of those views when considering the strategies of our investee companies.

UKFI is committed to continuing the policy of engagement with other shareholders and trade bodies (such as Association of British Insurers and The Investment Management Association) around major business issues and in the deliberation on matters brought to vote at the investee companies' Annual General Meetings and other shareholder meetings. UKFI will continue this contact with investors, within the context of protecting and creating value for the taxpayer. UKFI will consider the possibility of acting collectively on a case-by-case basis.

Any shareholders who would like to contact UKFI regarding stewardship of the investee companies are encouraged to do so, and in the first instance should contact UKFI by email at enquiries@ukfi.co.uk.

PRINCIPLE 6: INSTITUTIONAL INVESTORS SHOULD HAVE A CLEAR POLICY ON VOTING AND DISCLOSURE OF VOTING ACTIVITY.

UKFI has a clear policy on both voting and disclosure. UKFI will exercise its stewardship role through its voting rights wherever practicable to do so (i.e. on all resolutions other than where the government has been a related party). The decision on how to vote is made by the UKFI Board. UKFI does not make use of a voting advisory service – any recommendations on voting made to the UKFI Board come from analysis conducted by UKFI staff.

UKFI will inform our investee companies in advance of our intentions and rationale and we disclose publicly how we have voted. Disclosure of our votes is made on our website via a press release at <http://www.ukfi.co.uk/press-releases/>.

PRINCIPLE 7: INSTITUTIONAL INVESTORS SHOULD REPORT PERIODICALLY ON THEIR STEWARDSHIP AND VOTING ACTIVITIES.

UKFI is committed to being accountable and transparent. UKFI's Annual Report and Accounts contains information on the manner in which we have discharged our stewardship role. UKFI reports regularly to our parent company (UKGI) and our sole client (HM Treasury). UKFI holds regular meetings with HM Treasury, with the Quarterly Shareholder Meetings (QSMs) as the centrepiece of our formal reporting relationship. UKFI also complies with Managing Public Money. In addition, UKFI representatives attend Parliamentary Committee hearings upon request, generally at least once during the year.

UKFI also responds to requests under the Freedom of Information Act 2000 and to correspondence from members of the public, MPs, and other stakeholders. It is through these channels (the QSMs, Parliamentary hearings and our adherence to Managing Public Money) that UKFI's stewardship is independently assured. In addition, the UKFI Board undertakes an annual Board evaluation exercise, which identifies areas for further improvement. With the formation of UKGI in 2016, the UKFI Board have elected not to undertake an external review of Board effectiveness going forward, with UKGI providing future assurances of the Board's responsibilities.

NAMED INDIVIDUAL IN RELATION TO STEWARDSHIP MATTERS.

Please make any enquiries in relation to UKFI's stewardship matters to Oliver Holbourn, CEO UKFI.