

UK Financial Investments Ltd

UK FINANCIAL INVESTMENTS LIMITED (UKFI)
ANNUAL REPORT AND ACCOUNTS 2016/17



UK Financial Investments Limited (UKFI) Annual Report and Accounts 2016/17

Presented to Parliament
by the Economic Secretary to the Treasury
by Command of Her Majesty

July 2017

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CONTENTS

Chairman's Foreword	6
01 Strategic Report	9
02 Royal Bank of Scotland Group	18
03 Lloyds Banking Group	25
04 UK Asset Resolution Ltd	30
The UKFI Board	34
05 Directors' Report and Governance Statement	39
06 Directors' Remuneration Report	46
07 Independent Auditor's Report to the Shareholder of UK Financial Investments Limited	54
08 UK Financial Investments Limited Financial Statements	57

UKFI'S REMIT

UK Financial Investments Limited (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 (RBS) and Lloyds Banking Group (Lloyds). UKFI is also responsible for managing the Government's 100 per cent shareholding in and loans to UK Asset Resolution Ltd (UKAR). UKAR was formed in October 2010 to integrate the activities of NRAM (previously known as Northern Rock (Asset Management) plc) and Bradford & Bingley plc.

UKFI's 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 ownership stakes in an orderly and active way over time within the context of protecting and creating value for the taxpayer as shareholder; paying due regard to the maintenance of financial stability and acting in a way that promotes competition.

UKFI is a Companies Act company and operates at arm's-length from Government. Since 1 April 2016 UK Government Investments Limited has been its sole shareholder. UKFI's ultimate beneficial owner is HM Treasury. More detail on UKFI's role, remit and ownership approach is set out in our Framework Document and Investment Mandate with HM Treasury, which can be found at www.ukfi.co.uk.

CHAIRMAN'S FOREWORD

UKFI made further significant progress with the execution of its mandate this year. UK Asset Resolution Ltd (UKAR) continued to make material progress in the orderly reduction of its balance sheet announcing a £11.8bn sale of loans in March 2017, in addition to repayments and redemptions totalling £4.3bn in the financial year. As a result of these events the UKAR balance sheet has been reduced by £93bn since it was formed in 2010. We recommenced a disposal of Lloyds shares through a new trading plan which had reduced the Government's shareholding to less than 2 per cent by 31 March 2017. Subsequent to the year end, on 17 May 2017, it was announced that the Government was no longer a shareholder in the bank following the final sale of shares through the trading plan. The full exit of Lloyds represents a significant milestone for the Government, Lloyds and UKFI. Total proceeds realised from share sales and dividends received in relation to Lloyds were £21.2bn.

In 2016 the UK economy continued to perform solidly, growing at around 2 per cent. The volatility in financial markets we witnessed in the latter half of 2015 continued into the first half of 2016; however a marked decline in volatility in the latter part of the year created conditions which were more conducive to disposals. This helped to support our recommendation that further sales of Lloyds shares continue by way of a trading plan and enabled UKAR to conduct a competitive process for the sale of loans announced at the end of the year.

In the first half of the year, we made preparations for the launch of an offer of shares in Lloyds to the public. However, given the ongoing volatility in financial markets over the summer we recommended that plans for a retail offer of shares in Lloyds be withdrawn. Shares sales conducted through a retail offer remain part of our disposal tool kit which we continue to consider when assessing disposal options for the Government's bank shares. In October a trading plan was put in place (designed to sell shares in the market over time in an orderly and measured way) for the Government's residual holding in Lloyds shares. Similar to the previous trading plan, UKFI and the Government set a floor price and other parameters to ensure the taxpayer received value for money from every sale. Between 7 October 2016 (when the plan was announced) and 31 March 2017, 5.1bn shares were sold at an average price of 64.4p achieving total proceeds of £3.3bn.

In the previous financial year UKAR announced the sale of its mortgage servicing operations to Computershare Limited. This sale provided UKAR customers with stability and continuity of service, while enabling the company to continue to deliver taxpayer value through a controlled wind down of its balance sheet. At year end UKAR announced the sale of a portfolio of performing buy-to-let mortgages held by Bradford & Bingley. Final completion of the sale was announced in April 2017, enabling total repayments of £11.8bn to the taxpayer, including £11.0bn towards a reduction of the £15.7bn loan extended to the Financial Services Compensation Scheme (FSCS) by HM Treasury. A further sale programme is expected to be launched later in 2017 to enable full repayment of the FSCS loan.

We continue to review opportunities to make further reductions to the Government's shareholding in RBS, but the need to resolve legacy issues at the bank meant we were unable to recommend share disposals during the year. When he announced the launch of the Lloyds trading plan, the Chancellor said that further disposals of the Government's shares in RBS would require the resolution of legacy issues relating to the EU State Aid agreement and the conduct charges relating to Residential Mortgage Backed Securities (RMBS) in the US. We have continued to engage closely with RBS to monitor progress in relation to both of these issues.

31 March 2017 marked the completion of the first year of operations of UK Government Investments (UKGI). UKFI is a wholly owned subsidiary of UKGI and while we have continued to work this year as a separate company with our own Framework Document and Investment Mandate, we have been working closely with UKGI colleagues to prepare for the integration of the two companies. I mentioned in last year's Annual Report that UKFI and UKGI would become one company, and we have made significant progress towards creating a single operational platform for both companies. In view of the significant reduction in the size of the Government's financial sector assets under our stewardship, the Board of UKFI has concluded that financial year 2017/18 will be UKFI's last year of operations, and that UKFI will be fully integrated into UKGI on 31 March 2018.

I would like to take this opportunity to thank all my Board colleagues for their hard work over the year. Their experience and insightful advice has been of great value as we continue to carry out the mandate set by HM Treasury and make the necessary preparations to ensure a smooth integration into UKGI.



James Leigh-Pemberton
Chairman and Accounting Officer

5 July 2017

ANNUAL REPORT AND ACCOUNTS
2016/17

01

Strategic Report

Introduction

This Chapter provides an overview of UKFI's activities, with reference to UKFI's objectives for 2016/17 including:

- a summary of how we have approached our role as an active and engaged shareholder over the past year, with the objective of building sustainable shareholder value;
- an update on our strategy for disposing of the shareholdings;
- a review of the principal risks and uncertainties facing UKFI; and
- a description of UKFI's objectives for 2017/18.

More detailed information on the financial performance of each of the investee companies over the past year is provided in Chapters 2 to 4. Chapters 5 and 6 provide further information on UKFI's internal governance and remuneration policies. The UKFI Board, supported by its two sub-committees, takes all major strategic decisions for the Company. The directors provide the Company with the appropriate experience, expertise and independence to manage the Government's investments on a commercial basis.

Chapters 7 and 8 provide the independent auditor's report and UKFI's financial statements for 2016/17. UKFI has produced an unqualified set of accounts for the eight years of its operation. Our direct administration expenditure for the year under review was £2.6m, of which staff costs were £1.9m.

UKFI's role as an active and engaged shareholder

Under the framework set by the Government, UKFI is required to manage the shareholdings on a commercial basis, actively engaging at a strategic level rather than intervening in day-to-day management decisions. This approach aims to ensure that value is re-established in the banks under the leadership of their own boards and management teams, to the benefit of taxpayers. Our level of involvement varies between the partly and wholly-owned institutions:

- in the case of UKAR, in which the Government is a 100 per cent shareholder; UKFI works with the Board and management team in a manner similar to that in which a financial sponsor would engage with a wholly-owned portfolio company. For example, UKFI appoints the Chairman of the Board, is required to approve board nominations, is represented by two UKFI nominated non-executive directors on the Board and has approval rights over UKAR's business plans;
- in contrast, the nature of UKFI's interaction with Lloyds and RBS reflects the fact that both institutions are listed companies and that their directors have fiduciary duties under the Companies Act 2006 to act in the commercial interests of all shareholders, not just the largest one. UKFI therefore operates in line with best practice for institutional shareholders, exercising its voting rights and engaging actively with the Boards and senior management on key strategic issues, while preserving their independence and freedom to determine their own commercial policies and business plans. The frequency and intensity of our interaction with each bank reflects the level of Government ownership.

For all the investee companies, our engagement is focused on ensuring that their business strategies, performance, governance and risk management processes are aligned to deliver sustainable value for the taxpayer. This approach is consistent with the best practice set out in the Financial Reporting Council's Stewardship Code for Institutional Investors, which aims to enhance the quality of engagement between shareholders and companies. Alongside all other Code signatories, the FRC assessed our reporting against the Stewardship Code in November 2016 and UKFI was placed in Tier 1, the highest tier, as a result of that assessment. Further details of how we act in accordance with this Code are available on our website.

Our approach to the stewardship of the investments is also informed by active dialogue with a wide range of institutional investors and analysts, with whom UKFI holds regular meetings.

Engagement with UKAR

UKFI nominates two non-executive directors to the board of UKAR. David Lunn, previously Head of Wholly Owned, was one of UKFI's nominated non-executive directors until he left UKFI on 28 February 2017. Peter Norton, Head of Banking and Capital Markets, has been nominated by UKFI to replace David on the UKAR board. Keith Morgan remains UKFI's other nominated non-executive director on the UKAR Board.

During the year, UKFI engaged closely with UKAR on a range of topics relating to its objectives of winding down its balance sheet. We focussed particularly on the execution of the £11.8bn sale of a portfolio of buy-to-let loans in order to ensure the delivery of good value to the taxpayer and the fair treatment of customers; on the monitoring of performance under the servicing contract which UKAR entered into in 2016; and on the operating risks arising out of the continuing significant reduction in UKAR's balance sheet.

We have continued to engage with UKAR on regulatory and legal developments during the year, in order to assess their impact on UKAR's operating procedures, approach to treating customers fairly and financial performance.

Engagement with RBS and Lloyds

Over the last year, UKFI has continued to engage with RBS on the implementation of the bank's strategy to restructure and simplify its business and increase its focus on operations in the UK. UKFI's engagement continues to be focused on the consequences for shareholder value of a number of aspects of the strategy. We have also maintained an active dialogue with RBS on certain legacy issues, including the State Aid agreement and outstanding litigation in relation to RMBS issuance in the United States.

A significant portion of our engagement with Lloyds during the first part of the year related to the preparation, and then subsequent wind down, of those preparations for the Government's planned sale of shares to retail investors. The Government's shareholding in Lloyds further reduced during the financial year and on 9 January 2017 HM Treasury announced the Government were no longer the largest shareholder in the bank. As the Government's shareholding in Lloyds has reduced, our level of interaction with the bank has adjusted appropriately.

We have continued to engage with both banks to ensure that they remain focused on improving the risk management process used to underpin business decisions. This relates not only to the prudential management of each firm, but also to risk management processes in respect of conduct issues, where both banks continue to deal with legacy shortcomings and must continue to develop appropriate systems, processes and cultures to meet higher regulatory standards.

As in previous years, UKFI has voted on behalf of the Government on all resolutions put to shareholders in both Lloyds and RBS where it was permitted to do so under the listing rules. We inform the relevant bank in advance of our voting intentions and rationale, and we disclose on our website how we have voted. Many of these votes follow consultations by the Boards with us and other shareholders in relation to individual resolutions.

While it is for the Boards of Lloyds and RBS to make decisions on directors and senior appointments, as a large shareholder we are regularly consulted, and always seek to ensure that suitably qualified individuals are appointed. At RBS one new non-executive director was appointed during the year. Frank Dangeard joined the Board in May 2016 and became a member of the Board Risk Committee in August 2016. In January 2017 it was announced that Mark Seligman would join the board in April 2017. Dyfrig John retired from the Board of Lloyds in May 2016.

Remuneration

Remuneration in the banking sector remains a high-profile issue. UKFI has continued to work closely with the Boards to ensure they exercised appropriate judgement in relation to their approach to directors' remuneration. While both banks need to be sensitive to the wider economic, political and social environment in which they operate, it is also essential that they are able to offer remuneration packages that are adequate to attract and retain staff with the talent and experience needed to run their businesses effectively and create and sustain value for the taxpayer.

UKFI has continued to be closely engaged with Lloyds' and RBS's remuneration committees and has concluded that both committees exercised appropriate judgement in relation to their approach to remuneration in 2016, both in relation to financial performance and the retention of key employees.

At RBS the group bonus pool is now over 75 per cent lower than it was in 2010 with the pool decreasing again this year. The bank continues not to pay bonuses to executive board members or the eight highest paid senior executives below board level. RBS set out their new three year remuneration proposal for a binding vote at the AGM on which UKFI and other shareholders were extensively consulted. This new policy includes an increased role for shareholder feedback in setting management's variable remuneration, considerably reduces the overall maximum awards for executive directors and better aligns LTIP targets with RBS's risk appetite.

At Lloyds, the group bonus pool remains significantly below levels before the Government became a shareholder in the bank. The Board of Lloyds awarded the Chief Executive, António Horta-Osório a salary increase where full payment is again subject to the complete disposal of the Government's shares in Lloyds.

Disposals strategy

UKFI is responsible for devising and recommending to HM Treasury strategies for returning the banks to private ownership, realising value for the taxpayer and executing the chosen strategy. Further details of how we are approaching this task for each of the investee institutions are set out below.

UKAR

The March 2016 Budget announced that UKFI and UKAR were exploring options for future sales to raise sufficient proceeds for Bradford & Bingley to repay its £15.7bn loan from the Financial Services Compensation Scheme (FSCS), and in turn, for the FSCS to repay its corresponding loan from HM Treasury.

On 31 March 2017 UKAR announced that following an open and competitive sales process a portfolio of B&B performing buy-to-let loans were sold to Prudential plc and to funds managed by Blackstone. The transaction completed in April 2017 and enabled total loan repayments to HM Treasury of £11.8bn including £11.0bn of the £15.7bn FSCS loan.

This sale brings the total UKAR balance sheet reduction to £92.9bn (80 per cent) since formation in 2010. UKAR expect to launch the next phase of the programme of sales later in 2017, with the aim of repaying the remainder of the FSCS loan in full before the end of 2017/18.

Lloyds

In December 2014, UKFI announced a six month trading plan to dispose of shares in Lloyds, taking advantage of supportive market conditions and the increased free float of Lloyds shares that the Government's previous share sales had generated. This trading plan was extended on two occasions during 2015/16 and expired on 30 June 2016. Under this trading plan a total of 11.3bn shares were sold at an average price of 81.4p per share. This reduced the Government's shareholding to 9.1 per cent at the end of the trading plan and achieved total proceeds of £9.2bn.

The Government had announced in January 2016 that due to difficult market conditions the proposed retail share offer of Lloyds would be postponed until this financial year. Due to the volatility in global financial markets the Government announced on 7 October 2016 that plans for the retail sale would be withdrawn and a new trading plan would be launched to make further sales of the Government's shares. The trading plan was designed to sell shares in the market over time, in an orderly and measured way. The decision to implement this plan was made following detailed analysis by UKFI and its advisors of a range of matters including the structure of the plan, Lloyds' share price performance, a detailed assessment of fair value and wider market conditions. From 7 October 2016 to 31 March 2017 a total of 5.1bn shares were sold at an average price of 64.4p per share. Total proceeds were £3.3bn, taking the Government's stake to 2.0 per cent.

Subsequent to year end, on 17 May 2017, the Government announced it had disposed of its final shareholding in Lloyds. Across the Lloyds disposal programme an average price of 76.8p per share was achieved. Total proceeds, including dividends received, were £21.2bn.

RBS

In August 2015, the first sale of the Government's shares in RBS took place and achieved 330p a share for a 5.4 per cent stake in the bank and raising £2.1bn in proceeds. Following UKFI's advice in October 2015 the Government converted its non-voting B shares in to ordinary shares, helping to normalise the banks' capital structure and facilitate future sales, and in March 2016 RBS paid the Government the final Dividend Access Share (DAS) retirement amount of £1.2bn.

In line with our mandate, we continue to seek opportunities to make further disposals of the Government's shares in RBS. However, as the Government has stated, further sales are unlikely to occur until progress is made on outstanding legacy issues. The management of RBS continue to make significant progress in transforming the bank and tackling legacy issues. On 17 February 2017, the Government announced it had submitted to the European Commission an alternative proposal to the divestment of Williams & Glyn. Whilst this proposal is subject to approval, successful resolution of the outstanding obligations in relation to Williams & Glyn would remove one of the challenges to making further disposals.

Principal risks and uncertainties

UKFI actively manages the risks it faces as an organisation and has therefore put in place business and operational risk management arrangements so that the Board and, through it, 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.

UKFI maintains a risk register to record and facilitate the management of the risks faced by UKFI and the risks which arise from shareholdings in the banking sector. The risk register assigns risks to the following categories: operational, strategic and project. This document is maintained by the Chief Executive Officer and is reviewed and discussed by the UKFI Board on a regular basis.

The system of governance and 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 following sets out the key risks to UKFI identified during the year and the actions taken to mitigate them.

Operational risks

UKFI regularly reviews its operational capabilities in order to ensure that it has the operating infrastructure, human resources and other capabilities necessary to carry out its mandate. The risk of interruption to UKFI's business by an external event is mitigated by a business continuity plan which is reviewed annually.

Risks to data and information held by UKFI are owned and managed by individuals and collectively by the Company as a whole. There were no personal data related incidents during the year.

UKFI has policies and procedures which set out how staff are required to operate to discharge their duties. These cover the operation of the UKFI Board, compliance, risk management, procurement, finance and human resources. In addition, 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. There were three security incidents during the year, none of which resulted in the leak of any information.

Strategic risks

The UK economy has continued to perform well with robust growth and record levels of low unemployment, finishing 2016 as the fastest growing economy in the G7. Strong growth is expected again in 2017, but inflation is expected to increase having been low for a number of years. As we reported last year the operating conditions for banks have become more challenging as a result of a flattening yield curve and the continuing low interest rate environment. These conditions present challenges for our investee banks and our ability to fulfil our mandate. UKFI engages with the banks' management regularly on plans to prepare for potential risks of this kind, and to assess how they are adapting business plans to respond to changes in economic conditions.

The volatility we saw emerging in the market at the end of the last financial year continued in the first half of this financial year but improved conditions in the second half enabled us to make progress in reducing the assets under our stewardship at prices that represented value for money for the taxpayer. UKFI continues to manage and mitigate market risks by carrying out rigorous analysis, supported by its advisors, to assess the implications of market conditions for disposal opportunities.

The stress tests conducted by the Bank of England's Financial Policy Committee in November 2016 used a new more severe stress than in the previous years based on the seven participating banks end 2015 balance sheets. Lloyds was one of the four banks that did not reveal capital inadequacies in the test scenarios. Although RBS did not meet the minimum hurdle the Bank of England acknowledged in their results that RBS had already updated its capital plan to incorporate further capital strengthening and this plan has been accepted by the Board of the Prudential Regulation Authority.

Remuneration in the banking sector remains a high profile issue, particularly in light of the continued cost of legacy issues. UKFI worked with the banks' remuneration committees to ensure that they pursued policies that promote long-term sustainable performance.

Banks in the UK and elsewhere continue to face substantial costs from legacy regulatory and conduct issues. These include costs of payment protection insurance redress, packaged account redress, interest rate hedging products misselling as well as LIBOR and US mortgage-backed securities related litigation. UKFI is engaged closely with the management and Boards of Lloyds and RBS on the remediation of past conduct issues to ensure that robust risk management and control systems are developed and maintained to minimise the incidence of such failings in the future.

Project risks

In October 2016, UKFI announced it would sell shares in Lloyds through a trading plan. This announcement followed the success of the previous trading plan in realising value for the taxpayer and UKFI continues to work with its advisors to ensure that any risks to the trading plan are identified and

mitigated. At the same time, the Government announced that plans for a retail offer of their shares in Lloyds would be withdrawn.

On 31 March 2017 UKAR announced the sale of a portfolio of B&B buy-to-let loans to Prudential plc and to funds managed by Blackstone which completed in April 2017. UKAR expect to launch the next phase of programme sales later in 2017 and we are working closely with our financial advisor and UKAR to identify risks associated with this transaction and mitigate them as far as possible.

UK Government Investments began operating on 1 April 2016 as a government company wholly owned by HM Treasury, which brings together the functions of the Shareholder Executive and UKFI. UKGI's purpose is to be the Government's centre of excellence in corporate finance and corporate governance. We have continued to work with UKGI and HM Treasury to manage and mitigate the risks relating to the integration of our operations. Following the good progress made during this financial year the Board of UKFI has determined that 2017/18 will be UKFI's last financial year as an independent company.

UKFI's 2017/18 objectives

The key objectives which UKFI has agreed with HM Treasury for the 2017/18 reporting year are set out below.

Lloyds and RBS

1. To engage with the Boards and management teams of both banks to ensure that their strategies, performance and leadership remain appropriate to build sustainable shareholder value in the context of the evolving operating and regulatory environment, underpinned by high standards of customer conduct, risk management and regulatory compliance.
2. To develop, maintain and where appropriate execute a strategy for the effective disposal of the shareholdings, taking into account relevant market developments, and to work with HM Treasury to ensure that the analytical frameworks used to assess the value for money and wider policy, operational and legal implications of individual transaction proposals remain robust.
3. To maintain an ongoing dialogue and communication with both existing and prospective investors in Lloyds and RBS to inform our approach to both the stewardship and disposal of the shareholdings.

UKAR

4. To actively engage with UKAR in the ongoing orderly run-down of its closed mortgage books with a focus on maximising value for the taxpayer. This includes:
 - ongoing review of its business plan and balance sheet optimisation strategy;
 - working with the company to execute balance sheet transactions as appropriate; and
 - monitoring its approach to arrears management, treating its customers fairly, impairments and cost efficiency.

All investee companies

5. To ensure that strong governance and leadership are maintained at these institutions to oversee the successful development and implementation of the agreed strategies.
6. To engage actively with the remuneration committees of these institutions in striking an appropriate balance between incentives and restraint.
7. To provide input and expertise where appropriate to support HM Treasury and UKGI's wider policy interests in relation to the banking sector; in particular in relation to financial stability and competition.

UKGI

8. To work effectively with our parent company UKGI, including:
 - completing the integration of both entities including co-location; and
 - providing input and expertise to support UKGI's wider objectives.



James Leigh-Pemberton
Chairman and Accounting Officer

5 July 2017

ANNUAL REPORT AND ACCOUNTS
2016/17

02

The Royal Bank of Scotland Group plc

Summary of Government shareholding

As at the end of March 2017, the Government held a total of 8.4bn ordinary shares in RBS, equivalent to a 71.2 per cent voting share. The 31 March 2017 share price of 242.1p implied a current market value of the Government's shareholding of £20.4bn.

Company overview

RBS is a large banking group providing services to personal, commercial and large corporate and institutional customers. Headquartered in Edinburgh, the Group operates in the UK, through its two principal subsidiaries, RBS and NatWest, and internationally.

Company performance

The table below provides an overview of the key financial results for RBS from 2014 to 2016. Full details of the results, including for the first quarter of 2017, can be found on the Company's website: www.investors.rbs.com/results_centre.

Table 2.1: Key financial performance metrics

	2016	2015	2014
Risk measures (Group)			
Fully loaded Basel III common equity tier 1 ratio	13.4%	15.5%	11.2%
Loan to deposit ratio	91%	89%	95%
Short-term wholesale funding (<1 year)	£14bn	£17bn	£28bn
Liquidity portfolio ¹	£164bn	£156bn	£151bn
Leverage ratio ²	5.1%	5.6%	4.2%
Profitability Metrics (Core)			
Return on equity ³	11.1% ⁴	11.2% ⁵	13% ⁶
Cost to income ratio ³	63%	65%	63%

(All figures from RBS statutory accounts and results presentations)

Notes:

1. Eligible assets held for contingent liquidity purposes including cash, government-issued securities and other eligible securities with central banks.
2. Based on end-point CRR Tier 1 capital and revised Basel III leverage ratio framework.
3. Excluding restructuring and conduct charges.
4. Segmental adjusted ROE calculated using equity equivalent to 11% of average segmental RWA for Commercial Banking and Ulster Bank (RoI), 12% for RBS International and 15% for all other segments.
5. Segmental adjusted ROE calculated using a 28% notional tax rate and equity equivalent to 11-15% of average segmental RWAs for various segments.
6. Segmental adjusted ROE calculated using a 25% notional tax rate and equity equivalent to 12% of average segmental RWA.

Commenting on the Group's performance in 2016, Ross McEwan, CEO, said:

"In 2016 RBS made an attributable loss of £7.0 billion, mostly reflecting charges for outstanding litigation and conduct, and costs associated with restructuring of the bank. The financial impact of these issues is a difficult but necessary step in working through the bank's legacy issues. These costs are a stark reminder of what happens to a bank when things go wrong and you lose focus on the customer, as this bank did before the financial crisis. The more progress we have made on clearing these past issues, enables us to sharpen our focus on the core bank.

The bank we are today

We are now in a much better position to focus on our long term aspiration – to transform the bank into the number one for customer service, trust, and advocacy. While the signs of this transformation have at times been masked by our wider organisational changes, the core bank has already evolved materially since 2014.

Our decision to refocus on the UK has seen our balance sheet shrink by £229 billion since the start of our plan. This is net of the continued growth in our Personal and Business Banking and Commercial and Private Banking franchises. We are seeing the benefits of our service-led strategy in the financial performance of the core bank, generating £4.2 billion in adjusted pre-tax operating profit for the year, an average of £1 billion per quarter for the last eight quarters and 4% up on 2015.

The bank we are becoming

We still have more work to do. In part, that means finishing the restructuring of RBS, resolving the remaining legacy issues, and preparing the bank for ring-fencing. In the main, however, it is about adapting to the changing nature of the UK and Irish banking sectors, and investing to meet our customers' evolving needs.

Delivering our strategy

This year we have met all our operating financial targets, though the results of some of our customer NPS and employee engagement surveys show we still have work to do. After the EU referendum result, we promised an update on our targets. We are targeting an unadjusted 12% or greater return on tangible equity, and a below 50% cost to income ratio by 2020, one year later than envisaged when we first set out our plan in 2014.

Our focus on capital strength remains a cornerstone of our plan. In 2017, we will continue to reduce legacy RWAs, and we will target a CET1 ratio of at least 13%.

We no longer have global aspirations and we need to go further still on our operating costs. We expect to take out an additional £750 million of operating costs in 2017 through our focus on simplification and digital transformation. A simpler bank is a more profitable bank and a bank that delivers a better customer experience. Where we can make it easy for our customers, the more business they will do with us and the more sustainable our earnings will become.

Looking ahead

The progress of the last three years positions us well to achieve our vision for the future. We have the right strategy, and it is starting to deliver results. Now, we need to go further on cost reduction and faster on digital transformation.

We aren't alone in searching for efficiency gains and investing in digital capability, but the unique strength of this bank lies in the fact that we have a diverse business profile, with scale in all of our chosen markets. Investment in our market leading brands and better customer service will deliver steadier, higher quality earnings. Our focus on service rather than price has also shown that we can continue to grow in areas of strategic opportunity, such as mortgages, without compromising on risk. All of this will deliver a sustainable competitive advantage and a compelling investment case in the longer term.

This is a bank that has been on a remarkable journey. We still have further to go. But the next three years will not be the same as the past three. Legacy issues will take up a decreasing amount of our time and focus. Our customers, our cost base and the measures we plan to implement to return the bank to sustainable headline profits will be where we focus our efforts. Assuming we can conclude our issues on RMBS this year and resolve our residual State Aid obligations, we aim to have RBS back into profit in 2018 representing a significant step towards being able to start repaying UK taxpayers for their support."

Investment in RBS

The Government's investment in RBS was made in three different tranches, as summarised in the table below. The gross cost of these investments was £45,527m at an average cost per share of 502p. Taking into account underwriting fees received, and the DAS Retirement Dividend agreed with RBS, the net cost of the Government's remaining investment in RBS is £43,709m, equivalent to an average of 482p per share. Taking into account all fees received including the £2,504m Asset Protection Scheme (APS) exit fee and the £1,280m Contingent Capital Facility fees the net cost is £39,925m, equivalent to an average of 440p per share.

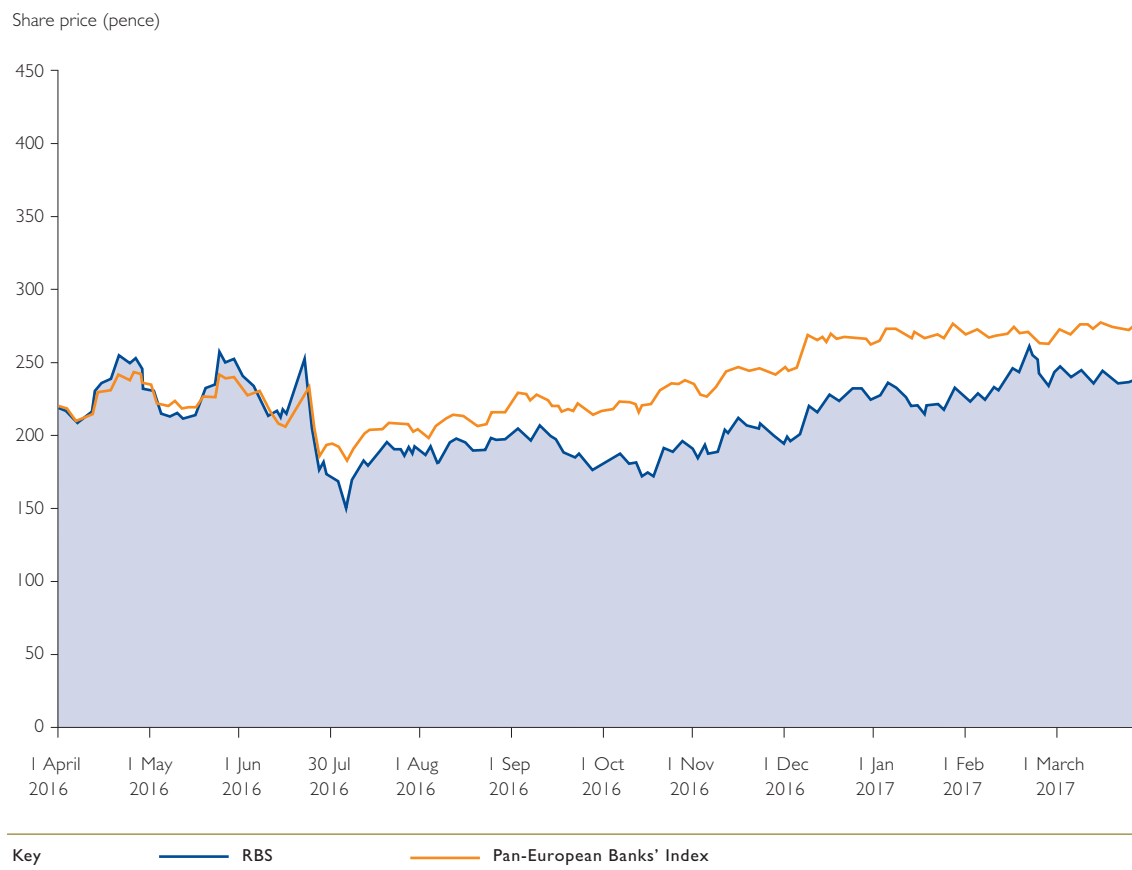
Table 2.2: HM Treasury's investment in RBS

		Shares ¹	Total investment	Investment per share
		m	£m	GBp
Initial recapitalisation	December 2008	2,285	14,969	665
Preference share conversion ²	April 2009	1,679	5,508	301
APS B Shares ³	December 2009	5,100	25,500	500
Total investment		9,064	45,527	502
DAS Retirement Dividend ⁴			(1,513)	
Total Investment net of dividends		9,064	44,014	486
Fees Received ⁵			(305)	
Total Investment net of fees and dividends		9,064	43,709	482
APS Exit Fee ⁶			(2,504)	
Contingent Capital Facility Fees ⁷			(1,280)	
Total Investment net of all fees and dividends		9,064	39,925	440

Notes:

1. On 6 June 2012 RBS executed a share consolidation exercise, the effect of which was to divide the ordinary share count by 10 and multiply the unit price by the same factor. The impact of this exercise is factored into the figures provided in this table.
2. Total investment includes accrued dividends and redemption premiums received of around £270m.
3. Share count of the total investment shown includes consideration of 51 billion B shares, as after the share consolidation exercise in June 2012, 10 B shares convert into one ordinary share.
4. In April 2014, RBS and HM Treasury reached an agreement to provide for the future retirement of the DAS. Following an initial payment of £320m in 2014 and a further payment of £1,193m in March 2016, the DAS has now been fully retired.
5. 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 APS and contingent capital facility.
6. In Q4 2012, RBS reached the full minimum payment of £2,500m for the implicit capital support provided by the APS since 2009.
7. In Q4 2013, RBS cancelled its Contingent Capital Facility with HMT following approval from the PRA. RBS paid a total of £1,280m of fees to HMT during the life of the facility, exiting it a year before it was due to expire.

Figure 2.1: RBS's share price performance



BOX 2.1: DEVELOPMENTS IN RBS SHAREHOLDING

As at the end of financial year 2016/17, the Government's holding in RBS was equivalent to 71.2 per cent economic and voting ownership. This reflects the completion of the first sale of the Government's shares in RBS, the conversion of its holding of B shares into ordinary shares, and the retirement of the Dividend Access Share ("DAS").

UKFI completed its first sale of shares in RBS in August 2015, raising £2,079m of proceeds through the sale of 630m shares at a price of 330p per share. This sale to institutional investors represented 5.4 per cent of the total issued share capital. Under the DAS retirement agreement, the DAS retirement amount was fully paid in March 2016 following approval from the PRA. Including interest accrued since the start of 2016, RBS paid a total of £1,193m to the Government in March, bringing the total paid to retire the DAS to £1,513m.

Summary of disposals in RBS

Method of disposal	Date	Size of disposal		Price achieved per share	Total proceeds achieved	Residual Governmental shareholding
		Shares	% of total issued share capital	GBP	£m	%
Institutional Accelerated Bookbuild	August 2015	630m	5.4%	330p	2,079	72.9%
DAS Retirement	March 2016	1	0.0%	n/a	1,513	72.3%

ANNUAL REPORT AND ACCOUNTS
2016/17

03

Lloyds Banking Group plc

Summary of Government shareholding

As at the end of March 2017, the Government held a total of 1.4 billion ordinary shares in Lloyds Banking Group (Lloyds), equivalent to 2.0 per cent of the total issued share capital. The 31 March 2017 share price of 66.3p implied a market value of the Government's shareholding of £0.9bn. Subsequent to the year end, on 17 May 2017, the Government announced it is no longer a shareholder in Lloyds following the final sale of shares through the trading plan.

Company overview

Lloyds 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 Halifax Bank of Scotland by what was Lloyds TSB at the time. The main activities are retail, commercial and corporate banking, general insurance and life, pensions and investment provision.

Company performance

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

The table below provides an overview of the key financial results for Lloyds from 2014 to 2016. Full details of the results, including for the first quarter of 2017, can be found on the Company's website at www.lloydsbankinggroup.com.

Table 3.1: Key financial performance metrics

	2016	2015	2014
Risk measures			
Pro forma common equity tier 1 ratio	13.8%	13.0%	12.8%
Loan to deposit ratio	109%	109%	108%
Short-term wholesale funding (<1 year)	£35bn	£38bn	£41bn
Liquidity coverage ratio – eligible assets	£121bn	£123bn	
Leverage ratio	5.0%	4.8%	4.9%
Profitability Metrics			
Statutory return on required equity	5.3%	1.5%	3.0%
Cost to income ratio	48.7%	49.3%	49.8%

(All figures from Lloyds' statutory accounts and results presentations. Comparatives restated in keeping with most recent statutory accounts.)

Commenting on the Group's performance over the course of 2016, António Horta-Osório, Chief Executive Officer, said:

"We have delivered strong financial performance in 2016 as we continue to make good progress against our strategic priorities.

As a simple, low risk, UK focused bank we are committed and well positioned to help Britain prosper and become the best bank for customers and shareholders."

Investment in Lloyds

The Government's investment in Lloyds Banking Group was made in three different tranches, as summarised in the table below. The gross cost of these investments was £20,313m at an average cost per share of 73.6p. Taking into account fees and dividends received, the net cost on the initial holding is £17,030m, equivalent to 61.7p per share.

Table 3.2: HM Treasury's investment in Lloyds on initial holding

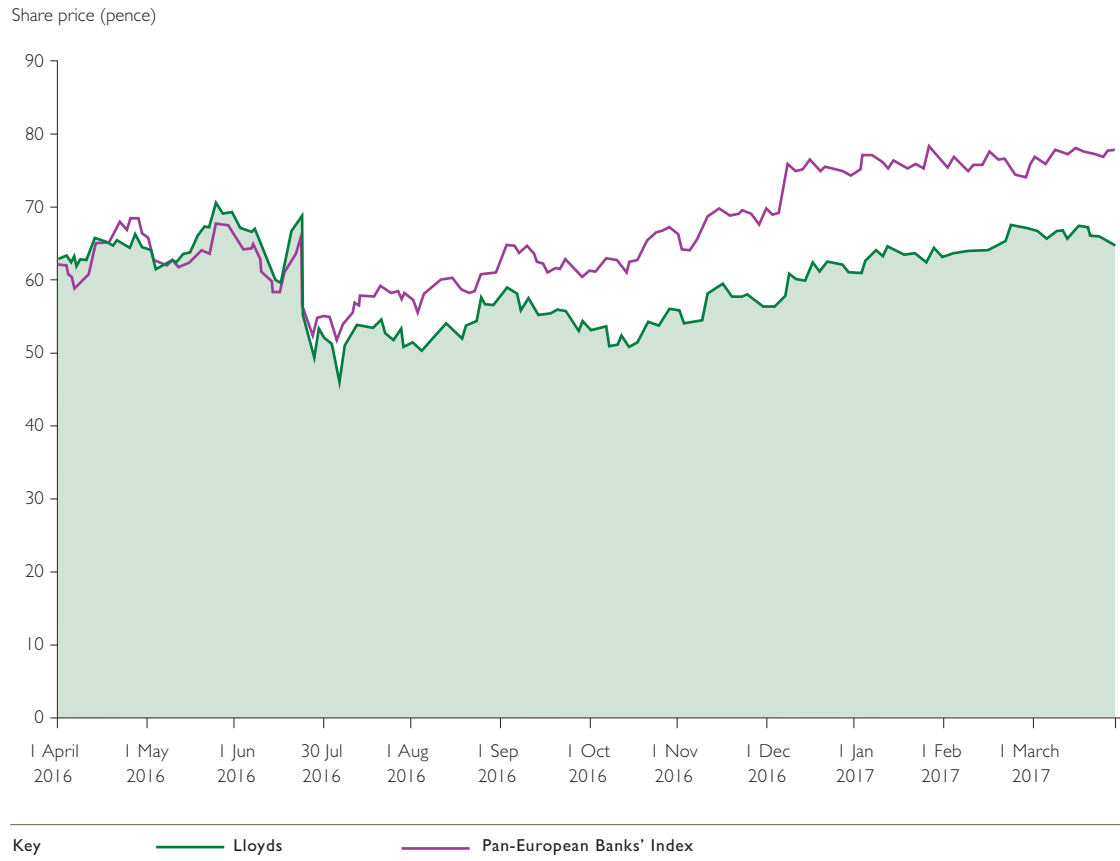
		Shares	Total investment	Investment per share
		m	£m	GBp
Initial recapitalisation ¹	January 2009	7,277	12,957	182.5
Preference share conversion ²	June 2009	4,521	1,506	38.4
Rights issue	December 2009	15,810	5,850	37.0
Total investment on initial holding		27,609	20,313	73.6
Paid dividends			(373)	
Announced but not paid dividends ³			(29)	
Fees Received ⁴			(381)	
APS Exit Fee ⁵			(2,500)	
Total Investment net of all fees and dividends on initial holding		27,609	17,030	61.7

(All figures from statutory accounts.)

Notes:

1. Includes Lloyds' capitalisation issue on 11 May 2009 (177 million shares).
2. Investment adjusted to include accrued dividends and redemption premiums of around £230m.
3. 2016 final ordinary dividend of 1.7p per share and 2016 special dividend of 0.5p per share announced with full year 2016 results but not paid until 16 May 2017. 2016 interim dividend of 0.85p per share was paid on 28 September 2016. 2015 final ordinary dividend of 1.5p per share and 2015 special dividend of 0.5p per share were paid on 17 May 2016. 2015 interim dividend of 0.75p per share was paid on 18 September 2015. 2014 dividend of 0.75p per share was paid on 19 May 2015.
4. Underwriting and commitment fees on transactions paid to HM Treasury, including in relation to the recapitalisation, preference share conversion and rights issue.
5. £2,500m paid by Lloyds for the implicit capital support provided by the APS in 2009.

Figure 3.1: Lloyds share price performance



BOX 3.1: DISPOSALS OF SHARES IN LLOYDS

On 17 December 2014 UKFI implemented a trading plan which was the third market operation employed by UKFI after two institutional accelerated bookbuilds in 2013 and 2014. The objective of the trading plan was to sell shares in a measured and orderly way over a defined period of time.

During the course of the 2015/16 financial year, UKFI extended the trading plan on two occasions. The first extension was announced on 1 June 2015 for expiry on 31 December 2015 and the second extension was announced on 4 December 2015 and expired on 30 June 2016.

From the period beginning 17 December 2014 until the expiration of the first trading plan on 30 June 2016, a total of 11.3bn shares were sold at an average price of 81.4p per share. Total proceeds were £9,174m. This reduced the Government's shareholding to 9.1 per cent as at 30 June 2016.

A new trading plan was announced on 7 October 2016 for a period of up to 12 months. From 7 October 2016 to 31 March 2017 a total of 5.1bn shares were sold at an average price of 64.4p per share. Total proceeds were £3,276m, taking the Government's stake to 2.0 per cent.

Subsequent to the year end, on 17 May 2017, the Government announced it had disposed of its final shareholding in Lloyds. Between 7 October and 17 May 2017 the trading plan sold 6,496m shares at a price of 65.0p per share and raised proceeds of £4,225m.

Across the Lloyds disposal programme a price of 76.8p per share sold was achieved. Total proceeds, including dividends received, were £21,207m.

Summary of disposals in Lloyds

Method of disposal	Date	Size of disposal		Price achieved per share	Total proceeds achieved	Residual Government shareholding
		Shares (m)	% total issued share capital	GBP	£m	%
Institutional Accelerated Bookbuild	September 2013	4,282	6.0%	75.0p	3,212	32.7%
Institutional Accelerated Bookbuild	March 2014	5,555	7.8%	75.5p	4,194	24.9%
Trading Plan 1	17 December 2014 to 30 June 2016	11,275	15.8%	81.4p	9,174	9.1%
Trading Plan 2	7 October 2016 to 31 March 2017	5,085	7.1%	64.4p	3,276	2.0%

ANNUAL REPORT AND ACCOUNTS
2016/17

04

UK Asset Resolution Ltd

Summary of Government shareholding

UKFI is responsible for managing the Government's 100 per cent shareholding in UKAR, and its subsidiaries, Bradford & Bingley plc and NRAM Ltd, on behalf of HM Treasury.

Company overview

On 1 October 2010 UKFI announced the establishment of UKAR as the single holding company to manage, on an integrated basis, the closed mortgage books of both NRAM and Bradford & Bingley. UKAR provides common governance, management and operations to both subsidiaries although both remain as separate legal entities with their own balance sheet and their own government support arrangements. The integration of the two companies, which was completed during the first half of 2012, created a larger entity, enjoying economies of scale, increased efficiency and shared capability in arrears management and treasury functions which is facilitating the accelerated repayment of government loans. Since UKAR was formed and allowing for the £11.4bn loan repayments made in April 2017, £35.1bn of Government loans have been repaid.

Following the split of Northern Rock on 1 January 2010, NRAM holds and services the closed mortgage book of the original Northern Rock. In November 2015 NRAM sold £13bn of assets to affiliates of Cerberus Capital Management LP (Cerberus) generating a premium of £280m over the book value of the assets at 30 June 2015. The cash proceeds from the sale were used to repay the outstanding Granite liabilities and the NRAM government loan. In May 2016 the Government received the final £520m from Cerberus as part of the sale completion process. As of 31 March 2017, total assets of NRAM were £9.8bn, of which £8.6bn were loans to customers.

Bradford & Bingley 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, including all of Bradford & Bingley's retail deposit accounts and its branch network, to Abbey National plc, part of the Santander Group. As of 31 March 2017, total assets of Bradford & Bingley were £24.6bn, of which £10.9bn were loans to customers and £11.4bn was the balance due from Blackstone and Prudential.

The March 2016 Budget announced that UKFI and UKAR would explore options for future sales to raise sufficient proceeds for Bradford & Bingley to repay its £15.7bn loan from the Financial Services Compensation Scheme (FSCS), and in turn, for the FSCS to repay its corresponding loan from HM Treasury. On 31 March 2017 it was announced that following an open and competitive sales process a portfolio of B&B performing buy-to-let loans were sold to Prudential plc and to funds managed by Blackstone. Final completion occurred in April 2017 taking total loan repayments to HM Treasury as a result of the transaction to £11.8bn including £11.0bn of the £15.7bn FSCS loan.

This sale brings the total UKAR balance sheet reduction to £92.9bn (80 per cent) since formation in 2010. UKAR expect to launch the next phase of the programme of sales later in 2017, with the aim of repaying the remainder of the FSCS loan in full before the end of 2017/18.

The continued focus of both the NRAM and Bradford & Bingley businesses is an orderly run-down of their closed mortgage books and the repayment of their Government loans. Neither of the companies

holds deposits or offers additional mortgage lending as EU State aid constraints prevent the companies from taking on new business.

In 2015/16, UKAR was appointed by HM Treasury to administrate the Help to Buy: ISA scheme on its behalf, in addition to the Help to Buy: mortgage guarantee scheme that UKAR undertook in 2013, UKAR continues to provide this ongoing service.

The year ending 31 March 2017 is the sixth year in which UKAR has produced consolidated results for the group. At 31 March 2017 UKAR owed HM Treasury £25.0bn and following the completion of the Bradford & Bingley asset disposal in April 2017 the amount owed to HM Treasury reduced to £13.6bn, an amount which the Company expects to repay in full.

Company performance

Table 4.1: UKAR key financials

	2016/17 £m	2015/16 £m	2014/15 £m
Underlying net operating income	800	1,151	1,408
Operating expenses	(162) ¹	(175) ²	(174) ³
Loan impairment credit/(loss)	68	78	151
Underlying profit/(loss) before tax	706	1,055	1,398
Statutory profit/(loss) for the year	347	1,176	972
Loans from HM Treasury (year-end)	25,031 ⁴	28,354	34,619
Shareholder funds (year-end)	8,093	7,890	7,053

(All figures from UKAR statutory accounts.)

Notes:

1. Excluding UKAR Corporate Services costs of £5.7m
2. Excluding UKAR Corporate Services costs of £5.4m
3. Excluding UKAR Corporate Services costs of £3.0m
4. Loans from HM Treasury at 31 March 2017 comprise: £4.6bn HM Treasury Loan to NRAM, £18.4bn B&B Statutory Debt to HM Treasury (of which £15.7bn is owed to the Financial Services Compensation Scheme) and £2.0bn HM Treasury Working Capital Facility to B&B. Shortly after the year end the B&B asset disposal completed in April 2017 and resulted in total loan repayments of £11.4bn to HM Treasury. Total loans from HM Treasury pro form for completion of the B&B disposal reduced to £13.6bn reflecting an £11bn repayment to the Financial Services Compensation Scheme and £0.4bn repayment to the Working Capital Facility.

Underlying profit for the year to 31 March 2017 decreased by £349.4m to £706.0m reflecting reduced net interest income due to the shrinking balance sheet. Ongoing administrative expenses, excluding £5.7m UKAR Corporate Services costs, were £13.2m lower than the previous year at £161.8m. Impairment on loans to customers for the year were a credit of £67.9m, a reduction of £9.7m from the prior year. Statutory profit before tax of £346.9m (March 2016: £1,175.8m) includes a £332.4m net loss on the sale of assets and an additional £64.4m provision for customer redress, partly offset by £50.0m received from an insurance claim.

The balance sheet reduced by £9.0bn to £34.3bn as at 31 March 2017 with a further reduction to £22.9bn in April 2017 following the completion of the Bradford & Bingley asset sale. Lending balances had reduced by £16.0bn (45.2 per cent) to £19.5bn over the year due to £12.3bn of asset sales, £3.3bn of secured residential redemptions, £0.2bn of commercial redemptions and £0.2bn of other regular repayments. At 31 March 2017 the balance sheet also included a £11.4bn balance due from Prudential and funds managed by Blackstone following the sale of assets. This was settled in April 2017 and the proceeds used to repay Government loans.

The number of mortgage accounts under management in arrears by three months or more reduced from 6,377 at 31 March 2016 to 4,617 at March 2017. The reduction was driven by asset sales (319) and strong underlying performance (1,441).

THE UKFI BOARD



James Leigh-Pemberton – Chairman and Accounting Officer

James joined UK Financial Investments in October 2013 as Chief Executive and in January 2014 James was appointed Executive Chairman. On 1 April 2016 James became Non-Executive Chairman of UKFI.

Before joining UKFI, James was Managing Director and Chief Executive Officer of Credit Suisse in the UK, based in London. In this role, he was responsible for developing the Bank's client relationships in Private Banking, Investment Banking and Asset Management in the UK. He was also a member of the Credit Suisse Europe, Middle East & Africa (EMEA) Operating Committee. James held several senior roles within Credit Suisse's Investment Banking Department, including Head of European Investment Banking Department, Head of European Equity Capital Markets and Chairman of UK Investment Banking. He joined Credit Suisse First Boston (CSFB) in 1994. Prior to joining CSFB, he was a Director of S.G. Warburg Securities, where he worked for 15 years.

James received his M.A. from Oxford University.



Oliver Holbourn – Chief Executive Officer

Oliver Holbourn was appointed to the role of Chief Executive of UK Financial Investments on 1 April 2016. Oliver joined UKFI in 2013 as Head of Capital Markets and was subsequently made Head of Market Investments in 2014.

Before joining UKFI Oliver worked at Bank of America Merrill Lynch for 13 years, where he undertook various roles including head of equity syndicate for Europe and head of UK equity capital markets origination.

Oliver holds a law degree from Oxford University.



Marshall Bailey – Non-Executive Director

Marshall has extensive capital markets and financial institutions experience gained over 25 years in Canada, Japan, Switzerland and the United Kingdom. He led the RBC Capital Markets global coverage of central banking clients, and was Managing Director and Head of Global Financial Institutions for EMEA and Asia prior to moving to State Street Bank and Trust, where he was COO, Chairman of State Street Global Markets International and CEO of the London Branch of State Street Bank Europe Ltd. As Global President of ACI Financial Markets Association, Marshall led the initiative for education and endorsement of ethical conduct in wholesale financial markets, which continues today.

Marshall is the non-executive Chairman at CIBC Capital Markets plc in London, and non-executive Chairman of the Risk Committee and board member at Chubb European Group. Marshall is a Chartered Financial Analyst

Marshall holds a Masters' Degree from the Graduate Institute of International Studies, Geneva.



Kirstin Baker – Non-Executive Director

Kirstin was HM Treasury's Finance and Commercial Director from January 2013 to March 2016. In this role she oversaw the Treasury's finances and Corporate Services and was a member of the Treasury Board.

Kirstin previously worked as a Senior Policy official in HM Treasury, heading the team responsible for coordinating public spending and managing many of the Treasury's interventions in individual banks in the wake of the 2008 crisis. Kirstin's earlier career was in European Policy and she worked as a Competition Official in the European Commission and in Policy Advisor roles in the Cabinet Office and the Foreign and Commonwealth Office. More recently, Kirstin was seconded to the Scottish Government, leading work on infrastructure investment.

Kirstin is a member of the Chartered Institute of Management Accountants. She was awarded a CBE in 2011 for her work during the financial crisis.



Jitesh Gadhia – Non-Executive Director

Jitesh Gadhia has over 25 years' investment banking experience, having held senior positions at Blackstone, Barclays Capital, ABN AMRO and Baring Brothers. He has advised on a wide range of high profile M&A and capital raising transactions across developed and emerging markets.

Jitesh is also a Board Member of UK Government Investments and BGL Group, which owns comparethemarket.com, the UK's largest financial price comparison website.

Jitesh graduated from Cambridge University with a degree in Economics and attended the London Business School as a Sloan Fellow. He has served as a Trustee of Guy's and St Thomas' Charity and of Nesta. He was selected as a Young Global Leader by the World Economic Forum. Jitesh has been a Member of House of Lords since September 2016.



Jane Guyett – Non-Executive Director

Jane is the Chair of Connect Plus (M25) Ltd, a director of DalCor Pharma (UK) Ltd and a non-executive director on the Boards of Kerry London Ltd, Trade Direct Insurance Services Ltd and UK Government Investments Ltd.

Jane spent 15 years with Bank of America Merrill Lynch where she held various roles in London and New York. She was Chief Operating Officer (EME and Asia) of the Global Markets Group and sat on the Board of Bank of America Securities. She began her career in Corporate Restructuring at Mitsubishi Bank Ltd London, before joining Bank of America in 1994.

Jane holds a degree in Economics.



Philip Remnant – Senior Non-Executive Director

Philip is the senior independent director of Prudential plc and Chairman of its subsidiary, M&G Group Limited. In addition Philip is Chairman of City of London Investment Trust plc, non-executive director of Severn Trent plc and a Deputy Chairman of The Takeover Panel.

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.

Philip was appointed a CBE in 2011.



Lucinda Riches – Non-Executive Director

Lucinda is a non-executive director of Ashted Group plc, CRH plc, the Diverse Income Trust plc, the British Standards Institution and ICG Enterprise Trust plc. She is also a Trustee of Sue Ryder.

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.

ANNUAL REPORT AND ACCOUNTS 2016/17

05

Directors' Report and Governance Statement

UKFI Board

The UKFI Board takes all major strategic decisions for the Company. The principal activity of the Company is to manage the Government’s investments in financial institutions commercially to protect and create 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, paying due regard to the maintenance of financial stability and acting in a way that promotes competition. The company has a Framework Document and Investment Mandate with HM Treasury appropriate for an arm’s-length body. These set out the key parameters for how UKFI will conduct its business, including a clear mandate to manage the investments commercially. The Framework document was last updated in May 2016.

The directors are listed below with the dates of their original appointment. They 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	Current position	Committee membership
James Leigh-Pemberton (31/10/2013)	Chairman and Accounting Officer	R
Oliver Holbourn (01/04/2016)	Chief Executive Officer	
Kirstin Baker (31/01/2013)	Treasury-Appointed Non-Executive	A (Chair)
Marshall Bailey (13/07/2014)	Independent Non-Executive	R
Jitesh Gadhia (13/07/2014)	Independent Non-Executive	R
Jane Guyett (13/07/2014)	Independent Non-Executive	A
Philip Remnant (11/03/2009)	Senior Independent Non-Executive	A
Lucinda Riches (15/01/2009)	Independent Non-Executive	R (Chair), A

Key: R = Remuneration Committee; A = Audit and Risk Committee.

On 1 April 2016 Oliver Holbourn, formerly UKFI’s Head of Market Investments, was promoted to Chief Executive Officer and was appointed to the UKFI Board. On this date James Leigh-Pemberton became Non-Executive Chairman of the Board whilst retaining his responsibilities as Accounting Officer for UKFI.

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.

The Board meets a minimum of nine times a year and on an ad-hoc basis as required. The Board met 15 times in person during this reporting period; additional discussions were held as required by telephone during the year.

The Board has oversight of the Company’s activities, and this close scrutiny ensures independent checks on all aspects of the Company’s activities. All committees are chaired by non-executive directors and the Chief Executive is not a member of any committees.

The Chairman considers the effectiveness of the Board on a regular basis, and also reviews compliance with the Corporate Governance Code. UKFI has complied with all relevant provisions of the Code except for not having a Nominations Committee. The Nominations Committee was formally disbanded in September 2014 following the requirement for UKFI to follow OCPA guidance and processes when recruiting Board members. This requirement superseded the role of the Nominations Committee. In order to ensure adequate oversight of succession planning, the Board as a whole approves the appointment of new directors.

Following the formation of UK Government Investments Limited (UKGI), and in light of UKFI's expected integration into UKGI in 2017/18, the UKFI Board have elected not to undertake an external review of Board effectiveness this year and will not do so going forward. However, during the year the Board undertook an appraisal of the Chairman the recommendations of which have been implemented.

Board committees

The Board is supported by two sub-committees to provide effective oversight and leadership: the Audit and Risk Committee and the Remuneration 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 Kirstin Baker (Committee Chair), Jane Guyett, Philip Remnant and Lucinda Riches. The Chairman also attends meetings as an observer in his role as Accounting Officer for UKFI. 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 as set out in the Framework Agreement and to seek any information it requires from any employee. The Board ensures that employees cooperate 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 and agreement of the audit fee; reviewing Financial Statements before submission to the Board; reviewing and considering reports from the auditors and the audit management letter and management response; and reviewing the operation and effectiveness of the Company's internal control systems with support of the Government Internal Audit Agency.

Remuneration Committee

The Remuneration Committee has met three 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 6).

Meetings

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

Total number of meetings held in 2016/17	Board	Audit and Risk	Remuneration
	15	3	3
Board Attendance at meetings held in 2016/17			
Kirstin Baker (A)	14	3	–
Marshall Bailey (R)	15	–	3
Jitesh Gadhia (R)	15	–	3
Jane Guyett (A)	14	3	–
James Leigh-Pemberton (R)	15	–	3
Oliver Holbourn	15	–	–
Philip Remnant (A)	13	3	–
Lucinda Riches (A, R)	15	3	3

The Board has responsibility for maintaining a sound system of governance and 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.

Sustainability

UKFI is committed to its contribution to sustainable development. UKFI is based on the Government estate in the HM Revenue and Customs building (HMRC). 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 government negotiated contracts which include 10 per cent renewable energy. We share HMRC's Facilities Management and Mail Service contractors and both contractors hold their own ISO 14001 accreditation.

Transparency

UKFI adheres to the Government's transparency agenda and publishes a range of data, either on our own website or on data.gov.uk, including:

- Directors' hospitality and expenses;
- Transactions over £25,000;
- Corporate credit card transactions over £500; and
- Awarded contracts.

Payment of suppliers

In May 2010, the Government introduced a five day target for SME suppliers to receive payment. This accelerated payment from the previous ten day target set in November 2008. During the year UKFI made 95 per cent (2015/16: 97 per cent) of all supplier payments within five days.

Internal controls

The Audit Committee has decided that it is not economically viable to have an internal audit function operating within UKFI and as such utilises the services of the Government Internal Audit Agency (GIAA) to provide assurance that internal financial and operational controls and processes are strong.

As Accounting Officer, the Chairman has responsibility for maintaining and reviewing the effectiveness of the system of internal controls, including having a quality assurance framework in place that is used for all business critical analytical models. He has confirmed that there were no significant control issues in the year under review and that UKFI has a quality assurance framework in place.

Going concern

As described in the UKFI remit section of these annual report and accounts UKFI was set up for a finite purpose, specifically: UKFI was created in November 2008 as part of the UK's response to the financial crisis with the overarching objective to manage the 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 ownership stakes in an orderly and active way over time. Further detail can be found in the company's Framework Document and Investment Mandate published on the company's website (www.ukfi.co.uk).

In view of the significant reduction in the size of the Government's financial sector assets under UKFI's stewardship, the Board of UKFI has concluded that the financial year ending 31 March 2018 will be UKFI's final year of operations. On this date the activities of UKFI will be transferred to its parent company, UKGI, which will assume responsibility for continuing UKFI's mandate. Prior to this date all UKFI liabilities will be settled and receivables recovered. Any remaining assets will transfer to HM Treasury. The financial statements have therefore been prepared on a basis other than going concern and all assets and liabilities have been classified as current. There have been no financial impairments to UKFI's assets as a result of this change in assessment.

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 that 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, in accordance with its Framework Document, 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. The remuneration paid to the auditors is disclosed in the Financial Statements. No non-audit work was undertaken by the auditors.

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 the applicable International Financial Reporting Standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on a 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 approved by the Board of Directors and is signed by the Chairman on behalf of the Board of Directors.

The Accounting Officer of HM Treasury has designated the Chairman as Accounting Officer of UKFI. 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 UKFI'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, unless it is inappropriate to presume that the company will continue in business.

The Accounting Officer confirms that the annual report and accounts as a whole are fair, balanced and understandable and takes personal responsibility for the annual report and accounts and the judgements required for determining that they are fair, balanced and understandable.



James Leigh-Pemberton
Chairman and Accounting Officer

5 July 2017

ANNUAL REPORT AND ACCOUNTS
2016/17

06


Directors' Remuneration Report

Remuneration Chair's foreword

UKFI is heavily dependent on its employees and its ability to attract high calibre staff to deliver its objectives. Continuing the substantial momentum from 2015/16, this has been one of the busiest years in the organisation's history. Despite a backdrop of considerable political and market uncertainty, throughout the year UKFI has succeeded in remaining flexible and responsive to the evolving environment and managed to deliver a number of significant achievements thanks to the strong efforts of its staff and leadership team.

These achievements have included both high profile successes, such as the further divestment of NRAM mortgage assets and the recommencement of the Lloyds trading plan, and less visible accomplishments, such as scaling up to support a planned Lloyds retail offer followed by the rapid but orderly return to core staffing levels once these plans were withdrawn. In addition UKFI has been willing and able to provide additional ad-hoc support and advice to HM Treasury whenever this has been called for. These achievements have been reflected in the bonuses awarded to staff in the year.

It is important for UKFI to operate a fair and transparent remuneration policy which motivates and retains high quality staff and rewards delivery of the company's key strategic objectives. This challenge will be all the greater as UKFI moves into its final year before being integrated into UKGI. Work is already underway at both a Board and executive level within both organisations to ensure that staff feel supported in the transition and are given clarity as to how they will fit in, develop and progress within UKGI. Notwithstanding this support it is appreciated that some staff will take this as an opportunity to seek challenges elsewhere and, where this is the case, every effort will be made to support these choices whilst ensuring that the operational effectiveness of UKFI is undiminished.



Lucinda Riches

Chair of the Remuneration Committee

5 July 2017

Remuneration Committee

The Remuneration Committee operates as a sub-committee of the UKFI Board. The membership of the Committee is required to comprise at least three independent non-executive members and excludes executive members. The Board is responsible for any new appointments to the Remuneration Committee. The current members of the Remuneration Committee are Lucinda Riches (Committee Chair), Jitesh Gadhia, Marshall Bailey and James Leigh-Pemberton. James Leigh-Pemberton joined the committee on 19 April 2016.

The Remuneration Committee meets a minimum of once a year and on an ad-hoc basis as required. The Remuneration Committee met three 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 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 and Executive Directors, if required;
- 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 Chief Executive or Chairman, or direct report to the Chief Executive or Chairman (and 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.

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 best practice, linked to performance, with no reward for failure or excessive risk taking; and
- are aligned with the objectives set out in the Framework Document and Investment Mandate.

UKFI operates a performance appraisal system and performance is reviewed semi-annually.

Performance-related pay is awarded based on the annual staff appraisal and takes the form of bonus payments for those staff who have performed well in their roles. Any UKFI performance-related pay is calculated as a fraction rather than multiple of salary. It is UKFI's policy that executive directors are entitled to be considered for variable pay each year on the basis of their performance.

The UKFI Chairman and non-executive directors are not eligible for UKFI's performance-related pay scheme.

Bonuses awarded

A total of £147,095 (2015/16: £123,358) was awarded as bonuses for the performance year 1 December 2015 to 30 November 2016, of which £75,051 (2015/16: £61,847) was paid out and £72,044 (2015/16: £61,511) was retained because UKFI bonuses are deferred over 3 years and subject to clawback over the period. The total award represents 7.6 (2015/16: 6.9) per cent of staff costs incurred over the year.

The appraisal year for UKFI runs from 1 December – 30 November. Any awards made for the period December 2016 to November 2017 will be determined by the Remuneration Committee in line with the annual performance timetable in January 2018. Bonus awards are recognised in the Financial Statements over the period to which they relate.

Directors' service contracts

UKFI's policy on duration of contracts is that directors' contracts continue for a period of 12 months to 3 years, 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.

At 31 March 2017 all directors' contracts were due to expire in 2017. The company expects to extend these contracts until 2018 and the expected integration of UKFI into UKGI. The notice period for the termination of all directors' contracts is three months.

The Company is not liable for any compensation, except in the case of outstanding fees. Non-executive directors do not receive any compensation, other than fees for their services.

Directors' remuneration policy

A summary of the remuneration policy for executive directors can be found in the table below:

Elements of remuneration	Purpose	Operation	Maximum potential value	Performance metrics
Base salary	To recruit and retain executive directors.	Paid monthly and reviewed annually.	Determined annually.	N/A
Pension	To support executive directors in long-term savings.	A defined contribution pension scheme is provided by Standard Life. Employee contributions are matched by UKFI between 3% and 15%.	Up to 15% of salary.	N/A
Bonus	Incentivise and reward good performance.	Bonuses are deferred over 3 years.	Up to 20% of salary.	Bonuses are awarded based on contribution of an individual to the furtherance of UKFI's objectives over the previous performance year.

Fees for non-executive directors

A summary of the remuneration policy for non-executive directors can be found in the table below:

Elements of remuneration	Purpose	Operation	Maximum potential value	Performance metrics
Fees	To recruit and retain non-executive directors with the appropriate skills and experience.	Paid monthly and reviewed annually.	Determined annually.	N/A

Directors' single total figure of remuneration

Executive directors

Oliver Holbourn was the sole executive director in place in the year. Details of his remuneration are set out below:

Director	Salary (£)		Bonus (£)		Pension (£)		Total (£)	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16
James Leigh-Pemberton ¹	–	180,000	–	–	–	–	–	180,000
Oliver Holbourn	175,000	–	35,000 ²	–	19,688	–	229,688	–

¹ James Leigh-Pemberton ceased to be an executive director on 31 March 2016 and his salary is now disclosed in the non-executive directors section.

² £35,000 represents the total bonus awarded in the 2016/17 year. This is paid in 3 equal instalments over 3 years according to the bonus scheme rules. This figure does not include the deferred elements of bonuses awarded in prior years which were paid in this period.

Non-executive directors

Each non-executive director is paid a fee of £28,500 for their attendance at the Board, plus £4,750 for each Board committee chairmanship held, plus £2,375 for each Board committee membership for which they are not Chairman. The Senior Independent Director is paid an additional fee of £4,750. The Board Chairman is paid a fee of £95,000 but is not entitled to the additional fees for committee memberships or chairmanships held.

The table below reports the salary for each non-executive director for the year ending 31 March 2017. The value of non-cash benefits is zero, and salary therefore includes only gross salary. Non-executive directors are not entitled to bonus or pension payments.

Director	Salary (£)	
	2016/17	2015/16
Kirstin Baker ¹	5,542	–
Marshall Bailey	30,875	30,875
Jitesh Gadhia	30,875	30,875
Jane Guyett	30,875	30,875
James Leigh-Pemberton ²	95,000	–
Philip Remnant	35,625	35,625
Lucinda Riches	35,625	35,625

¹ Until 31 January 2017 Kirstin Baker was a member of the Board as an employee of HM Treasury and did not receive remuneration for her services from UKFI. From 1 February 2017 Kirstin Baker has been paid a board fee by UKFI as per the fee structure outlined above.

² James Leigh-Pemberton was an executive director in 2015/16 and his comparative salary is disclosed in the previous section.

Directors' expenses

Expenses claimed by the Directors in the year are detailed below.

Director	Expenses (£)	
	2016/17	2015/16
Kirstin Baker	–	–
Marshall Bailey	–	–
Jitesh Gadhia	–	–
Jane Guyett	–	–
Oliver Holbourn	401	–
James Leigh-Pemberton	157	265
Philip Remnant	–	–
Lucinda Riches	–	–

Previous directors

During the year a payroll systems discrepancy was identified which had resulted in two previous executive directors of the company, Keith Morgan and James O'Neill, being granted more tax relief on their pension contributions than they were entitled to. The individuals were not aware of this at the time. If it is agreed with HMRC that the liability arising from this rests with UKFI, the result will be that the following additional pension contributions will have been made by the company in connection with their terms as directors. These amounts have been provided for within this year's financial statements.

Director	Pension (£)		
	2013/14	2012/13	2011/12
Keith Morgan ¹	–	–	1,250
James O'Neill ²	3,188	6,750	1,125

1. Director from 31 January 2012 to 24 July 2012.

2. Director from 31 January 2012 to 20 September 2013.

Staff profile

UKFI is a small organisation and as a result this report does not include detailed statistics on the UKFI workforce. 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. A summary of UKFI's staff numbers can be found in the table below.

	UKFI employees	UKFI non-executive directors
Full time equivalents as at 31st March 2017	11 (20)	2 (1) ¹
Average full time equivalents over 2016/17 period	14 (15)	2 (1) ¹
Average Headcount over 2016/17	14 (15)	7 (6)

Figures in brackets relate to 2015/16

1. Non-executive director roles are accounted for on a part time basis equivalent to 20% of a full time role with the exception of the Chairman who is accounted for on part time basis equivalent to 80% of a full time role.

During the year UKFI staff took an average of 2.1 (2015/16: 2.5) days of sickness absence.

The ratio between the highest paid director and the UKFI median pay of £37,110 is 5.7 (2015/16: ratio of 3.9 between the highest paid director and the median pay of £46,655). Total pay includes salary, bonuses and any benefits in kind but excludes employer pension contributions. The increase in the ratio is a result of the changes in UKFI's governance structure following the creation of the Chief Executive Officer role at director level. These changes resulted in an overall net reduction to UKFI's staff costs.

UKFI is not part of the civil service and its permanent 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. Where secondees are recruited they are done so on the terms and conditions of their home departments. It is important that the pay policy is flexible enough to respond to individual circumstances where necessary. Information on UKFI's total remuneration can be found in the UKFI Financial Statements in Chapter 8.

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.



Lucinda Riches

Chair of the Remuneration Committee

5 July 2017

ANNUAL REPORT AND ACCOUNTS
2016/17

07

Independent Auditor's Report
to the Shareholders of UK Financial
Investments Limited

Independent Auditor's Report to the Shareholders of UK Financial Investments Limited

I have audited the financial statements of UK Financial Investments Limited for the year ended 31 March 2017 which comprise the Income Statement, Statement of Financial Position, Statement of Cash Flows, Statement of Changes in Equity 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 the directors and the auditor

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 and express an opinion on 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 Practices 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 Strategic Report, Directors Report and Governance Statement and Remuneration Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements 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 2017 and of its results for the year then ended; and
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by European Union; and
- the financial statements have been prepared in accordance with the Companies Act 2006.

Emphasis of Matter

Without qualifying my opinion, I draw attention to the disclosures made in Note 2c of the financial statements. The directors have announced that the activities of UK Financial Investments Ltd will be transferred to its parent company, UK Government Investments Ltd on 31 March 2018. As a consequence the financial statements have been prepared on a basis other than going concern. Details of the impact of this on the financial statements are provided in Note 2c of the financial statements.

Opinion on regularity

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

Opinion on other matters

In my opinion:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and these reports have been prepared in accordance with the applicable legal requirements; and
- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors' Report.

Matters on which I 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 by UK Financial Investments Ltd, or returns adequate for my audit have not been received from branches not visited by my staff; 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 of the information and explanations I require for my audit.

Peter Morland

Senior Statutory Auditor

5 July 2017

For and on behalf of the

Comptroller and Auditor General (Statutory Auditor)

National Audit Office

157-197 Buckingham Palace Road

London SW1W 9SP

ANNUAL REPORT AND ACCOUNTS
2016/17

08

UK Financial Investments Ltd
Financial Statements

Income statement for the year ended 31 March 2017

	Note	2016/17 £000	2015/16 £000
Revenue	3(b), 4	4,687	8,526
		4,687	8,526
Expenses and fees incurred on asset disposals		(3,969)	(6,104)
Administrative expenses		(2,593)	(2,422)
		(6,562)	(8,526)
Loss before tax		(1,875)	–
Taxation	3(f), 6	(22)	–
Loss for the year after tax		(1,897)	–

The notes on pages 62 to 73 are an integral part of these financial statements.

The company had 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.

Statement of financial position as at 31 March 2017

	Note	31 Mar 17 £000	31 Mar 16 £000
Non-current assets			
Property, plant and equipment	9	–	25
Total non-current assets		–	25
Current assets			
Trade and other receivables	10	415	2,292
Cash and cash equivalents	11	2,685	4,235
Total current assets		3,100	6,527
Total assets		3,100	6,552
Equity			
General reserve	3(c)	2,424	–
Share capital	12	–	–
Total equity		2,424	–
Current liabilities			
Trade and other payables	13	545	6,489
Provisions	14	131	–
Total current liabilities		676	6,489
Non-current liabilities			
Trade and other payables	15	–	63
Total non-current liabilities		–	63
Total liabilities		676	6,552
Total equity and liabilities		3,100	6,552

The notes on pages 62 to 73 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 5 July 2017 and were signed on its behalf by:



James Leigh-Pemberton
Chairman and Accounting Officer

5 July 2017

Company Number 06720891

Statement of cash flows for the year ended 31 March 2017

	Note	31 Mar 17 £000	31 Mar 16 £000
Cash flows from operating activities			
Loss for the year before tax		(1,875)	–
Adjustments for:			
Depreciation	9	2	12
Loss on disposal of fixed assets	9	23	–
Corporation tax paid	6	(1)	–
Decrease/(increase) in trade and other receivables	10	1,877	(2,129)
(Decrease)/increase in trade and other payables	13, 15	(6,028)	5,622
Increase in provisions	14	131	–
Net cash inflow/(outflow) from operating activities		(5,871)	3,505
Cash flows from investing activities			
Acquisition of property, plant and equipment	9	–	(8)
Net cash outflow from investing activities		–	(8)
Cash flows from financing activities			
Grant-in-aid received from HM Treasury	3(c)	4,321	–
Net cash inflow from financing activities		4,321	–
Net increase/(decrease) in cash and cash equivalents		(1,550)	3,497
Cash and cash equivalents at 1 April	11	4,235	738
Cash and cash equivalents at 31 March	11	2,685	4,235

The notes on pages 62 to 73 are an integral part of these financial statements.

Statement of changes in equity for the year ended 31 March 2017

Mar 17	Note	Share capital £000	General reserve £000	Total equity £000
Balance at 1 April 2016		–	–	–
Loss for the year after tax		–	(1,897)	(1,897)
Total comprehensive loss for 2016/17		–	(1,897)	(1,897)
Grant-in-aid received from HM Treasury	3(c)	–	4,321	4,321
Balance as at 31 March 2017		–	2,424	2,424
Mar 16	Note	Share capital £000	General reserve £000	Total equity £000
Balance at 1 April 2015		–	–	–
Loss for the year after tax		–	–	–
Total comprehensive loss for 2015/16		–	–	–
Grant-in-aid received from HM Treasury	3(c)	–	–	–
Balance as at 31 March 2016		–	–	–

The notes on pages 62 to 73 are an integral part of these financial statements.

Notes to the financial statements

1. Reporting entity

UK Financial Investments Limited (UKFI) is a company incorporated and domiciled in the UK. UKFI is a wholly owned subsidiary of UK Government Investments Limited (UKGI) and its ultimate beneficial owner is HM Treasury. UKFI's registered office is at 27-28 Eastcastle Street, London W1W 8DH and it operates as an investment management business under the terms of the Companies Act 2006.

2. Basis of preparation

(a) Statement of compliance

These financial statements have been prepared in accordance with the Companies Act 2006 and International Financial Reporting Standards as adopted by the EU (IFRS). In addition these financial statements follow the requirements and principles of the Government Financial Reporting Manual (FReM) to the extent that they clarify or build on the requirements of IFRS and the Companies Act 2006.

These financial statements were authorised for issue by UKFI's Board of Directors on 5 July 2017.

(b) Basis of measurement

These accounts have been prepared on an accruals basis under the historic cost convention.

(c) Going concern

As more fully described in the Chairman's Foreword and Directors' Report, the Directors have determined that the financial year ending 31 March 2018 will be UKFI's final year of operations. On this date the activities of UKFI will be transferred to its parent company, UKGI, which will assume responsibility for continuing UKFI's mandate. Prior to this date all UKFI liabilities will be settled and receivables recovered. Any remaining assets will transfer to HM Treasury. The financial statements have therefore been prepared on a basis other than going concern and all assets and liabilities have been classified as current. There have been no financial impairments to UKFI's assets as a result of this change in assessment.

(d) Functional and presentation currency

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

(e) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRS 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. There were no such revisions to estimates or judgements in this period.

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 in sterling at the foreign exchange rate ruling at the date of the transaction. Any monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. There were no such monetary assets or liabilities denominated in foreign currencies in either the current or comparative periods.

(b) Revenue

Revenue, which excludes value added tax (VAT), comprises fees arising from investment management, prior to 1 July 2016, and reimbursement of fees relating to asset disposals. Revenues are recognised in the income statement as they are earned.

(c) Grant-in-aid

During the year UKFI's Framework Document was amended and its funding mechanism from HM Treasury was changed from a management fee to a grant-in-aid basis. This change took effect on 1 July 2016.

Grant-in-aid financing is provided by HM Treasury and is credited to the general reserve as it is received. This represents UKFI's cash requirement for the period and the cash and working capital balance carried over into the following year.

(d) Employee benefits

i) Defined contribution plans

UKFI operates two defined contribution post-employment benefit plans under which it pays fixed contributions to separate legal entities and has no legal or constructive obligation to pay further amounts. These schemes are available to all qualifying employees. Payments to this plan are recognised as an expense when employees have rendered service entitling them to the contributions.

ii) Short and long-term employee benefits

Short and long-term employee benefit obligations are measured on an undiscounted basis and are recognised as the related service is provided. A liability is recognised for benefits accrued by employees in respect of wages, salaries and annual leave for the amount expected to be paid out in exchange for that service. A liability is also recognised in respect of bonuses which have been awarded but deferred, these bonuses may be subject to claw-back.

(e) Leased assets

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

Notes to the financial statements (continued)

(f) Corporation tax

UKFI is registered for the purposes of corporation tax but has no intention of making a profit at any point. Consequentially no deferred tax asset has been recognised in respect of losses incurred to date.

(g) VAT

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

Following UKFI's switch to grant-in-aid funding on 1 July 2016 UKFI does not reclaim VAT on its administrative expenditure. Unrecoverable VAT is included in the income statement under administrative expenditure.

(h) 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, UKFI 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 UKFI 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 the income statement 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 the income statement 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 year end and adjusted if appropriate.

(i) Trade and other receivables

Trade receivables and other are recognised at cost.

Notes to the financial statements (continued)

(j) Cash and cash equivalents

Cash and cash equivalents comprise solely of cash balances.

(k) Trade and other payables

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 business requirements, are recognised when, and to the extent which, performance occurs.

All financial liabilities are recognised at cost. The carrying values of short-term liabilities (at amortised cost) are not considered different from fair value.

(l) Provisions

Provisions are recognised when there is; a present obligation (legal or constructive) as a result of a past event, it is probable that there will be requirement to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Provisions are measured on an undiscounted basis.

(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 2017, and have not been applied in preparing these financial statements. None of these are expected to have an effect on the UKFI's financial statements.

(n) Segmental reporting

UKFI has two reportable segments: administrative expenses and expenses incurred on asset disposals. Budget updates are provided to the chief operating decision maker, UKFI's Board. Certain fees incurred on asset disposals are recharged to Lloyds Banking Group, Royal Bank of Scotland Group and UKAR as detailed in note 20.

4. Income

	Mar 17 £000	Mar 16 £000
Investment management fees	718	2,422
Reimbursement of fees relating to asset disposals	3,969	6,104
Total	4,687	8,526

Notes to the financial statements (continued)

5. Profit before tax

Loss before tax is stated after charging:

	Mar 17 £000	Mar 16 £000
Auditors' remuneration: Audit of these Financial Statements	12	12

6. Taxation

Corporation tax recognised in the income statement represents:

	Mar 17 £000	Mar 16 £000
UK corporation tax	–	–
Prior year adjustments	22	–
Total	22	–

The corporation tax charge for the year is reconciled to the accounting loss as follows:

	Note	Mar 17 £000	Mar 16 £000
Loss before tax		(1,875)	–
Tax on profit at the standard rate of 20% (2016: 20%)		(375)	–
Effects of:			
non-deductible expenses		5	–
unrecognised deferred tax asset	3(f)	370	–
prior year adjustments		22	–
Corporation tax recognised in the income statement		22	–

Notes to the financial statements (continued)

7. Remuneration of Directors

	Mar 17 £000	Mar 16 £000
Directors' emoluments	564	385
Total	564	385

Directors' emoluments includes salary, associated employer's national insurance contributions and employer's pension contributions. Full details of the Directors' remuneration including remuneration policies are available within section 6 of this report.

8. Personnel expenses

The average number of full time equivalents working at UKFI during the period was 16 (2015/16: 16). This figure includes Directors and long-term inward secondees. The aggregate payroll costs of these people were as follows:

	Mar 17 £000	Mar 16 £000
Wages and salaries	1,485	1,477
Social Security contributions	178	185
Defined contribution plans	196 ¹	75
Contributions to other pension plans	85	62
Total	1,944	1,799

1. This figure includes £131,000 to provide for a potential settlement in relation to the over claiming of income tax relief on employees' pension contributions in prior years. See note 14.

Contributions to other pension plans comprises amounts recharged from HM Treasury, the Department for Energy and Climate Change, the Ministry of Justice and the Department for Work and Pensions. UKFI has no ongoing liability in respect of the underlying pension schemes.

Notes to the financial statements (continued)

9. Property, plant and equipment

Mar 17	IT £000	F&F £000	Total £000
Cost or valuation			
At 1 April 2016	41	6	47
Additions	–	–	–
Disposals	(41)	(6)	(47)
At 31 March 2017	–	–	–
Depreciation			
At 1 April 2016	(17)	(5)	(22)
Charged in year	(2)	–	(2)
Relating to disposals	19	5	24
At 31 March 2017	–	–	–
Carrying Value at 31 March 2017	–	–	–
Carrying Value at 31 March 2016	24	1	25
Mar 16			
Cost or valuation			
At 1 April 2015	33	6	39
Additions	8	–	8
Disposals	–	–	–
At 31 March 2016	41	6	47
Depreciation			
At 1 April 2015	(5)	(5)	(10)
Charged in year	(12)	–	(12)
Relating to disposals	–	–	–
At 31 March 2016	(17)	(5)	(22)
Carrying Value at 31 March 2016	24	1	25
Carrying Value at 31 March 2015	28	1	29

Notes to the financial statements (continued)

10. Trade receivables and other current assets

	Note	31 Mar 17 £000	31 Mar 16 £000
Trade receivables due from related parties	20	397	1,555
Prepayments		17	736
Other receivables		1	1
Total		415	2,292

11. Cash and cash equivalents

	31 Mar 17 £000	31 Mar 16 £000
Government Banking Service	2,685	4,235
Total	2,685	4,235

12. Called up share capital

	31 Mar 17	31 Mar 16
Authorised		
Equity: Ordinary shares of £1 each	100	100
Allotted, called up and fully paid		
Equity: Ordinary shares of £1 each	1	1

13. Trade payables and other current liabilities

	Note	31 Mar 17 £000	31 Mar 16 £000
Trade and other payables due to related parties	20	87	5,700
Trade payables due to non-related parties		6	11
Other payables due to non-related parties		371	705
Taxation and social security		60	73
Corporation tax		21	–
Total		545	6,489

Notes to the financial statements (continued)

14. Provisions

	Taxation and social security £000	Total £000
At 1 April 2016	–	–
Additional provisions	131	131
Amount utilised	–	–
Amount reversed	–	–
At 31 March 2017	131	131

A provision has been recognised in respect of a tax liability identified as due to HM Revenue and Customs (HMRC). This issue arose as a result of an inconsistent tax treatment being applied between UKFI's pension provider and payroll provider and resulted in UKFI's employees receiving more tax relief than they were entitled to. The company is in discussions with HMRC as to the size and nature of this liability and the provision recognised represents management's best estimate of the liability in consideration of these uncertainties. The liability is expected to be fully settled in financial year 2017/18.

15. Non-current liabilities

	31 Mar 17 £000	31 Mar 16 £000
Other payables	–	55
Taxation and social security	–	8
Total	–	63

16. Operating leases

Total future minimum lease payments under operating leases are given below analysed according to the period in which they expire.

	31 Mar 17 £000	31 Mar 16 £000
Less than one year	123	120
Between two and five years	–	–
More than five years	–	–
Total	123	120

In the year £170,000 (2015/16: £180,000) was recognised as an operating lease expense. All operating lease expenses are in respect of UKFI's accommodation lease.

Notes to the financial statements (continued)

17. Dividends

UKFI has no intention of making a profit, and does not intend to declare a dividend at any point. No dividend was declared or paid during the year (2015/16: Nil).

18. Financial instruments

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

UKFI's financial assets are: trade receivables due from related parties and other trade receivables. All are classified as 'loans and receivables' and denominated in pounds sterling (note 10).

UKFI's financial liabilities are: trade and other payables due to related parties, other trade payables, non-trade payables, taxation and social security and other payables. All are classified as 'other financial liabilities' 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 15).

The carrying values of short-term financial assets and liabilities (at amortised cost) are not considered different from fair value.

(a) 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.

(b) 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 and UKAR is considered negligible; UKFI's operating costs are recovered from HM Treasury, which is financed by resources voted by Parliament and UKAR is part of the HMT Group. Surplus operating cash is only held within the Government Banking Service.

(c) Liquidity risk

Liquidity risk is the possibility that UKFI might not have funds available to meet its commitments to make payments; this is managed through prudent cash forecasting and is considered negligible as expenses are recouped through grant-in-aid. The mechanism is described in the UKFI Framework Document published on www.ukfi.co.uk.

Notes to the financial statements (continued)

19. Contingent liabilities

UKFI indemnifies 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.

20. Related parties

UKFI is a wholly owned subsidiary of UK Government Investments Limited which is registered in England and Wales and operates in the United Kingdom. UKFI's ultimate beneficial owner is HM Treasury which is also registered in England and Wales and operates in the United Kingdom

UK Asset Resolution Ltd is considered a related party as it is wholly owned by HM Treasury and Peter Norton, UKFI's Head of Banking and Capital Markets, is a non-executive director of B&B, NRAM and UKAR.

Although Lloyds Banking Group falls outside the resource accounting boundary for the HM Treasury Group, due to the ownership of share capital by HM Treasury in the Group and UKFI's objectives described in Chapters 1 and 3, they have been classified as a related party.

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

Trade receivables due from related parties

	31 Mar 17	31 Mar 16
	£000	£000
HM Treasury	–	–
Lloyds Banking Group	20	1,204
Royal Bank of Scotland Group	119	99
UK Asset Resolution Ltd	258	252
Total	397	1,555

Trade and other payables due to related parties

	31 Mar 17	31 Mar 16
	£000	£000
HM Treasury	87	5,137
Lloyds Banking Group	–	563
Total	87	5,700

Notes to the financial statements (continued)

Income received from related parties

	31 Mar 17 £000	31 Mar 16 £000
HM Treasury – provision of investment management services	718	2,422
HM Treasury – expenses for asset disposals	–	149
Lloyds Banking Group – expenses for asset disposals	3,142	4,616
Royal Bank of Scotland Group – expenses for asset disposals	1	139
UK Asset Resolution Ltd – expenses for asset disposals	826	1,200
Total	4,687	8,526

Expenditure due to related parties

	31 Mar 17 £000	31 Mar 16 £000
HM Treasury	504	377
Royal Bank of Scotland Group	1	–
Total	505	377

21. Events after the reporting period

Subsequent to the year end, following the final sale of shares through the trading plan, on 17 May 2017 the Government announced it is no longer a shareholder in Lloyds. This event has had no impact on these financial statements.

