

UK Financial Investments Ltd

UK FINANCIAL INVESTMENTS LIMITED (UKFI)
ANNUAL REPORT AND ACCOUNTS 2010/11

UK FINANCIAL INVESTMENTS LTD ANNUAL REPORT AND ACCOUNTS 2010/11

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UKFI'S REMIT

UK Financial Investments (UKFI) was created in November 2008 as part of the UK's response to the financial crisis.

UKFI is responsible for managing the Government's shareholdings in The Royal Bank of Scotland Group plc and Lloyds Banking Group plc, collectively the "Market Investments". UKFI is also responsible for managing the Government's 100 per cent shareholdings in Northern Rock plc and UK Asset Resolution Ltd (which was formed during 2010 to integrate the activities of Northern Rock (Asset Management) plc and Bradford & Bingley plc), collectively the "Wholly-Owned companies".

Our overarching objective is to manage these shareholdings commercially to create and protect

value for the taxpayer as shareholder and to devise and execute a strategy for realising value for the Government's investments in an orderly and active way over time within the context of protecting and creating value for the taxpayer as shareholder and where applicable, as provider of financial support, paying due regard to the maintenance of financial stability and acting in a way that promotes competition.

More detail on UKFI's role, remit and ownership approach is set out in our Framework Document and Investment Mandate with HM Treasury and our Framework Documents with our Wholly-Owned companies. These can be found on our website www.ukfi.co.uk and on the Wholly-Owned companies' websites.

CHAIRMAN'S FOREWORD

UKFI's remit is to manage the Government's shareholdings in the banks on an arm's-length commercial basis, with an overarching objective to dispose of the Government's investments.

The focus of our work over the past year having been on our role as an active and engaged shareholder, operating within the remit set out in our Framework Document and Investment Mandate in place with HM Treasury.

The investee banks have faced challenging economic conditions in the main markets in which they operate, but determined management action enabled all our banks to reach important milestones in their paths to recovery.

In 2010 Lloyds Banking Group returned to profitability and made good progress on the integration of HBOS. However, since the autumn of 2010 the share price has been impacted by the outlook for interest margins and by profitability falling short of previous company guidance, together with significant additional provisions in relation to Ireland and for Payment Protection Insurance compensation claims. The new Chief Executive and his management team are now focusing on implementing the measures set out in the Strategic Review published on 30 June 2011.

RBS made good progress in 2010 and is on or ahead of its published goals for this stage of its recovery plan.

The Wholly-Owned companies have undergone substantive restructuring during the year and have performed in line with expectations.

The past year has seen significant and ongoing reform of the international and domestic system of banking regulation, including increasing capital requirements, more effective resolution regimes and, in the UK, a specific levy on banks' balance sheets. This process of reform will continue over the next year, including through the publication of the Independent Commission on Banking's (ICB) final report in September and the Government's response to the report. Once implemented, these regulatory changes should strengthen the stability and resilience of the banking sector thereby reducing risks to the UK economy and public finances. However, the cumulative effect of these changes will also impact negatively on the profitability of banks and therefore on the value of the taxpayers' stakes in Lloyds Banking Group and RBS. The current share prices of Lloyds Banking Group and RBS reflect the ongoing uncertainty about banks' recovery prospects, particularly in view of the current problems in the Eurozone, as well as the long-term impact on value as a result of these regulatory changes.

We will continue to work with the banks on their governance, restructuring and long-term strategies, but we will increasingly also be focused on the work of preparing for, and undertaking, a disposal of the Government's investments.

The Chancellor has accepted our recommendation that options for returning Northern Rock plc to the private sector are explored and this process is now under way. Northern Rock (Asset Management) plc has repaid £1.1 billion of Government loans during 2010 and we are also supporting the development of a strategy to accelerate and enhance the value of the repayments of the rest of the Government's debt in UK Asset Resolution Ltd. In that regard we worked with Northern Rock (Asset Management) plc and Bradford & Bingley plc on two liability management exercises during the year creating a benefit to taxpayers with a present value of £1.5 billion.

Our ability to commence a share sale programme of the Government's investments in Lloyds Banking Group and RBS has been impacted by the ongoing regulatory uncertainty noted above. However, we believe it is important that the Government is not seen to be a permanent investor in UK financial institutions. We therefore await further clarity emerging in relation to the work of the ICB and the other regulatory changes that I have mentioned above before we will be able to recommend the start of the process of selling the Government's shareholdings.

I am very grateful to all the team at UKFI and to my Board colleagues for their continued dedication and work. I would like to thank Louise Tulett who served as a UKFI Board member until October 2010 when she moved from HM Treasury to the Ministry of Defence. I would also like to thank Ken Beeton who acted as a temporary director until Julian Kelly, the newly appointed Group Director of Finance and Commercial at HM Treasury, was appointed as Louise's successor to the UKFI Board.

A handwritten signature in black ink, appearing to read 'David Cooksey', with a long horizontal stroke extending to the right.

David Cooksey

Chairman

13 July 2011

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01

Chief Executive's Review

This Annual Report aims to provide Parliament, HM Treasury, the public and other stakeholders with an update and assessment on how UKFI is approaching its task.

Information on the financial performance of the investee banks over the year is set out in the chapters on RBS, Lloyds Banking Group, Northern Rock plc and UK Asset Resolution Ltd.

Whilst the banks' share price and financial performance are closely reviewed, we do not believe these alone are an adequate test of UKFI's effectiveness in managing the investments as they are influenced by a range of factors outside UKFI's control. Ultimately, our performance as an organisation will be judged on the effectiveness of our performance as an active and engaged shareholder and in relation to the disposal programme. Accordingly, we set out here a summary of our performance during the year of the stewardship activities we consider to be important for the effectiveness of our role.

UKFI performance as an active and engaged shareholder

UKFI carries out its role as an active and engaged shareholder through in-depth interaction at all levels within each of the investee banks. Our work with the investee banks focuses on governance, strategy and performance against strategy.

As financial institutions with private as well as Government investors, Lloyds Banking Group and RBS are run by their own independent Boards and management teams who have legal and fiduciary responsibilities to all their shareholders. UKFI therefore takes a commercial and active approach to managing these investments as a shareholder, working alongside other investors.

The Wholly-Owned companies are also run by their Boards and management teams but UKFI has some additional involvement in these companies given the Government's 100 per cent shareholding. UKFI engages with these companies in a manner similar to a financial sponsor engaging with wholly-owned portfolio companies. For example, UKFI appoints the Chairman of the Board, is required to approve Board nominations, is represented at Board meetings and has approval rights over the companies' business plans.

Restructuring the investment in the investee banks

2009/10 saw a substantial restructuring of the Government's investments in Lloyds Banking Group and RBS. In 2010/11 UKFI's restructuring work has focused primarily on the Wholly-Owned companies.

On 1 January 2010, following a legal and capital restructuring, the former Northern Rock's business was split into two separate entities: Northern Rock plc and Northern Rock (Asset Management) plc. Northern Rock plc is a new savings and mortgage bank that holds all of the former Northern Rock's pre-existing customer savings accounts and some of its pre-existing mortgage accounts. Northern Rock (Asset Management) plc now holds the "closed mortgage book" from the former Northern Rock. Achieving a full operational separation of these two companies was a condition of European Commission state aid approval.

On 1 October 2010, UKFI announced the establishment of UK Asset Resolution Ltd as the single holding company for Northern Rock (Asset Management) plc and Bradford & Bingley plc. The integration of these companies creates a larger entity which will enjoy significant economies of scale. Increased efficiency and shared capability in areas such as arrears management and treasury functions will therefore enhance the future repayment of Government loans.

In keeping with our remit to create value for the taxpayer, UKFI worked with Northern Rock (Asset Management) plc and Bradford & Bingley plc on two rounds of liability management exercises. These involved the companies buying back debt in the market at a lower price than the debt was originally issued.

Buying back the debt at a discount reduced potential future claims on the company from subordinated debt holders and creates a gain for the taxpayer as shareholder. Through these liability management exercises, Northern Rock (Asset Management) plc and Bradford & Bingley plc successfully bought back £2.4 billion of subordinated debt, which was recognised by the National Audit Office¹ as resulting in either an increase in shareholders' equity of £1.7 billion or a benefit to taxpayers with a present value of £1.5 billion.

Improving governance in the investee banks

The Boards of all the investee banks have been fundamentally restructured since the time of the Government's initial investment. The restructuring of the Wholly-Owned companies, described in the previous section, required the creation of new Boards for Northern Rock plc, for UK Asset Resolution Ltd, and its subsidiaries Northern Rock (Asset Management) plc and Bradford & Bingley plc. As the 100 per cent shareholder in these companies UKFI agreed all the appointments to the Boards.

On 9 April 2010 UKFI announced that Richard Pym, formerly Chairman of Northern Rock (Asset Management) plc and Bradford & Bingley plc, had been appointed Chairman designate of UK Asset Resolution Ltd and that Richard Banks, formerly Managing Director of Bradford & Bingley plc, had been appointed Chief Executive designate of UK Asset Resolution Ltd. These appointments, along with the other non-executive director positions, including Keith Morgan, Head of Wholly-Owned Investments, as the UKFI Board representative, were formally confirmed on 1 October 2010 when UK Asset Resolution Ltd was established as the holding company for Northern Rock (Asset Management) plc and Bradford & Bingley plc.

At Northern Rock plc, following the resignation of Gary Hoffman as Chief Executive, Ron Sandler reverted from Non Executive Chairman to Executive Chairman on 4 November 2010.

UKFI worked closely with the Board of Lloyds Banking Group on its appointment of a new Chief Executive. On 20 September 2010 Lloyds Banking Group announced that Eric Daniels had informed the Board of his decision to retire. Lloyds Banking Group proceeded to search for an appropriate successor and on 3 November 2010 announced that António Horta-Osório, formerly Chief Executive of Santander UK, was to be appointed – he became Group Chief Executive on 1 March 2011. UKFI believes it appropriate that the bank has new leadership to take it forward and that Mr Horta-Osório is the right person to do so.

As well as the appointment of a new Chief Executive at Lloyds Banking Group, one new non-executive director was appointed to each of the Boards of both Lloyds Banking Group and RBS.

Monitoring investee bank strategies

UKFI engages closely and regularly with the Chief Executives, Boards of Directors and senior management as appropriate at all the investee banks on issues such as strategy, funding and financial performance, to ensure that the strategies being devised and implemented are ones that build sustainable value for the taxpayer as shareholder. UKFI is either represented or is in attendance at Board meetings of all the Wholly-Owned companies.

During 2010, RBS focused on making further progress against the five-year strategic plan set out in 2009, which aims to deliver sustainable profitability, a lower risk balance sheet and a stable funding position. Whilst monitoring overall progress against these goals, over the past year UKFI has particularly focused on the run-down of RBS's non-core assets, its funding and liquidity position in light of external developments such as the financial instability in the Eurozone and the evolution of RBS's strategy for its Global Banking & Markets Division in light of regulatory developments.

¹National Audit Office, *Stewardship of the wholly-owned banks: buy-back of subordinated debt*, 18 March 2011. Available at: http://www.nao.org.uk/publications/1011/stewardship_of_wholly_owned_ba.aspx

At Lloyds Banking Group, 2010 saw progress on returning the bank to consistent profitability and its goal of becoming the UK's best financial services provider. As with RBS, in the year under review, UKFI has focused on funding and liquidity and balance sheet rundowns but also on the continued integration of Lloyds TSB and HBOS. In recent months we have also engaged with the new management team on the development of their new strategy.

Given the split of the former Northern Rock on 1 January 2010, UKFI has focused on overseeing the process of the separation and ensuring that commitments made to the European Commission were met during the year, including the release of Northern Rock plc's deposit guarantees and conclusion of operational separation by 31 December 2010. In parallel, UKFI was instrumental in the strategy to create UK Asset Resolution Ltd as the new holding company for Bradford & Bingley plc and Northern Rock (Asset Management) plc, and supported the development of the new unified management team.

All the banks in which the taxpayer has a financial interest are conscious of their role in supporting UK growth and their strategies are designed to facilitate this, subject to their obligations to act in the best interests of all their shareholders. In February 2011, Lloyds Banking Group and RBS participated, along with other UK banks, in an agreement with the Government involving further lending commitments to UK companies and other measures designed to promote a constructive relationship.

Reforming risk management

The banks' approach to risk management is a key issue for UKFI and we engage closely and regularly with their risk officers and Board risk committees.

Both Lloyds Banking Group and RBS continue to embed a new set of risk management disciplines to underpin their efforts to de-risk their balance sheets and achieve a secure funding position. This includes the development of risk control frameworks to set the parameters for financial decisions made across both Groups, ensuring appropriate alignment with their overall strategic objectives.

The split of the former Northern Rock and the subsequent integration of Northern Rock (Asset Management) plc and Bradford & Bingley plc has allowed the Board Risk Committees of the organisations to be enhanced with additional expertise.

During the year Bradford & Bingley plc worked closely with the Financial Services Authority, which approved its application to change from BIPRU to the simpler MIPRU regulatory status, in recognition of the fact that it was a provider of mortgage services rather than being a bank. Bradford & Bingley plc's regulatory status now aligns with that of Northern Rock (Asset Management) plc.

At all the banks, we have ensured that input from the risk functions is a key component of remuneration decisions, that bonus plans include clawback provisions reflecting ongoing risk and that awards under long-term incentive plans take account of specific risk measures.

Changing the approach to remuneration

UKFI understands the real public concern about levels and structure of pay in the banking sector and particularly at banks where the taxpayer has made a financial investment. Equally, it is vital for UKFI's objective of protecting and creating value that the banks can offer competitive remuneration packages enabling them to continue to attract, retain and motivate employees to deliver performance for shareholders including the taxpayer.

UKFI sees continued reforms to remuneration practices as vital. As such, we have only approved remuneration structures that include significant levels of deferral and clawback in order to encourage long-term sustainable performance and to discourage excessive risk-taking. UKFI has sought to ensure that

the banks are at the forefront of implementing relevant remuneration requirements, such as the Financial Services Authority's updated Remuneration Code of Practice, which came into effect on 1 January 2011.

UKFI also recognises that it is essential that the quantum of remuneration properly reflects performance and is appropriate for the relevant role. UKFI therefore engaged closely with the banks throughout this year seeking to ensure that levels of potential remuneration for individuals are rigorously benchmarked and that actual remuneration properly reflects performance. In addition, UKFI assessed the aggregate level of remuneration paid against the banks' financial performance, again taking account of appropriate external benchmarks in relation to key financial measures, both on an absolute basis and relative to year-on-year progress.

Given the work done by the banks in relation to remuneration, UKFI voted in favour of the Directors' Remuneration Reports of both Lloyds Banking Group and RBS at their AGMs in 2011.

Our role as active shareholder

UKFI is committed to an active, engaged shareholder role and is a signatory to the Financial Reporting Council's Stewardship Code for Institutional Investors. We have published our statement of compliance with the UK Stewardship Code on our website. Our role as an engaged shareholder is, to the extent appropriate, to ensure that the banks have sound long-term strategies, and that they are effectively managed and properly governed.

Over this financial year UKFI has voted the Government's shares on all resolutions put to shareholders. We inform the relevant bank in advance of our voting intentions and rationale, and we disclose on our website how we have voted on the resolutions at Lloyds Banking Group and RBS. Many of these votes follow consultations by the Board with us and other shareholders in relation to individual resolutions.

We have held more than 150 meetings with other institutional shareholders since our inception in November 2008. Our aims in these meetings include explaining our remit and the arm's-length nature of our relationship with Government to ensure that investors are clear that the banks are being run on a commercial basis. We also seek other investors' views so we are aware of and responsive to the wider shareholder perception of the investee banks.

Accountability to the public and Parliament

Pursuant to our commitment to being accountable and transparent, UKFI representatives attend Parliamentary Committee hearings when requested, including this year a hearing of the House of Commons Treasury Select Committee. UKFI also holds regular meetings with our shareholder, HM Treasury, as set out in our Framework Document and Investment Mandate.

Since inception, UKFI has responded to more than 60 requests under the Freedom of Information Act 2000 and to more than 1,000 letters and e-mails from members of the public, MPs, and other stakeholders.

Internal UKFI governance

The UKFI Board, supported by three sub-committees, takes all major strategic decisions for the company. The Directors provide the company with the appropriate experience and expertise to manage the Government's investments commercially. This year the Board implemented the recommendations of an independently run Board Effectiveness Review. This Review concluded that the Board was run effectively, but recommended a number of initiatives to improve the communication flow for the non-executive Directors.

Details of the development of our internal controls during the year are fully set out in the Statement on Internal Control (Chapter 8). We continue to keep our compliance and governance across the company under review, in line with the UKFI Governance Manual and the UKFI Compliance Manual, to which all UKFI employees must adhere. UKFI has stringent procurement policies and procedures in place which have been used over the year to improve the value for money secured from our suppliers.

UKFI has produced an unqualified set of accounts for the three years of its operation. Our direct administration expenditure for the year under review was £2.7 million, of which staff costs were £1.8 million. In 2009/10 our direct expenditure was £3.7 million, of which staff costs were £2.0 million.

Disposal strategy

UKFI is charged with devising and recommending to HM Treasury a strategy for returning the banks to private ownership and executing the chosen strategy. This therefore requires a disposal of Northern Rock plc, as mandated by the State Aid agreement in respect of the former Northern Rock, a disposal of the shareholdings in Lloyds Banking Group and RBS and managing the orderly wind-down of the closed book companies that form UK Asset Resolution Ltd.

Northern Rock plc disposal

On 15 June 2011 the Chancellor of the Exchequer announced that a sales process for Northern Rock plc should commence. The sale process is to be open and transparent and in line with state aid rules and any interested parties can bid, including mutuals. This does not mean that other options to return Northern Rock plc to the private sector (including stand-alone remutualisation and a public share offering) have been ruled out, however a sale is to be explored as a first option.

This announcement followed a recommendation from UKFI that options for returning Northern Rock plc to the private sector be explored, based on an assessment of potential options for exiting Northern Rock plc from Temporary Public Ownership conducted in conjunction with Deutsche Bank AG and Northern Rock plc. Further information on the assessment of strategic options to return Northern Rock plc to the private sector is included in Chapter 4.

UK Asset Resolution Ltd

Having formed UK Asset Resolution Ltd we are achieving synergies from operating Northern Rock (Asset Management) plc and Bradford & Bingley plc as a larger entity. Alongside this we are supporting the development of a strategy to accelerate and enhance the value of the rundown of the balance sheets of the combined business in order to facilitate an improved schedule of repayments of the Government's debt. This will build upon the success of the two liability management exercises carried out in 2010.

Lloyds Banking Group and RBS disposals

Disposing of the Government's shares in Lloyds Banking Group and RBS will constitute the largest ever privatisation programme in the UK, and is likely to rank globally amongst the biggest equity market transactions during the course of the implementation period. We set out the details of our approach to this challenge in the document *UKFI Strategy: Market Investments and Annual Report and Accounts 2008/09*, published in July 2009, and available on our website.

Given the substantial size of the Government's combined holdings we have deliberately not set a predefined timetable for the disposal of these investments. We are exploring all options for a sale of the shares. Consistent with UKFI's Investment Mandate, the decision to proceed with any transaction rests with HM Treasury. We will make our recommendations to Ministers on the basis of our core objective of maximising the realisation of value for the taxpayer as shareholder; paying due regard to financial stability and competition issues (although the latter is only likely to be a relevant consideration if another incumbent bank was seeking to acquire a controlling stake in one of the businesses).

The assessment of the value for money of individual transactions will focus on securing fair value based on the circumstances at the time, and on improving the prospects for subsequent disposals.

We will continue to monitor market developments so we are ready to capitalise on suitable disposal opportunities as they emerge. The evolution of value in Lloyds Banking Group and RBS will be heavily determined by external factors over the next few years – in particular the speed and strength of recovery of the UK economy and the other markets in which the banks operate, and the resolution of current international and domestic policy debates on reform of the regulatory framework for banking.

In relation to this last point, of particular importance to the investments is the work that is being led by the Basel Committee on Banking Supervision (BCBS), the G20 Financial Stability Board and the European Union to co-ordinate stronger capital and liquidity requirements and more effective resolution regimes for banks in distress. In the UK, the Independent Commission on Banking (ICB) published its interim report on 11 April 2011, including proposals to increase loss-absorbing capacity within each bank, structural reforms to protect domestic retail banking activities from risks arising elsewhere and measures to strengthen competition. Following a period of consultation the ICB will publish its final recommendations on 12 September 2011, which will subsequently be considered by the Cabinet Committee on Banking.


Taken together, these reforms should strengthen the stability and resilience of the banking sector, thereby reducing future risks to the UK economy and public finances. However, as the ICB and others have noted, there will inevitably be a cumulative impact on the profitability and return on equity of the banking sector in general, with consequent implications for the value of the taxpayer's stakes in Lloyds Banking Group and RBS.

The magnitude of these effects will depend on the precise shape of the final reforms and we will review the implications for our disposals strategy as further details emerge. Greater regulatory certainty is required to enable both UKFI and the market to make a clearer assessment of the fundamental value of Lloyds Banking Group and RBS, and is therefore likely to be a precondition for a more stable trading performance in the stocks and the initiation of the disposal programme.

The UKFI team

UKFI will remain a small, streamlined organisation, employing relevant expertise from across the private and public sector to allow us to optimise our role as a commercial and arm's-length shareholder and to effect the disposal of the Government's investments in the banks.

On a personal note, I would like to say that I am privileged to continue to lead this organisation with its small but highly professional team. There have been some changes in the senior management of UKFI over the course of the year, and I would like to thank Tim Sykes and Sam Woods for their substantial contribution to the work of UKFI and I am delighted that Jim O'Neil has joined us as Head of Market Investments.



Robin Budenberg
Chief Executive

12 July 2011

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02

The Royal Bank of Scotland Group plc

Summary of Government shareholding

As at the end of March 2011, the Government held a total of 90.6 billion shares in RBS, including 51 billion non-voting B shares and the enhanced Dividend Access Share (see Box 2.1). This was equivalent to 67 per cent of voting share capital and 83 per cent economic ownership at that point. .

Company overview

The Royal Bank of Scotland Group plc is a global banking group, providing services to personal, commercial and large corporate and institutional customers in more than 50 countries. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its two principal subsidiaries, RBS and NatWest. In the United States, the Group's subsidiary, Citizens, is a large retail and commercial banking organisation.

Company performance

The table below provides an overview of the key financial results for RBS in 2009 and 2010. Full details of the results, including for the first quarter of 2011, can be found on the company's website: www.investors.rbs.com/results_presentations.

Table 2.1: RBS key financials (pro forma)

£m	2010	2009
Total income	32,662	29,567
Operating expenses	16,710	17,401
Impairment losses	9,256	13,899
Profit/(loss) before tax	(239)	(1,928)
Profit/(loss) attributable to ordinary and B shareholders	(1,125)	(3,607)

Note

See page 51 of the RBS 2010 Annual Report & Accounts for an explanation of which items are included and excluded from the pro forma data and how it can be reconciled to a statutory reporting basis.

Commenting on the Group's performance in 2010, Stephen Hester, Chief Executive said:

"2010 results were a large improvement on 2009 and our budgets for the year. At Group level RBS posted £1.9 billion of operating profits, excluding fair value of own debt (from a £6.1 billion loss in 2009). It was only after the post tax effect of APS (£1.1 billion) that we reported a net attributable loss of £1.1 billion. We are taking significant steps toward repaying the support we have received.

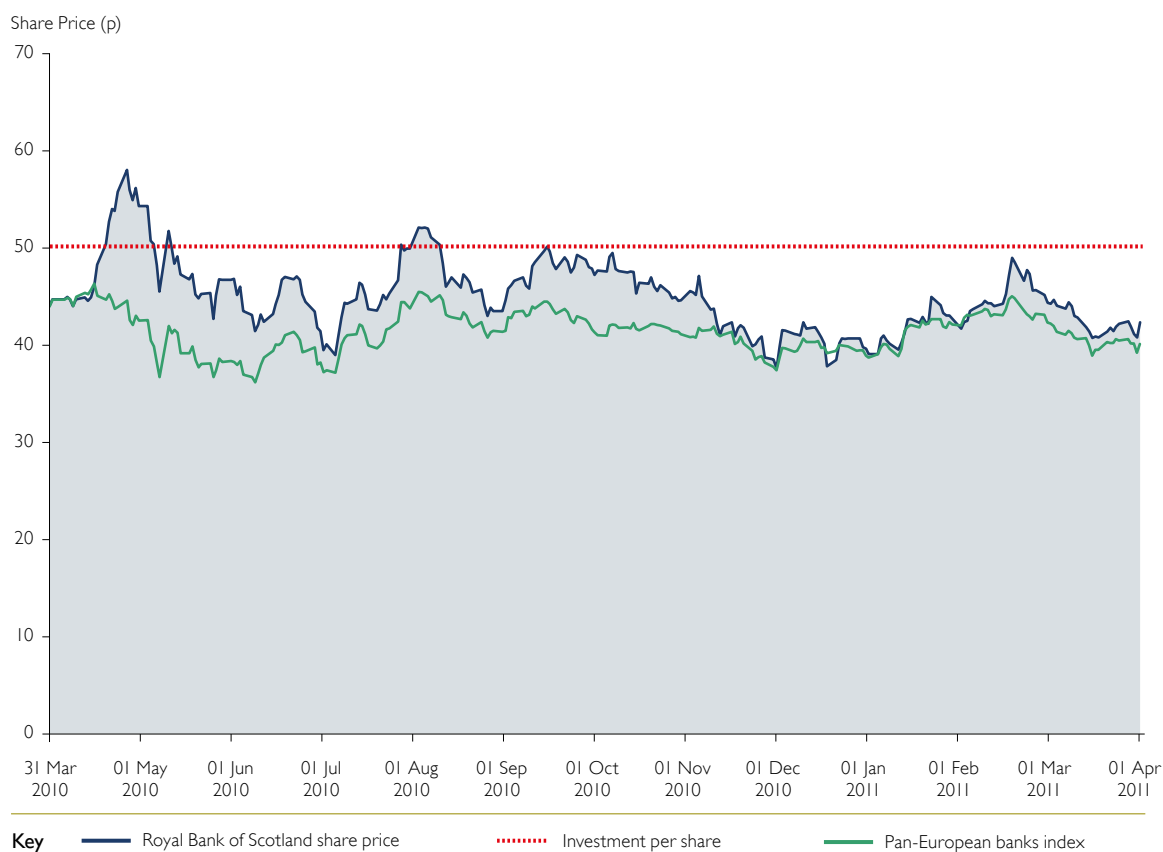
The RBS Core business posted operating profits of £7.4 billion and return on equity of 13%, above its cost of capital. Importantly the quality of results also improved. While still significantly impacted by high credit costs, low interest rates and other economic challenges, our Retail and Commercial businesses increased operating profits by 66% to £3.8 billion with a 10% ROE. Our Irish bank and our Insurance business remained in loss as a result of prior risk exposures which we are working down. Our investment banking arm, despite tough markets, posted £3.4 billion operating profits and a 17% ROE – a competitive result when compared with peers, though down from the record prior year. Adding the related parts of our GTS business gives still stronger returns for our wholesale client activity as a whole.

2010 results were achieved with strong attention to efficiency – beating our cost targets and allowing vital investment right across the Group to enhance future growth and business quality.

In Non-Core progress was also pleasing, though losses will continue in this division during the remaining Plan period as assets are sold and run down. Non-Core assets reduced by £63 billion to £138 billion during 2010, beating our targets. Losses narrowed sharply though they are still significant.”

Figure 2.1: RBS share price performance

As shown in the table below the RBS share price decreased from 44.0p to 40.8p over the year under review, a decrease of 7 per cent. RBS therefore slightly outperformed the European Banks Index, a capitalisation-weighted index of European companies that are involved in the banking sector, which decreased by 11 per cent over the same period.



Investment in RBS

The Government's investment in RBS has been made in three different tranches, as summarised in the table below. Taking into account fees received, the net cost of the Government's investment in RBS is £45,222 million, equivalent to an average of 49.9p per share.

HM Treasury shareholdings in Royal Bank of Scotland		Shares	Total Investment	Investment per share	Value at 31 March ¹
		m	£m	p	£m
Initial Recapitalisation	December 2008	22,854	14,969	65.5	9,322
Preference Share conversion ²	April 2009	16,791	5,058	31.75	6,849
APS B shares ³	December 2009	51,000	25,500	50.0	20,802
Total investment		90,645	45,527	50.2 (avg)	36,973
Fees received ⁴			(305)		
Total net investment		90,645	45,222	49.9 (avg)	

Notes

1. Based on RBS share price of 40.79p as at 31 March 2011.
2. Total investment includes accrued dividends and redemption premiums received of around £270 million.
3. Excludes theoretical valuation of the enhanced dividend access share, valued as £2.3 billion as at 31 March 2011. See Box 2.1.
4. Underwriting fees on transactions paid to HM Treasury, including the recapitalisation and preference share conversion. Excludes annual fees paid to HM Treasury in relation to the Asset Protection Scheme and contingent capital facility.

BOX 2.1: B SHARES AND THE DIVIDEND ACCESS SHARE

As part of the arrangements for RBS's participation in the Asset Protection Scheme (APS) in 2009, the Government subscribed to 51 billion B shares, together with one enhanced Dividend Access Share (DAS). The £25.5 billion investment in the form of B shares counts towards the bank's core tier 1 capital. B shares do not confer voting rights, but otherwise rank pari passu with ordinary shares. The market value of each B share is therefore assumed to be equivalent to the value of an ordinary share.

The B shares are convertible into ordinary shares at the Government's option (subject to certain parameters agreed with the European Commission). However, the Government has agreed not to convert B shares to the extent that its holding of ordinary shares would represent more than 75 per cent of the bank's total ordinary share capital.

Alongside the APS agreement, the Government also provided an £8 billion contingent capital facility, under which it would acquire further B shares in the event that RBS's core tier 1 ratio falls below 5 per cent.

The single DAS confers the right to an enhanced dividend over and above the dividend entitlement of each ordinary and B share, providing the greater of 7 per cent of the B share nominal amount of £25.5 billion, or 250 per cent of the ordinary share dividend. DAS dividends are payable at the discretion of the RBS board, but must be paid if a dividend is awarded on ordinary shares. The DAS expires when the RBS ordinary share price equals or exceeds 65p for 20 days in any 30-day period.

There is no market price for the DAS. However, its value can be estimated using an option based valuation model on the basis of market-observable and non-observable data and assumptions, further details of which are provided in HM Treasury's Annual Report and Accounts (available at www.hm-treasury.gov.uk). Given the expiration trigger noted above, the value of the DAS diminishes as the share price approaches 65p.

Using this financial model, the DAS was valued as £2.3 billion at 31 March 2011. It should be noted that this theoretical valuation does not necessarily reflect the ultimate value that may be realised from the DAS.

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Lloyds Banking Group plc

Summary of Government shareholding

As at the end of March 2011, the Government held a total of 27.6 billion ordinary shares in Lloyds Banking Group, equivalent to 41 per cent of total share capital.

Company overview

Lloyds Banking Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers.

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS by Lloyds TSB. The main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

The Group has a large and diversified customer base in the UK, providing services through a number of recognised brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and Cheltenham & Gloucester.

Following his appointment as Group Chief Executive on 1 March 2011, António Horta-Osório published the outcome of his strategic review on 30 June 2011. This set out plans for a simpler organisation and substantial investments in better-value products and services for customers, to deliver strong, stable and sustainable returns for shareholders.

Company performance

The table below provides an overview of the key financial results for Lloyds Banking Group in 2009 and 2010. Full details of the results, including for the first quarter of 2011, can be found on the company's website: www.lloydsbankinggroup.com.

Table 3.1: Lloyds Banking Group's key financials (pro forma)

£m full year	2010	2009
Total income	23,986	24,601
Operating expenses	10,928	11,609
Impairment losses	13,181	23,988
Profit/(loss) before tax	2,212	(6,300)

Note

See page 3 of the Lloyds 2010 Annual Report & Accounts for an explanation of which items are included and excluded from the pro forma data and how it can be reconciled to a statutory reporting basis.

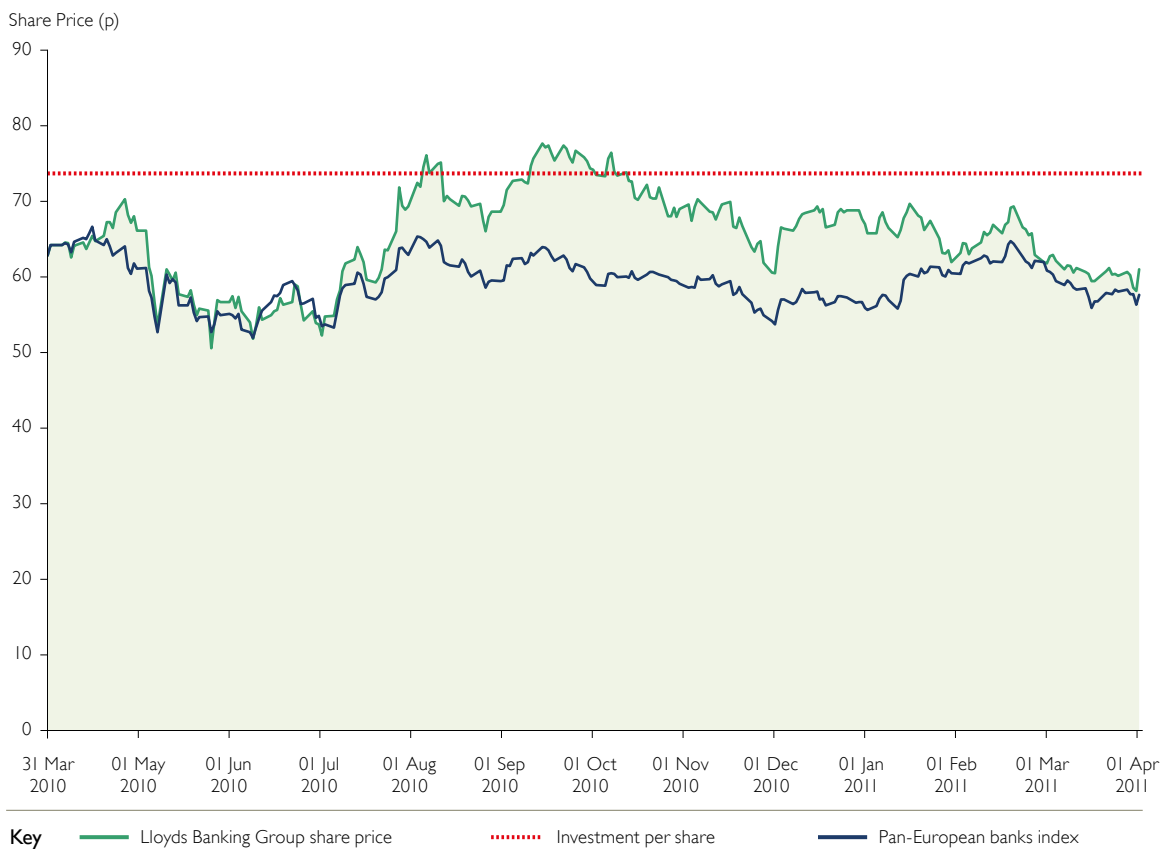
Commenting on the Group's performance over 2010, Sir Winfried Bischoff, Chairman, said:

"We have made considerable progress in 2010, delivering good growth in our core business and reducing the risk in the business. The integration of the HBOS business continues to progress well and we remain confident of achieving our target of run-rate synergy benefits of £2 billion per annum by the end of 2011, a substantial achievement."

"The successful execution of our strategy demands from us focus on core markets, on customer engagement, on cost leadership, on capital efficiency and on a prudent risk and funding profile. Carried out well these attributes should enable the Group to deliver earnings growth and shareholder value whilst achieving our aim of becoming recognised as the best financial services company in the UK."

Figure 3.1 Lloyds Banking Group share price performance

As shown in the table below the Lloyds Banking Group share price decreased from 62.8p to 58.1p over the year under review, a decrease of 7 per cent. Lloyds Banking Group therefore slightly outperformed the European Banks Index, a capitalisation-weighted index of European companies that are involved in the banking sector, which decreased by 11 per cent over the same period.



Investment in Lloyds

The Government's investment in Lloyds Banking Group has been made in three different tranches, as summarised in the table below. The gross cost of these investments is £20,313 million, at an average cost per share of 73.6p. Taking into account the fees received from Lloyds, including £2.5 billion in relation to the implicit capital support provided by the APS in 2009, the net cost is £17,433 million, equivalent to 63.1p per ordinary share.

HM Treasury ordinary shareholding in Lloyds Banking Group		Shares	Total Investment	Investment per share	Value at 31 March ¹
		m	£m	p	£m
Initial Recapitalisation ²	January 2009	7,277	12,957	182.5	4,227
Preference Share conversion ³	June 2009	4,521	1,506	38.43	2,626
Rights issue	December 2009	15,810	5,850	37.0	9,184
Total investment		27,609	20,313	73.6 (avg)	16,037
Fees received⁴			(381)		
Total investment net of fees		27,609	19,933	72.2 (avg)	
APS exit fee⁵			(2,500)		
Total investment net of all fees		27,609	17,433	63.1 (avg)	

Notes

1. Based on Lloyds Banking Group share price of 58.09p as at 31 March 2011.
2. Includes Lloyds Banking Group capitalisation issue on 11 May 2009 (177 million shares).
3. Investment adjusted to include accrued dividends and redemption premiums of around £230 million.
4. Underwriting and commitment fees on transactions paid to HM Treasury, including in relation to the recapitalisation, preference share conversion and rights issue.
5. £2,500 million paid by Lloyds Banking Group for the implicit capital support provided by the APS in 2009.

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Northern Rock plc

Summary of Government shareholding

UKFI is responsible for the management of the Government's 100 per cent shareholding in Northern Rock plc.

Company overview

On 22 February 2008, following financial difficulties, the original Northern Rock was brought into temporary public ownership by way of a Transfer Order. Under State Aid approval¹ from the European Commission, which was granted on 28 October 2009, Northern Rock was required to restructure its business into two legal entities – Northern Rock plc and Northern Rock (Asset Management) plc – both of which remain in public ownership. The legal and capital separation took place on 1 January 2010 while operational separation continued during 2010, with the transfer of 1,250 employees out of Northern Rock plc on 1 November 2010.

Northern Rock plc is the new savings and mortgage bank that holds and services all pre-existing customer savings accounts and some pre-existing mortgage accounts. As of 31 December 2010, total assets of the company were £18.6 billion, of which £12.2 billion were mortgages. Northern Rock plc is authorised and regulated as a deposit taker by the Financial Services Authority and offers savings and mortgages products. The Government injected £1.4 billion of equity on 1 January 2010 to capitalise the bank at inception.

Recognising that Northern Rock plc is now a strongly capitalised and highly liquid bank, on 24 February 2010, HM Treasury announced a three-month notice period for the lifting of the Government guarantee arrangements relating to Northern Rock plc's retail deposits². The change took effect at close of business on 24 May 2010. Northern Rock plc's retail savers continue to be covered by the Financial Services Compensation Scheme, which provides protection up to £85,000 per person, the same as for other bank and building societies. On 2 August 2010, HM Treasury announced a similar lifting of the Government wholesale guarantee arrangements, which took effect on 2 November 2010.

The new Northern Rock plc is much smaller than its predecessor. Its share of the UK retail deposit market is approximately 1.3 per cent and it holds approximately 1.0 per cent of the stock of UK mortgages. The company operates through 75 branches, alongside internet, post and telephone channels.

Company performance

Table 4.1: Northern Rock key financials³

£m	2010
Total income	105
Operating expenses	327
Loan impairment loss	2
Profit/(loss) before taxation	(224)
Profit/(loss) for the year	(224)
Shareholder funds (year end)	1,188

¹The full text of the State Aid approval is available on the European Commission's website at: http://ec.europa.eu/competition/state_aid/cases/225083/225083_1058677_200_1.pdf

²Excluding pre-existing fixed rate deposits which remain guaranteed until maturity.

³Northern Rock Annual Report and Accounts 2010 (to year end 31 December 2010).

As a new company, Northern Rock plc did not trade in the period to 31 December 2009 and thus it is not possible to include comparatives for that year.

During 2010, Northern Rock plc performed in line with expectations, recording a statutory loss before taxation of £224m, which in part reflects the high level of liquidity held and exceptional costs incurred as the Company was restructured during the year.

- Total income in 2010 was £105 million, with £29 million in the first half and £76 million in the second half of the year. This improvement was driven by an increase in high quality mortgage lending, a run-down of lower yielding liquid investments that Northern Rock plc had held following the legal and capital restructure, as well as a planned reduction in retail deposit balances to improve margins.
- Operating expenses in 2010 were £327 million, with £156 million incurred in the second half of the year, 9 per cent lower than in the first half. Operating expenses included £60 million of exceptional expenses related to the separation of Northern Rock plc from Northern Rock (Asset Management) plc and restructuring which resulted in approximately 650 redundancies.
- Gross mortgage lending of £4.2 billion was undertaken in 2010, which, after redemptions and repayments, led to an overall growth in the mortgage book of £1.9 billion. The quality of mortgage lending was high, with an average loan to value for new lending completed during the year of 62 per cent. The number of mortgage accounts more than three months in arrears at 31 December 2010 represented 0.17 per cent of the book. There were associated impairment losses on loans and advances during 2010 of £1.9 million.

BOX 4.1: ASSESSMENT OF STRATEGIC OPTIONS TO RETURN NORTHERN ROCK PLC TO THE PRIVATE SECTOR

An evaluation framework was developed for the assessment, consistent with UKFI's overarching objective to protect and create value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to act in a way that promotes competition. A full range of options was analysed, including a sale process where Northern Rock plc could be acquired by a new entrant or in-market player (including remutualisation through a sale to an existing mutual organisation), a stand-alone remutualisation and a public share offering (IPO).

The risk-adjusted financial assessment indicated that a sale to a single buyer would likely deliver greatest value to the taxpayer. This assessment was principally based on the strategic premium a bidder could be willing to pay, economies of scale that might be achieved in a combination and potential bidder interest in the company. At this stage of the assessment, and prior to testing the market for a sale, other options for the return of the company to the private sector were considered to be relatively less attractive in terms of risk-adjusted value.

Stand-alone remutualisation would involve gifting some of the existing shareholding to mutual members, with the balance converted into mutual capital instruments and retained by the Government. These capital instruments would pay annual dividends or coupons and could be sold at a subsequent date. Proceeds from an IPO would be influenced by current pricing of UK banking stocks and potential investor demand for the company's stock.

The options were also assessed from a competition and financial stability perspective, the latter with appropriate input from HM Treasury. Given the company's current scale and focus on mortgage and savings products, the competition assessment did not raise material concerns over the impact on market concentration of a sale. However, a sale which contributed to the development of a new/emerging challenger bank was viewed as enhancing the company's ability to improve competition in the UK market relative to stand-alone options. No material issues were identified in the financial stability assessment of the strategic options.

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UK Asset Resolution Ltd

Summary of Government shareholding

UKFI is responsible for managing the Government's 100 per cent shareholding in UK Asset Resolution Ltd, and its subsidiaries, Bradford & Bingley plc and Northern Rock (Asset Management) plc, on behalf of HM Treasury which owns 100 per cent of the share capital of UK Asset Resolution Ltd.

Company overview

On 1 October 2010 UKFI announced the establishment of UK Asset Resolution Ltd as the single holding company to manage, on an integrated basis, the closed mortgage books of both Northern Rock (Asset Management) plc and Bradford & Bingley plc. UK Asset Resolution Ltd provides common governance and management to both subsidiaries although both remain as separate legal entities with their own balance sheet and government support arrangements.

The integration of these companies creates a larger entity, enjoying significant economies of scale. Increased efficiency and shared capability in arrears management and treasury functions will enhance future repayment of Government loans.

Northern Rock (Asset Management) plc

Following the split of Northern Rock on 1 January 2010, Northern Rock (Asset Management) plc now holds and services the closed mortgage book of the original Northern Rock. As of 31 December 2010, total assets of the company were £66.3 billion, of which £47.8 billion were loans to customers.

The portfolio includes those mortgages allocated to the Granite securitisation and to Northern Rock's covered bond programme. Northern Rock (Asset Management) plc's liabilities include the former Northern Rock's pre-existing wholesale funding, subordinated debt instruments and the loan from the Government. As of 31 December 2010, the Government loan stood at £21.7 billion. Northern Rock (Asset Management) plc is authorised and regulated as a mortgage administrator by the Financial Services Authority and continues its work on the orderly run-down of its closed book and repayment of Government funds.

The company does not hold deposits and offers no additional mortgage lending.

Bradford & Bingley plc

Following financial difficulties, Bradford & Bingley plc was brought into public ownership by way of a Transfer Order on 29 September 2008. The Transfer Order also facilitated the sale of the UK and Isle of Man retail deposit business to Abbey National plc, part of the Santander Group, including all of Bradford & Bingley plc's retail deposit accounts and its branch network. The ongoing focus of the remaining business is an orderly run-down of the closed mortgage book and repayment of Financial Services Compensation Scheme (FSCS) and Government funds.

As of 31 December 2010, total assets of the company were £45.4 billion, of which £36.4 billion were loans and advances to customers. The working capital facility provided by the Government stood at £8.6 billion. Bradford & Bingley plc has an additional £18.4 billion of Statutory Debt comprising £15.7 billion owed to the FSCS (via a loan from HM Treasury) and £2.8 billion owed directly to HM Treasury. The Statutory Debt reflects the value of the retail deposits which were transferred to Abbey National plc.

The company does not hold deposits and offers no additional mortgage lending. The current portfolio includes the mortgages allocated to the Aire Valley securitisation and to its covered bond programme in addition to wholesale funding and subordinated debt instruments.

Company performance

Table 5.1: Northern Rock (Asset Management) key financials¹

£m full year	2010
Net operating income	1,463
Operating expenses	304
Loan impairment loss	813
Profit/(loss) before tax	401
Profit/(loss) for the year	410
Loans from HM Treasury (year end)	21,713
Shareholder funds (year end)	1,109

Given that the split of Northern Rock, which established Northern Rock (Asset Management) plc, occurred on 1 January 2010 there is no representative comparison information for 2009.

Over the last year (to year end 31 December) Northern Rock (Asset Management) plc, has made good progress, reporting a statutory profit before tax of £401 million.

- Underlying net operating income of £1,463 million benefited in part from a reduction in the cost of funds due to Government funding replacing retail deposits after the separation from Northern Rock plc.
- Of operating expenses of £304 million, ongoing administrative expenses of £165 million were largely recharges from Northern Rock plc until the transfer of employees from Northern Rock plc in October 2010. A further £56 million related to the costs of restructuring and separation from Northern Rock plc.
- Impairment losses on loans and advances to customers were £813 million. As expected, arrears levels increased reflecting the impact of the economic downturn on mortgage customers, with accounts more than three months in arrears excluding possessions representing 6.07 per cent of all accounts as at 31 December 2010.
- The repurchase of capital instruments with a carrying value of £1,343 million at a discount resulted in shareholder gains of £951 million. Of this, £60 million was recognised through the Income Statement in respect of instruments classified as liabilities. The balance of the gain, £891 million arising from instruments classified as equity, was recognised in Shareholder equity.
- During the year the company repaid £1.1 billion of the Government loan, ahead of expectations.

¹Northern Rock (Asset Management) plc Annual Report and Accounts 2010.

Company performance

Table 5.2: Bradford & Bingley plc key financials¹

£m full year	2010	2009 ²
Net operating income	673	623
Operating expenses	126	137
Loan impairment loss	277	594
Profit/(loss) before tax	1,082	(196)
Profit/(loss) for the year	819	(98)
HM Treasury Working Capital Facility (year end)	8,564	8,538
Statutory Debt ³ (year end)	18,416	18,416
Shareholder funds (year end)	2,207	1,394

Over the last year (to year end 31 December) Bradford & Bingley plc has made good progress, reporting a statutory profit of £1,082 million compared to a £196 million loss in 2009, largely due to the repurchase of subordinated liabilities at a discount, but also reflecting lower impairments on loans and advances to customers.

- Net operating income was 8 per cent higher in the year at £673 million in part due to a one-off benefit from a £104 million discount on subordinated liabilities, a result of a decision not to make any principle or interest payments on subordinated liabilities prior to fully repaying the Statutory Debt.
- Operating expenses fell 8 per cent to £126 million, reflecting lower investment spend and the benefit of efficiency initiatives.
- The loan impairment charge decreased from £594 million to £277 million, reflecting a lower number of arrears cases and a reduction in the size of the provision for fraudulent loans. Arrears levels fell, with accounts more than three months in arrears excluding possessions representing 5.25 per cent of all accounts as at 31 December 2010.
- The repurchase of capital instruments with a carrying value of £1,102 million at a discount benefited profit before tax by £786m, which was fully recognised in the income statement.
- No draw-downs or repayments were made in the year from the HM Treasury Working Capital Facility.

¹Bradford & Bingley plc Annual Report and Accounts 2010.

²Bradford & Bingley has amended the presentation of its Consolidated Income Statement and has restated some elements of its 2009 results.

³Comprising £15,654m from the Financial Services Compensation Scheme who in turn are loaned the funds from HM Treasury, and a direct loan of £2,762m from HM Treasury.

THE UKFI BOARD AND SENIOR MANAGEMENT



David Cooksey – Chairman

Sir David Cooksey joined UK Financial Investments as Chairman in August 2009. He is also Chairman of Bechtel Ltd and Chairman of the UK Centre for Medical Research & Innovation. He retired as Chairman of London & Continental Railways Ltd in March 2011. David started his career as an industrial engineer and held a number of management positions in business before forming Advent Venture Partners, one of the first private equity/venture capital firms in the UK, in 1981 which he chaired until 2006.

David has held a number of other senior positions in the private and public sectors including 9 years as Chairman of the Audit Commission and 11 years as a Director of the Bank of England. He has been an adviser to HM Government on innovation policy leading several taskforces and review teams. He was knighted in 1993 and appointed a Knight Grand Cross of the Order of the British Empire (GBE) in 2007.



Robin Budenberg – Chief Executive

Robin Budenberg joined UKFI on 1 January, 2010 from UBS where he was responsible for senior UK client relationships. He was involved in the Government Bank Recapitalisation Scheme in October 2008. He qualified as a Chartered Accountant with Price Waterhouse before joining SG Warburg in 1984. He subsequently worked at the successor firms – SBC Warburg, UBS Warburg and latterly UBS. He carried out various management roles and he also advised a number of the UK's largest companies on major projects.



Peter Gibbs – Non-Executive Director

Peter Gibbs has a wealth of financial services experience in the Asset Management sector. Having begun his career at Brown Shipley, he joined Bankers Trust in 1985 as a Senior Portfolio Manager. In 1989 he joined Mercury Asset Management (MAM) where he rose to become Head of the International Equities Division. Following the acquisition of MAM by Merrill Lynch he was appointed Co-Head of Equity Assets worldwide. In 2003 he became Chief Investment Officer for Merrill Lynch's Investment Management activities outside the US.

Peter retired from Merrill Lynch at the end of 2005. He currently serves as Non-Executive Director of Intermediate Capital Group plc, Non-Executive Director of Evolution Group plc, Non-Executive Director of Impax Asset Management Group plc and as a Director of Merrill Lynch (UK) Pension Plan Trustees Ltd. Between June 2006 and August 2007 he was a Non-Executive Director of Bridgewell Group plc.



Michael Kirkwood – Non-Executive Director

Michael Kirkwood retired from a 31 year career with Citigroup at the end of 2008 where he was most recently UK Senior Officer and Chairman of Corporate Banking. Currently, Michael is Chairman of Ondra Partners, Chairman of Circle Holdings plc, Senior Adviser to Eros International Group and Chairman of Habitat for Humanity GB. Schooled in Scotland and a graduate of Stanford University, Michael initially worked for HSBC and the Bowater-Ralli Group. His career has taken him to Asia, the USA, Continental Europe, Scandinavia as well as the UK.

Michael served on the board of Kidde plc for four years prior to its acquisition by United Technologies. Until June 2011 he was Deputy Chairman of PwC's Advisory Board. During his City career Michael served as Vice Chairman of the British Bankers Association, President of the Chartered Institute of Bankers, Chairman of the Association of Foreign Banks, Chairman of British American Business, Master of the Worshipful Company of International Bankers, a member of the CBI's Financial Services Council and he remains a member of the Advisory Board of the Association of Corporate Treasurers. A former HM Lieutenant for the City of London, Michael was appointed a Companion of the Order of St. Michael & St. George (CMG) in the Queen's 2003 Birthday Honours.



Lucinda Riches – Non-Executive Director

Lucinda Riches is a non-executive director of The Diverse Income Trust plc (appointed March 2011), an Adviser to the Board of The British Standards Institution (appointed May 2011) and a Trustee of Sue Ryder (since 2008).

Lucinda was formerly an investment banker and has extensive experience in capital markets and privatisations. She began her career at Chase Manhattan Bank. Lucinda worked at UBS and its predecessor firms for 21 years until 2007. At UBS, she was a Managing Director, Global Head of Equity Capital Markets and a member of the Board of the Investment Bank.

Lucinda has an MA in Philosophy, Politics and Economics from Brasenose College, Oxford and an MA in Political Science from the University of Pennsylvania.



Philip Remnant – Non-Executive Director

Philip Remnant is Chairman of the Shareholder Executive, which was formed in 2003 to improve the Government's performance as a shareholder in government-owned businesses. He is a Senior Adviser of Credit Suisse's investment banking division in Europe and a Non-Executive Director of City of London Investment Trust plc.

Previously, Philip was a Vice Chairman of Credit Suisse First Boston in Europe and was Director General of the Takeover Panel for two years between 2001 and 2003, and again in 2010. He formerly held senior investment banking positions with BZW and Kleinwort Benson. He is a qualified chartered accountant and has an MA in Law from New College, Oxford.

He was appointed a Commander of the Order of the British Empire (CBE) in 2011.



Julian Kelly – Non-Executive Director

Julian was appointed Group Director of HM Treasury Finance and Commercial in January 2011. Previously, Julian has been the Director of Finance, Commercial and Estates at the UK Border Agency since 2009, and Director of Finance there since 2007. Julian is a qualified Chartered Accountant and a member of the Chartered Institute of Management Accountants.

Before that he held various roles in the Treasury, including leading the spending team covering the Home Office and Criminal Justice Department as Head of the Home, Legal and Communities team between 2003 and 2007, and roles in the Prime Minister's Strategy Unit and at HSBC in their Treasury and Capital Markets team. Julian brings a wealth of experience from both in and out of the Treasury, and from corporate and policy roles.



Keith Morgan – Head of Wholly-Owned companies

Keith is responsible for managing the Government's shareholdings in Northern Rock plc and UK Asset Resolution Ltd. Keith, who joined UKFI from Banco Santander, has strong retail and commercial banking experience. Before joining UKFI he was a Board director of Sovereign Bancorp in the US focusing on the integration of Sovereign into Santander. Keith sits on the Boards of Bradford & Bingley plc, Northern Rock plc, Northern Rock (Asset Management) plc and UK Asset Resolution Ltd. He was previously Director of Strategy & Planning at Abbey National, where he was a member of the Executive Committee, and was also Chairman of Santander's Asset Management and Credit Card businesses in the UK. Before joining Abbey in 2004, Keith spent 18 years at L.E.K. Consulting, where he was a Partner specialising in financial services.



Jim O'Neil – Head of Market Investments

Jim is responsible for managing the Government's shareholdings in the Lloyds Banking Group and Royal Bank of Scotland. Jim joined UKFI from Bank of America Merrill Lynch where he spent 17 years. He has extensive experience of both the capital markets and the banking sector and has worked on many of the highest profile capital markets transactions for European financial institutions in recent years. He joined Merrill Lynch in 1993 in New York and relocated to London in 1999. Most recently he was Head of International Corporate Finance. He holds a BSc from the University of Virginia and an MBA from the University of Chicago Graduate School of Business.

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Directors' Report

UKFI Board

The UKFI Board takes all major strategic decisions for the Company. The principal activity of the Company is managing the Government's investments in financial institutions to protect and create value for the taxpayer as shareholder, and where applicable, as provider of financial support, through active engagement with the investee companies. The Company has a Framework Document and Investment Mandate with HM Treasury appropriate for an arm's-length body. This sets out the key parameters for how UKFI will conduct its business, including a clear mandate to manage the investments commercially.

The directors, as set out below with their dates of appointment, provide the Company with the appropriate expertise, skills and experience required to manage the investments effectively. The UKFI Board operates to the highest standards of corporate governance, and its members have over 100 years' banking experience across a wide range of areas in the sector.

Board Membership		Committee Membership
David Cooksey (01.08.2009)	Chairman	N (Chair), R
Robin Budenberg (01.01.2010)	Chief Executive	
Peter Gibbs (18.01.2009)	Independent Non-Executive	N, R, A
Michael Kirkwood (18.01.2009)	Independent Non-Executive	N, R (Chair), A
Lucinda Riches (15.01.2009)	Independent Non-Executive	N, R, A
Philip Remnant (11.03.2009)	Treasury-Appointed Non-Executive	N
Julian Kelly (27.01.2011)	Treasury Appointed Non-Executive	A (Chair)

Key to abbreviations: N=Nominations Committee, R=Remuneration Committee, A=Audit and Risk Committee.

During 2010/11 the membership of the Board changed as some members stepped down from the Board. In accordance with the Framework Document between UKFI and HM Treasury, HM Treasury appointed both Ken Beeton and Julian Kelly as Government officials to the Board of UKFI. As these were Government appointments, the UKFI Nominations Committee was not required to approve them.

Former Board Members		Committee Membership
Louise Tulett (11.03.2009 – 29.10.2010)	Treasury Appointed Non-Executive	A (Chair)
Ken Beeton (24.11.2010 – 26.01.2011)	Interim Treasury Appointed Non-Executive	A (Chair)

The Board has put in place arrangements to manage any conflicts of interest. As part of this, each director has disclosed, at the outset of their term as a director, any direct or indirect conflicts of interest they are aware of and may have in connection with being appointed a director of the Company. In addition, all Board members have updated these disclosures during 2010/11.

The Board meets a minimum of nine times a year, and on an ad hoc basis as required. The Board met 14 times during this reporting period.

Board Committees

The Board is supported by three sub-committees to provide effective oversight and leadership: the Audit and Risk Committee, the Remuneration Committee and the Nominations Committee. The Board is also supported by the Executive Management Committee, which is not a Board Committee.

Audit and Risk Committee

The Audit and Risk Committee has met three times during this reporting period.

All members of the Audit and Risk Committee are non-executive directors. The current members of the Committee are Julian Kelly (Committee Chair), Peter Gibbs, Lucinda Riches and Michael Kirkwood. Only Audit and Risk Committee members have the right to attend Audit and Risk Committee meetings. However, other individuals may be invited to attend for all or part of any meeting as and when appropriate. The Audit and Risk Committee normally meets at least three times a year and on an ad hoc basis as required.

The Audit and Risk Committee is authorised by the Board to investigate any activity within its terms of reference and to seek any information it requires from any employee. The Board will ensure that employees co-operate fully with the Audit and Risk Committee. The Committee has worked over the year to fulfil its detailed responsibilities including: considering the scope and planning of the audit, the audit fee and any questions of dismissal of the auditors; reviewing financial statements before submission to the Board; agreeing the internal audit plan, and reviewing and considering the associated reports; reviewing and considering reports from the auditors and the audit management letter and management response; and reviewing the Company's annual statement on internal control systems prior to endorsement by the Board and regularly reviewing the effectiveness of these systems.

Remuneration Committee

The Remuneration Committee has met two times during this reporting period. The membership, details and terms of reference for the Remuneration Committee are set out in the Directors' Remuneration Report (Chapter 7).

Nominations Committee

The Nominations Committee did not meet during this reporting period.

All members of the Nominations Committee are non-executive directors. The current members of the Nominations Committee are the Chair of the Board (Committee Chair), Peter Gibbs, Lucinda Riches, Michael Kirkwood and Philip Remnant. Only members of the Nominations Committee have the right to attend Nominations Committee meetings. However, other individuals may be invited to attend for all or part of any meeting as and when appropriate. Meetings are held as and when the Chair of the Nominations Committee deems it necessary.

The Nominations Committee works to fulfil its responsibilities for adopting a formal rigorous and transparent procedure for the appointment of new directors to the Board. It is responsible for considering and recommending to the Board and, through the Board, to HM Treasury where required by the Framework Document, suitable candidates as directors. These directors need to have the time to commit to the Company and appropriate experience, qualifications, background and reputation, so that any such appointment will enhance the Board's ability to discharge its functions and responsibilities as set out in the Framework Document.

The Nominations Committee is not required to meet to approve the senior Government officials nominated by HM Treasury.

Meetings

The number of meetings of the Board and the Audit, Remuneration and Nominations Committees and individual attendance at these meetings by members in the reporting period is shown in the table below.

	Board	Audit	Remuneration	Nomination
Total number of meetings held in 2010/11	14	3	2	0
Number of meetings attended in 2010/11				
Sir David Cooksey	14		2	-
Robin Budenberg	14			-
Peter Gibbs	13	1	2	-
Julian Kelly	5 ¹			
Michael Kirkwood	13	3	2	-
Philip Remnant	13			-
Lucinda Riches	14	3	2	-
Former Directors				
Kenneth Beeton	2 ²			
Louise Tulett	5 ³	3		

Notes

1. Julian Kelly was appointed as Non-Executive Director on 27 January 2011.
2. Kenneth Beeton was appointed as Non-Executive Director on 24 November 2010 and resigned on 26 January 2011.
3. Louise Tulett resigned as Non-Executive Director on 29 October 2010.

Diversity and sustainability

UKFI seeks to actively promote a culture that values difference and diversity. As an employer, UKFI seeks to be open and inclusive in its management policies and processes and seeks to recruit and develop a diverse and talented workforce, from across the private and public sector, that is representative of the society it serves. Given that UKFI is such a small organisation of 14 staff, we do not report a detailed breakdown of diversity statistics as the release of such data would enable personal information on individual staff to be identified which individual staff would have no reasonable expectation of being disclosed.

The UKFI sustainability policy in relation to the investee companies can be found on the UKFI website. This sets out that we expect each investee company to act ethically and sensibly on sustainability issues and to set out clearly which of the ethical and environmental standards set by Government, advisory and regulatory bodies it has committed to adhere to and report against. We meet with the investee companies to discuss sustainability issues, and if it were proved to be the case that any of the investee companies' sustainability policies were significantly out of line with existing standards such that they would have a negative effect on the value of the company and its shares, UKFI would engage with the bank's senior management or board to protect the value of the Government's holding.

UKFI is committed to its contribution to sustainable development. UKFI is based on the Government estate in a Department for Culture, Media and Sport (DCMS) building. We use recycled paper for day-to-day use and UKFI publications, have segregated waste streams collected for recycling, and purchase all electricity and gas through the central Office for Government Commerce negotiated contracts which include 10 per cent renewable energy. We share DCMS's Facilities Management and Mail Service contractors and both contractors hold their own ISO 14001 accreditation.

Disclosure of information to auditors

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish the Company's auditors were aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

UKFI has appointed the Comptroller and Auditor General as its external auditor. The National Audit Office carries out the audit for and on behalf of the Comptroller and Auditor General.

Statement of Directors' and Accounting Officer's responsibilities in respect of the Directors' Report and the financial statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Accounting Standards and applicable law (International Financial Reporting Standards). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

This report has been prepared in accordance with the special provisions of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 as set out in Statutory Instrument 2008/409.

This report has been approved by the board of directors and is signed by the Chief Executive on behalf of the board of directors.

The Accounting Officer of HM Treasury has designated the Chief Executive as Accounting Officer of UK Financial Investments Limited. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding UK Financial Investment Limited's assets, are set out in Managing Public Money published by HM Treasury.

In preparing the accounts, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements; and
- prepare the financial statements on a going concern basis.



Robin Budenberg
Chief Executive

12 July 2011

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Directors' Remuneration Report

Remuneration Committee

The current members of the Remuneration Committee are Michael Kirkwood (Committee Chair), the Chair of the Board, Peter Gibbs and Lucinda Riches. The Remuneration Committee met two times in this reporting period. Only members of the Remuneration Committee have the right to attend Remuneration Committee meetings. However, other individuals may be invited to attend for all or part of any meeting as and when appropriate.

The Remuneration Committee operates as a sub-committee of the UKFI Board. The membership of the Committee comprises the Chair of the Board and non-executive directors and shall consist of not less than three members. The Board is responsible for any new appointments to the Remuneration Committee. The Remuneration Committee meets a minimum of two times per year and on an ad hoc basis as required.

The Remuneration Committee has worked over the year to fulfil its responsibilities to:

- approve and agree with HM Treasury the remuneration levels for UKFI Directors;
- approve UKFI's broad policy relating to remuneration for all UKFI employees;
- ensure that the individuals for whom the Remuneration Committee is responsible are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their contributions to the success of UKFI;
- periodically review the broad policy and make recommendations to the Board for changes, as appropriate;
- review, and by reference to the broad policy applying from time-to-time, approve the terms of any contract of employment and remuneration arrangements, including any annual or longer-term incentive packages and pension rights of:
 - the Chairman of the Board;
 - the Chief Executive; and
 - any other Executive Director;
- review the executive recommendations on, and approve the remuneration of, any employee who is a member of the Executive Committee;
- monitor against the agreed Board policy:
 - the level and structure of total remuneration for senior management; and
 - the application of the policy across the whole organisation to ensure transparency, fairness and consistency;
- approve both the policy for and any compensation packages or arrangements following the severance of the employment contract applicable to the Chairman of the Board, the CEO, any Executive Director or direct report to the CEO (plus any other member of staff where the terms proposed are unusual or exceptional) with a view to ensuring that the individual is treated fairly, but that failure is not rewarded.

UKFI operates a performance appraisal system and performance is reviewed semi-annually. Performance related pay takes the form of bonus payments.

Remuneration policy

In approving the remuneration for Board members and other UKFI employees, the Remuneration Committee takes into account all factors which it deems necessary, including that HM Treasury's interest is primarily in ensuring that remuneration levels:

- deliver value for money;
- are sufficient to attract and motivate high-calibre individuals to drive the delivery of the activities and objectives set out in the Framework Document;
- are in line with the FSA code: linked to performance, with no reward for failure or excessive risk taking; and
- are aligned with the objectives set out in the Framework Document, Business Plan and Investment Mandate.

UKFI has a policy to recognise those staff that have performed well in their roles through the payment of bonuses. Performance-related pay is awarded in relation to performance linked to the annual staff appraisal. Information on UKFI remuneration can be found in the UKFI financial statements 2010/11 in Chapter 10.

Any UKFI performance-related pay is calculated as a fraction rather than multiple of salary. A total of £85,000 was awarded for the performance year 1 December 2009 – 30 November 2010, of which £36,000 was paid out and £49,000 was retained because UKFI bonuses are deferred over three years and subject to clawback in line with the arrangements now in place at the investee banks. The total award represents 4.5 per cent of staff costs incurred over the same period.

In the previous performance year (3 November 2008 – 30 November 2009) a total of £198,000 was awarded, representing 11.8 per cent of staff costs for the same period, of which £75,000 was paid out and £123,000 retained. This year £65,000 was paid out from that retained amount.

The Remuneration Committee considers the level of bonus awarded for performance year 1 December 2009 – 30 November 2010 to be lower than would be expected in subsequent years, due to key individuals not being eligible to receive a bonus payment in this performance year.

None of the UKFI non-executive directors are eligible for UKFI performance related pay, and the Chief Executive has declined any participation in the UKFI bonus scheme.

Staff profile

UKFI is a small organisation. At 31 March 2011, the number of full-time employees including the Chief Executive was 13. The average over the 2010/11 period was 14 excluding non-executive directors, and 20 including non-executive directors. UKFI is not part of the Civil Service, and the majority of posts are occupied by staff with directly relevant expertise from the private sector. UKFI recruitment procedures are based on the principles of fair and open competition and selection on merit.

UKFI's executive team is comprised of:

- a Chief Executive;
- a Market Investments Team which manages investments in Lloyds Banking Group and RBS;
- a Wholly-Owned companies Team which manages investments in Northern Rock plc, UK Asset Resolution, Northern Rock (Asset Management), and Bradford and Bingley; and
- a Policy and Operations team.

The total wage bill for UKFI executive and non-executive staff, including wages, salaries paid or payable, social security costs, and other pension costs is £1.82 million for the period 1 April 2010 to 31 March 2011. The same figure for the period 1 April 2009 to 31 March 2010 was £1.96 million.

During the year UKFI staff took an average of 8.4 days of sickness absence. Last year this figure was 2.5 days. This year's figure is higher due to three instances of long-term absence which increases the average figure for a small team of employees.

There have been no personal data related incidents in the year.

Service contracts

UKFI policy on duration of contracts is that directors' contracts continue for a period of 36 months, unless terminated earlier by HM Treasury, in accordance with the Company's Articles of Association, or by either party giving written notice to the other. Upon termination of the appointment, subject to any fees outstanding, directors have no entitlement to compensation in respect to any loss.

Directors' remuneration

The table below reports the remuneration of each director for the period ending 31 March 2011 and has been audited by the Company's Auditors. None of the directors of UKFI are eligible for UKFI performance-related pay, and the value of their non-cash benefits is zero. Salary therefore includes only gross salary and expenses are shown in the separate table below.

During the year all UKFI Board members agreed to reduce their fees by 5% effective as of July 2010, effective May 2010 for Robin Budenberg.

Director	Salary Year ended 31-3-2011	Salary and full year equivalent (FYE) (£) Year ended 31-3-2010
David Cooksey	96,250	66,700 (100,000 FYE)
Robin Budenberg	147,896	38,750 (155,000 FYE)
Peter Gibbs	36,094	37,500
Michael Kirkwood	38,500	40,000
Lucinda Riches	36,094	37,500
Philip Remnant	31,281	32,500
Louise Tulett	0	0
Julian Kelly	0	-
Ken Beeton	0	-
John Kingman ¹	-	95,333 (143,000 FYE)

Note

1. John Kingman was paid a salary through his employment contract with HM Treasury. The amount above reflects the salary recharged to UKFI in relation to his secondment for the period 1 April 2009 to 7 December 2009.

Director	Expenses (£) Year ended 31-3-2011	Year ended 31-3-2010
David Cooksey	0	-
Robin Budenberg	453	215
Peter Gibbs	0	0
Michael Kirkwood	0	598
Lucinda Riches	0	92
Philip Remnant	0	0
Louise Tulett	0	0
Julian Kelly	0	-
Ken Beeton	0	-
John Kingman	-	1,173

Directors' pension arrangements

None of the directors of UKFI receive a pension from the Company.

John Kingman, who was CEO of UKFI until 7 December 2009 and on secondment from HM Treasury, was a member of the Principal Civil Service Pension Scheme through his employment contract with HM Treasury. This information in respect of the previous financial year is provided for the purposes of clarity.

John Kingman	Year ended 31-3-2010 £
Real increase in the accrued pension benefits and related lump sum at age 60 during the period	0-2,500
Value of the accrued pension benefits at the end of the reporting period and the related lump sum at age 60	5,000-10,000
Value of the cash equivalent transfer value at the beginning of the period	310,000
Value of the cash equivalent transfer value at the end of the period	360,000
Real increase in the cash equivalent transfer value during the period	24,000

This report has been approved by the board of directors and is signed by the Chairman of the Remuneration Committee on behalf of the board of directors.



Michael Kirkwood

Chair of Remuneration Committee

12 July 2011

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Statement on Internal Control

Scope of responsibility

The Board has responsibility for maintaining a sound system of internal control 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.

Context

The system of internal control has been in place in UKFI for the year ended 31 March 2011 and up to the date of approval of the annual report and accounts and accords with central HM Treasury guidance. This period has comprised the second full year of UKFI's existence and from a control perspective effort has therefore been focused on maintaining the robust governance, compliance and risk procedures already in place.

Appropriate account of best practice has also been taken. For instance, although UKFI's activities do not require FSA 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 principles of Managing Public Money are being followed to manage the Company's resources.

The purpose of the system of internal control

The Company has put in place business and operational risk management arrangements so that the Board, and through them UKFI's stakeholders, can be reassured that UKFI is operating within the risk parameters set by the Framework Document and the Investment Mandate in place between UKFI and HM Treasury. The strategies and policies for taking up, managing, monitoring and mitigating, where possible, UKFI's exposure to risk, including those posed by the macroeconomic environment in which the Company operates, are periodically reviewed, most recently in April 2011.

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on managing risks efficiently, effectively and economically.

Risk Categories

Operational risk is defined as the risk resulting from inadequate or failed internal processes, people and systems or from external events, including reputational risk. Operational risk management policies and procedures have been implemented and are maintained, including procedures for risk assessment, which identify the risks relating to our activities, processes and systems. The following are monitored:

- The adequacy and effectiveness of those risk management policies and procedures;
- Compliance with arrangements, processes and mechanisms in place to manage risks; and
- The adequacy and effectiveness of the measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms. This includes the impact of failures by personnel to comply with arrangements or processes and mechanisms or follow such policies and procedures.

The requirements for credit risk policies, processes and controls have been considered and it has been determined that they would have very limited impact on UKFI delivering its business plan because our operations will be backed and supported by the Company's parent, HM Treasury.

Risks to data and information held by UKFI are owned and managed by individuals and collectively by the Company as a whole. UKFI has appointed a Senior Risk Officer who is responsible for maintaining UKFI's risk register.

The risk and control framework and the capacity to handle risk

Oversight Committees

As set out in Chapter 6 of this report, the UKFI Board is supported in its responsibility of managing risk by three sub-committees: the Audit and Risk Committee, the Remuneration Committee and the Nominations Committee. The Board is also supported by the Executive Management Committee, which provides operational leadership for the risk management process and is accountable to the Board. The terms of reference for these committees are detailed in UKFI's Board Governance Manual.

Internal Policies and Procedures

The policies and procedures which identify risks relating to our activities are encompassed in the following documents:

- Board Governance Manual – describes the Governance arrangements for UKFI including: the terms of reference for the Board and its key committees; the matters reserved to the Board; and the authorities the Board has delegated to its committees and to the Executive Management to ensure the delivery of the Overarching Objective outlined in the Framework Agreement.
- Compliance Manual – describes the Compliance policies and procedures used to conduct UKFI's business in compliance with the applicable rules and regulations and Board policies.
- Compliance Procedures Guide – designed to assist UKFI Compliance staff with the day-to-day operation of the Compliance function. It serves as a guide to tasks, projects and repositories, and a step-by-step guide to key compliance activities.
- Investment Administration Manual – sets out the processes which UKFI expects to perform in administering the asset portfolio.
- Risk management manual – sets out the principles, processes and procedures by which risks and opportunities are managed within UKFI.
- Risk register – provides a view of the risk exposure within UKFI, and allocates discrete risks to specific members of the Executive Management Committee.
- Procurement Policies and Procedures Manual – describes UKFI's procurement procedures, which will ensure appropriate controls are in place and that contracts are accurately recorded within the Company's accounting systems.
- Accounts Receivable, Accounts Payable and Expenses Policies and Procedures Manual – describes UKFI's accounts receivable, accounts payable and expenses policies and procedures, which will ensure that UKFI is compliant with Her Majesty's Treasury's guidelines as appropriate and that invoices are accurately recorded within the Company's accounting systems.
- Human Resources Policies and Procedures Manual – details the code of conduct to which all UKFI staff are bound, and contains information pertinent to Human Resources.

UKFI's relationship with HM Treasury is set out in the Framework Document and Investment Mandate, which are available at www.ukfi.co.uk

Audit

UKFI have appointed Grant Thornton as its outsourced internal auditors, and an audit plan is in place which has been agreed by the Audit and Risk Committee. Internal audit reviews are used to assess the effectiveness of the design and implementation of internal controls. Internal Audit has thus far performed reviews of:

- Governance arrangements
- Compliance arrangements
- Payments process
- Arrangements put in place to manage the departure of John Kingman (ex-CEO)
- Investment Administration
- IT
- HR

UKFI's External Auditors, the National Audit Office, have also considered UKFI's control framework during the course of the audit of this document.

Training

All UKFI staff are required to undertake mandatory training which ensures awareness of the major risks associated with UKFI's day-to-day operating environment.

Potential Risk Events

The following events were potential risk events during the year. UKFI identified these and took action to mitigate that risk.

1. During 2010 fears around a sovereign debt crisis impacted countries within the Eurozone, most notably Greece, Ireland and Portugal. This led to concerns about the cost of financing government debt and also to concerns about the ability of banks to fund themselves. Throughout this period UKFI monitored the banks' funding positions and engaged regularly with the banks' management on the issue.
2. During the year there were management changes at Lloyds Banking Group, including most notably, a change of CEO. UKFI engaged closely with the Board of Directors of Lloyds Banking Group throughout this process to ensure that these changes were undertaken smoothly and to the benefit of Lloyds Banking Group and shareholders.
3. Throughout the year a number of changes have taken place in the regulatory environment in which the banks operate, both at the domestic and international levels. UKFI reviewed the impact of proposed regulatory changes, including through discussions of the UKFI Board. UKFI also discussed with the banks in which the Government is a shareholder how proposed regulatory changes would impact upon their operations.
4. During 2010 Northern Rock plc and Northern Rock Asset Management (NRAM) completed their full operational separation, which was a condition of European Commission state aid approval. UKFI worked closely with the management of these companies throughout the process to ensure this was managed effectively and did not detract from their business focus.

5. Alongside the work undertaken to split Northern Rock, UKFI worked to create a new holding company, UK Asset Resolution Limited, to integrate Northern Rock Asset Management and Bradford & Bingley. This was done to realise efficiencies and economies of scale through common governance and management.
6. Remuneration in the banking sector remains a high profile issue, with the UKFI banks attracting a high degree of attention and scrutiny. UKFI worked with the banks' Remuneration Committees on their approach to remuneration ensuring they were at the forefront of implementing the relevant remuneration requirements, such as the updated FSA Remuneration Code.
7. During the year there were changes to the UKFI Executive Committee. UKFI ensured processes were in place to manage effectively the succession risk associated with operating a small team. UKFI ensured that appropriate handover periods were used and also that arrangements were put in place to manage possible conflicts arising from the departure of senior staff members.

It is my view that none of the above events resulted in any significant control issues and that any potential impacts on internal control were effectively managed.

Review of effectiveness

As Accounting Officer, under the terms of my appointment, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the company who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Audit & Risk Committee and a plan to ensure it continues to operate effectively is in place.

Significant control issues

There were no significant control issues in the year under review.



Robin Budenberg

Chief Executive

12 July 2011

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Independent Auditor's Report
to the shareholders of UKFI

I have audited the financial statements of UK Financial Investments Limited for the period ended 31 March 2011 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practice Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2011 and of its results for the period then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the Companies Act 2006.

Opinion on Regularity

In my opinion, in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on other matter prescribed by the Companies Act 2006

In my opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I have nothing to report in respect of the following matters where the Companies Act 2006 requires me to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- I have not received all the information and explanations I require for my audit.

Bryan Ingleby (Senior Statutory Auditor)

Date: 14 July 2011

for and on behalf of the
Comptroller and Auditor General (Statutory Auditor)
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

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UKFI Financial Statements

Income Statement for the year ended 31 March 2011

	Note	2011 £000	2010 £000
Revenue	3(e)	2,702	3,745
Other operating income – amounts recharged to Investee companies	3(f)	215	199
		2,917	3,944
UKFI administrative expenses		2,702	3,745
Amounts incurred on behalf of Investee companies		215	199
Profit before corporation tax	2-7	0	0
Taxation	3(g)	0	0
Profit for the period		0	0

The Company has no recognised gains or losses in the year other than those included in the income statement and therefore no separate statement of comprehensive income has been prepared.

All activities are classified as continuing.

The notes on pages 61 to 70 are an integral part of these financial statements.


Statement of financial position as at 31 March 2011

	Note	31 Mar 2011 £000	31 Mar 2010 £000
Non-current Assets			
Property, plant and equipment	8	142	215
Intangible Assets	9	17	25
Total Non-current Assets		159	240
Current Assets			
Trade and other receivables	10	288	481
Cash and cash equivalents	11	113	129
Total Current Assets		401	610
Total Assets		560	850
Equity			
Share capital	12	0	0
Retained earnings		0	0
Total Equity		0	0
Liabilities			
Current Liabilities			
Trade and other payables	13	488	736
Total Current Liabilities		488	736
Non-current Liabilities			
Trade and other payables	14	72	114
Total Non-current Liabilities		72	114
Total Liabilities		560	850
Total Equity plus Liabilities		560	850

These financial statements were approved by the Board of Directors on 12 July 2011 and were signed on its behalf by:



Sir David Cooksey
Director



Robin Budenberg
Director

Statement of cash flows for the year ended 31 March 2011

	Note	31 Mar 11 £000	31 Mar 10 £000
Cash flows from operating activities			
Profit for the period		0	0
Adjustments for:			
Depreciation	8	67	13
Amortisation	9	8	1
		75	14
Change in trade and other receivables	10	193	196
Change in trade and other payables	13,14	(290)	(66)
Net cash from operating activities		(22)	144
Cash flows from investing activities			
Acquisition of property, plant and equipment	8	0	(228)
Acquisition of intangible assets	9	0	(26)
Proceeds of disposal of property, plant and equipment		6	0
Net cash used in investing activities		6	(254)
Net increase/(decrease) in cash and cash equivalents		(16)	(110)
Cash and cash equivalents at 1 April	11	129	239
Cash and cash equivalents at 31 March	11	113	129

The notes on pages 61 to 70 are an integral part of these financial statements.

Notes to the financial statements

1. Reporting entity

UK Financial Investments Limited (the “Company”) is a Company domiciled in the United Kingdom. The address of the Company’s registered office is 2 Lambs Passage, London EC1Y 8BB. The Company operates as an investment management business under the terms of the Companies Act 2006.

2. Basis of preparation

(a) Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs).

These financial statements are prepared in accordance with the Government Financial Reporting Manual (FRM) where this exceeds the requirements of the Companies Act 2006.

The financial statements were authorised for issue by the Board of Directors on 12 July 2011.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

The going concern of UKFI is dependent on successfully funding its balance sheet and maintaining adequate resources to continue to operate for the foreseeable future. HM Treasury has stated that it will fund UKFI's operations for the next financial year.

The directors have considered a number of key risk factors which could adversely affect UKFI's future results as set out in note 17 to these annual accounts.

Having considered the above, the directors have a reasonable expectation that UKFI will continue in operational existence for the foreseeable future. Accordingly, the financial statements have been prepared on a going concern basis.

(c) Functional and presentation currency

These financial statements are presented in pounds sterling, which is the Company's functional currency. All financial information has been rounded to the nearest thousand.

(d) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Notes to the financial statements (continued)

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(a) Foreign currency

Transactions which are denominated in foreign currencies are translated into Sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

(b) Property, plant and equipment and intangible assets**(i) Recognition and measurement**

Items of property, plant and equipment are measured at cost less accumulated depreciation. Intangible assets are measured at cost less accumulated amortisation. In line with HM Treasury Group policy, the Company does not capitalise items with a cost less than £5,000.

(ii) Subsequent costs

The cost of replacing a part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

(iii) Depreciation and amortisation

Depreciation and amortisation are calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation and amortisation are recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment and intangible assets, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

The estimated useful lives for the current and comparative periods are as follows:

Furniture, fixtures and fittings	3 to 10 years
Computer and telecom hardware, software and licences	3 to 10 years

Depreciation and amortisation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

(c) Leased assets

All of the Company's leases are classified as operating leases, and the leased assets are not recognised in the Company's statement of financial position. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

(d) Employee benefits**(i) Defined contribution plans**

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

(ii) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

(e) Revenue

Revenue, which excludes value added tax, comprises of fees arising from investment management and other related services. Management fees are recognised in the income statement as they are earned.

(f) Other operating income

Other operating income, which excludes value added tax, comprises of adviser fees recharged to the Investee companies.

(g) Corporation tax

The Company is registered for the purposes of corporation tax. The amount of corporation tax payable in respect of this period is nil.

(h) VAT

The Company is treated as carrying on a business for VAT purposes; services provided are standard-rated for VAT purposes.

(i) Trade receivables

Trade and other receivables are stated at cost.

(j) Trade payables

Trade and other payables are stated at cost.

(k) Cash and cash equivalents

Cash and cash equivalents comprise solely of cash balances.

(l) Financial Assets and Financial Liabilities**(i) Recognition**

Financial assets and financial liabilities which arise from contracts for the purchase of non-financial items (such as goods and services) which are entered into in accordance with UKFI's normal purchase or usage requirements, are recognised when, and to the extent which, performance occurs, i.e. when receipt or delivery of the goods or service is made.

(ii) De-recognition

All financial assets are de-recognised when the rights to receive cash flows from the assets have expired or UKFI has transferred substantially all of the risks and rewards of ownership.

Financial liabilities are de-recognised when the obligation is discharged, cancelled or expires.

Notes to the financial statements (continued)

(iii) Classification and measurement

Financial assets are categorised as “Loans and receivables”.

Financial liabilities are categorised as “Other financial liabilities”.

(iv) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments which are not quoted in an active market. UKFI has no loans, however it has the following receivables included in current assets: cash at bank and in hand, accrued income owed by group undertakings, and “other debtors”.

Receivables are recognised at cost; in accordance with IFRS 7, the carrying values of short-term financial assets and liabilities (at amortised cost) are not considered different to fair value.

(v) Other financial liabilities

All financial liabilities are recognised at cost; in accordance with IFRS 7, the carrying values of short-term financial assets and liabilities (at amortised cost) are not considered different to fair value.

(m) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 March 2011, and have not been applied in preparing these financial statements. None of these is expected to have an effect on the financial statements of the Company.

(n) Segment reporting

UKFI only has one reportable segment, consistent with the budget updates provided to the Chief operating decision maker, which is UKFI's Board.

The main activity of the Company is managing, from its London headquarters, the Government's investments in financial institutions.

4. Income

	For the year ended 31-3-2011 £000	For the year ended 31-3-2010 £000
Investment management fees	2,702	3,745
Adviser fees recharged to Investee companies	215	199
Total	2,917	3,944

5. Remuneration of directors

	For the year ended 31-3-2011 £000	For the year ended 31-3-2010 £000
Directors' emoluments	387	348
Total	387	348

6. Personnel expenses

The average number of people working at the Company during the period was 20. This figure includes directors and long-term inward secondees.

The aggregate payroll costs of these people were as follows:

	For the year ended 31-3-2011 £000	For the year ended 31-3-2010 £000
Wages and salaries	1,513	1,614
Social Security contributions	184	180
Contributions to defined benefit plans	60	98
Contributions to other pension plans	64	70
Total	1,821	1,962

Wages and salaries include Board fees and the costs of long-term inward secondees.

Contributions to other pension plans are included in the amount recharged for HM Treasury and Office of Government Commerce secondees. UKFI has no ongoing liability in respect of the underlying pension schemes.

A bonus amount of £84,712 was awarded in respect of the period 1 December 2009 to 30 November 2010, representing 4.5% of staff costs incurred over the same period. In respect of the previous performance year, £64,850 was paid out this year in deferred bonuses.

7. Profit before tax

	For the year ended 31-3-2011 £000	For the year ended 31-3-2010 £000
Profit before tax is stated after charging:		
Auditors' remuneration: Audit of these financial statements	18	18

8. Property, plant and equipment

	IT £000	Furniture & Fittings £000	Total £000
2010-11			
Cost or valuation			
At 1 April 2010	109	119	228
Additions	0	0	0
Disposals	(6)	0	(6)
At 31 March 2011	103	119	222
Depreciation	0	0	0
At 1 April 2010	3	10	13
Charged in year	34	33	67
At 31 March 2011	37	43	80
Carrying Value at 31 March 2011	66	76	142
Carrying Value at 1 April 2010	106	109	215

Notes to the financial statements (continued)

2009-10	IT £000	Furniture & Fittings £000	Total £000
Cost or valuation			
At 1 April 2009	0	0	0
Additions	109	119	228
At 31 March 2010	109	119	228
Depreciation	0	0	0
At 1 April 2009	0	0	0
Charged in year	3	10	13
At 31 March 2010	3	10	13
Carrying Value at 31 March 2010	106	109	215
Carrying Value at 1 April 2009	0	0	0

9. Intangible Assets

2010-11	Software £000	Total £000
Cost or valuation		
At 1 April 2010	26	26
Additions	0	0
At 31 March 2011	26	26
Amortisation		
At 1 April 2010	1	1
Charged in year	8	8
At 31 March 2011	9	9
Carrying Value at 31 March 2011	17	17
Carrying Value at 1 April 2010	25	25

2009-10	Software £000	Total £000
Cost or valuation		
At 1 April 2009	0	0
Additions	26	26
At 31 March 2010	26	26
Amortisation		
At 1 April 2009	0	0
Charged in year	1	1
At 31 March 2010	1	1
Carrying Value at 31 March 2010	25	25
Carrying Value at 1 April 2009	0	0

10. Trade receivables and other current assets

	31-3-2011 £000	31-3-2010 £000
Trade receivables due from related parties	288	318
Other trade receivables	0	163
Total	288	481

11. Cash and cash equivalents

	31-3-2011 £000	31-3-2010 £000
Government Banking Service, Commercial Banks and cash in hand	113	129
Total	113	129

12. Called up share capital

	31-3-2011	31-3-2010
Authorised		
Equity: Ordinary shares of £1 each	100	100
Allotted, called up and fully paid		
Equity: Ordinary shares of £1 each	1	1

Notes to the financial statements (continued)

13. Trade payables and other current liabilities

	31-3-2011 £000	31-3-2010 £000
Amounts falling due within one year		
Trade and other payables due to related parties	50	135
Other trade payables	214	424
Non-trade payables and accrued expenses	114	81
Taxation and social security	110	96
Total	488	736

14. Non-current liabilities

	31-3-2011 £000	31-3-2010 £000
Amounts falling due after more than one year		
Trade and other payables due to related parties	5	0
Non-trade payables and accrued expenses	59	101
Taxation and social security	8	13
Total	72	114

15. Operating leases

Operating lease rentals are payable as follows:

	31-3-2011 £000	31-3-2010 £000 (Restated)
Less than one year	219	218
Between one and five years	154	373
More than five years	0	0
Total	373	591

The company leases an office under an operating lease, which is due to expire in December 2012. During the year ended 31 March 2011 an amount of £213,000 was recognised as an expense in profit or loss in respect of operating leases (2009: £280,000).

Figures for operating leases in 2009-10 have been updated to show the actual amounts payable.

16. Dividends

UKFI has no intention of making a profit at any point, and does not intend to declare a dividend at any point. No dividend was declared or paid during the period (2010: nil).

17. Financial Instruments

IFRS 7 and IAS 39, Financial Instruments, require disclosure of the role that financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities.

UKFI is not exposed to significant financial risk factors arising from financial instruments. Financial assets and liabilities are generated by day-to-day operational activities rather than being held to change the risks facing UKFI in undertaking its activities.

UKFI holds the following financial assets: trade receivables due from related parties, other trade receivables and cash at bank and in hand. All are classified as “Loans and Receivables” and denominated in pounds sterling (notes 10 and 11).

UKFI's financial liabilities are: trade and other payables due to related parties, other trade payables, non-trade payables and accrued expenses and taxation and social security. All are classified as “Loans and Receivables” and denominated in pounds sterling. The maturity analysis of the financial liabilities is less than one year (note 13) and more than one year (note 14).

In accordance with IFRS 7, the carrying values of short-term financial assets and liabilities (at amortised cost) are not considered different to fair value.

Market Risk

Market risk is the possibility that financial loss might arise as a result of changes in such measures as interest rates and stock market movements. The vast majority of UKFI's transactions are undertaken in Sterling and so its exposure to foreign exchange risk is minimal. UKFI's income and operating cash flows are substantially independent of changes in market interest rates.

Credit Risk

Credit risk is the possibility that other parties might fail to pay amounts due to UKFI. Credit risk arises from deposits with banks as well as credit exposures to HM Treasury and other debtors. The credit risk exposure to HM Treasury is considered to be negligible: the Company's operating costs are recovered from HM Treasury, which is financed by resources voted by Parliament. Surplus operating cash is only held with the Office of the Paymaster General.

Liquidity Risk

Liquidity risk is the possibility that UKFI might not have funds available to meet its commitments to make payments. Prudent liquidity risk management includes maintaining sufficient cash to settle obligations.

18. Contingent liabilities

United Kingdom Financial Investments continues to indemnify its directors against liabilities and losses incurred in the course of their actions as directors, these in turn are guaranteed by HM Treasury. The potential liabilities in relation to these indemnities are considered unquantifiable.

Notes to the financial statements (continued)

19. Related parties

As at 31 March 2011, the Company is a wholly owned subsidiary undertaking of Her Majesty's Treasury, which is registered in England and Wales and operates in the United Kingdom.

Keith Morgan, UKFI's Head of Wholly-Owned Investments is a non-executive director of Bradford & Bingley plc, Northern Rock plc, Northern Rock (Asset Management) plc and UK Asset Resolution Ltd.

Details of the salary and other remuneration payable to senior management are provided in the Remuneration Report.

At the end of the period, the Company had the following balances with related parties:

	31-3-2011 £000	31-3-2010 £000
Trade receivables due from related parties – HM Treasury	285	257
Trade receivables due from related parties – salary adjustment	3	0
Trade receivables due from related parties – Northern Rock (Asset Management) plc	0	90
Total	288	347

	31-3-2011 £000	31-3-2010 £000
Trade and other payables due to related parties – HM Treasury less than one year	50	135
Trade and other payables due to related parties – HM Treasury more than one year	5	0
Total	55	135

During the period the Company received income from the following related parties:

	31-3-2011 £000	31-3-2010 £000
HM Treasury – provision of investment management services	2,702	3,745
Northern Rock (Asset Management) plc – recharge of adviser fees	21	90
Bradford & Bingley plc – recharge of adviser fees	194	0
Total	2,917	3,835



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