UK Financial Investments Ltd

UK FINANCIAL INVESTMENTS LIMITED (UKFI)
ANNUAL REPORT AND ACCOUNTS 2013/14

UK FINANCIAL INVESTMENTS LTD ANNUAL REPORT AND ACCOUNTS 2013/14

Presented to the House of Commons pursuant to section 7 of the Government Resources and Accounts Act 2000.

Ordered by the House of Commons to be printed on 16 June 2014.

HC 161

Any enquiries regarding this document should be sent to us at enquiries@ukfi.co.uk.

This document is also available from our website at
https://www.gov.uk/government/publications

Print: ISBN 9781474105491

Web: ISBN 9781474105507

Printed in the UK by the Williams Lea Group
on behalf of the Controller of Her Majesty's Stationery Office

ID P002648572 06/14

Printed on paper containing 75% recycled fibre content minimum.

UKFI CONTACTS

This document can be found on our website at: www.ukfi.co.uk

General enquiries should be addressed to:
Enquiries
UK Financial Investments Limited
100 Parliament Street
London
SW1A 2BQ

Email: enquiries@ukfi.co.uk

Company number 6720891

CONTENTS

UKFI'S REMIT

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

UKFI is responsible for managing the Government's shareholdings in The Royal Bank of Scotland Group plc (RBS) and Lloyds Banking Group plc (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.

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.

EXECUTIVE CHAIRMAN'S FOREWORD

Since its inception in 2008, UKFI has played an important role managing the Government's interests in its investee companies: Lloyds, RBS and what is now UKAR. I was delighted to join UKFI during the year and I am very much looking forward to continuing the work undertaken by my predecessors, and cooperating closely with UKFI's Board and senior management team, the investee companies and HM Treasury, to ensure that UKFI's objectives are met.

2013 saw positive trends in the UK economy, with GDP growing around 2 per cent and positive revisions to the medium and longer-term outlook. The improving domestic backdrop together with more stable financial markets in Europe enabled the FTSE 100 to perform strongly over the course of 2013, rising 14 per cent, although there was a more uncertain market environment in the first quarter of 2014. Lloyds announced its first statutory profit before tax since 2010 in its 2013 full year results, and its share price continued to outperform its peers, appreciating 53 per cent over the course of the financial year. In that context, UKFI was able to take a significant step in the execution of its mandate by disposing of two tranches of shares, realising proceeds of £7.4bn and reducing the Government's stake in Lloyds to less than 25 per cent. UKFI will continue to assess all options for future sales in light of its overarching mandate to secure value for money for the taxpayer.

In November 2013, RBS announced a new strategic direction including the creation of RBS Capital Resolution (RCR) and the acceleration of the divestment of Citizens. At the same time, HM Treasury published a review into the case for a 'bad bank' which concluded that the establishment of RCR would help deliver against the Government's objectives to a much greater extent than an external bad bank. In addition, following a period of engagement between RBS and HM Treasury, it was announced in April 2014 that an agreement had been reached for RBS to provide for the future retirement of the Dividend Access Share (DAS). This represents another important step in the path to the bank's privatisation.

UKAR has continued to make progress in its objective of winding down the mortgage books of both NRAM and Bradford & Bingley. In the 15-month period ended 31 March 2014, UKAR reported an underlying profit of £1,523.2m, and total customer balances were reduced from £68.7bn to £61.2bn. Arrears levels continue to fall as a result of UKAR's proactive arrears management coupled with the continued low interest environment. UKAR sold an unsecured loan portfolio, realising proceeds of £400m in August 2013, and in this financial period has repaid over £5bn to the Government.

Last year also saw a number of changes in personnel at the banks and at UKFI.

In October 2013, Ross McEwan became Chief Executive Officer (CEO) of RBS. Ross has moved swiftly to redefine and enhance the business model and strategy of the bank.

On 3 April this year, Lord Norman Blackwell became Chairman of Lloyds, taking over from Sir Winfried Bischoff. In last year's Annual Report, my predecessor paid tribute to Sir Win's contribution to the strengthening of Lloyds and I would like to add my thanks to Sir Win for his important contribution since his appointment in 2009. I look forward to working with Lord Blackwell as he oversees the execution of Lloyds' business plan and the continuing focus on growing shareholder value.

Robin Budenberg retired as Chairman of UKFI at the end of 2013, having joined initially as Chief Executive in 2010. I would like to thank Robin for the skill and dedication with which he carried out his duties at UKFI. Robin made an enormous contribution to the achievement of UKFI's objectives and was highly respected by colleagues in the public and private sector alike. All of us at UKFI are grateful for his strong leadership during a difficult and demanding period. Jim O'Neil stood down from his role as Chief Executive of UKFI in September last year, having joined initially as Head of Market Investments in 2010. Jim's energy and experience made him an outstanding leader of the UKFI team and his skills were particularly valuable in the successful execution of the first disposal of Lloyds shares. I wish him well in his new role.

I would also like to take this opportunity to thank my Board colleagues for their hard work over the year. In my short time at UKFI, I have already benefitted significantly from their thoughtful and astute advice on the broad range of issues with which UKFI has to contend. In line with corporate governance best practice, we have started a process to recruit new non-executive directors to refresh the membership of the Board.

James Leigh-Pemberton
Executive Chairman

5 June 2014

ANNUAL REPORT AND ACCOUNTS
2013/14

01

Review of the past year and objectives for 2014/15

Introduction

This Chapter provides an overview of UKFI's activities including:

- a summary of how we have approached our role as an active and engaged shareholder over the past year, with the aim of building sustainable value for taxpayers;
- an update on our strategy for disposing of the shareholdings; and
- a description of UKFI's objectives for the year ahead.

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 three sub-committees, takes all major strategic decisions for the company. The directors provide the company with the appropriate experience and expertise to manage the Government's investments on a commercial basis.

Chapter 7 provides the independent auditor's report and UKFI's Financial Statements for 2013/14. UKFI has produced an unqualified set of accounts for the five years of its operation. Our direct administration expenditure for the year under review was £2.0m, of which staff costs were £1.3m.

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 boards and management teams 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 at Board meetings and has approval rights over UKAR's business plans;
- in contrast, the nature of UKFI's interaction with Lloyds and RBS is reflective of 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.

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. 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 other institutional investors, with whom UKFI holds regular meetings.

Engagement with UKAR

Christopher Fox, Head of Banking at UKFI, joined the Board of UKAR in September 2013. Keith Morgan, who left UKFI in July 2012, has remained on the UKAR Board as the other UKFI nominated non-executive director.

During the year, UKFI has engaged closely with UKAR on assessing a number of projects to progress its objectives of safely winding down its balance sheet, including UKAR's sale of its unsecured loan portfolio in August 2013 and actions to enhance the cost-effectiveness of its liabilities.

UKFI also continued to engage closely with UKAR's Board on the remediation of Consumer Credit Act regulated loans. This is to ensure that all actions taken are consistent with UKAR's Treating Customers Fairly obligations, whilst minimising costs to the taxpayer.

Engagement with RBS and Lloyds

Over the last year, the focus of our engagement with RBS has been on the new management's development of a revised strategy. In November RBS announced a new direction including the creation of an internal 'bad bank' (RCR) to manage the accelerated run-down of higher-risk capital-intensive assets, and the acceleration of the divestment of Citizens (the Group's US banking subsidiary). Alongside RBS's announcement on its new direction, the Government published its Review into the case for creating a taxpayer-funded external bad bank, which concluded that RBS's new direction would help deliver against the Government's objectives to a much greater extent than would be possible through establishing an external bad bank alone.

Full details of the revised strategy for the bank were then announced by RBS CEO Ross McEwan on 27 February. This revised strategy is focused on earning the trust and meeting the needs of customers. It involves a significant restructuring and simplification of the business, including a greater focus on operations in the UK. Throughout these developments and in keeping with our mandate, UKFI engaged with RBS in relation to the shareholder value impacts across a number of areas in relation to its revised strategy.

Lloyds is further advanced in its restructuring than RBS. Therefore, our focus has been predominantly on engaging management on the continuing progress of the bank's strategy and the prospects for a return to sustained profitability and the reinstatement of dividends.

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

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

There have been a number of changes to the boards and senior management teams of both banks. 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 seek to ensure that suitably qualified individuals are appointed. At RBS, Ross McEwan became the new CEO in October, and Ewen Stevenson was announced as the new Chief Financial Officer in April 2014. During the reporting year, RBS also appointed Robert Gillespie and Morten Friis as non-executive directors. At Lloyds, Lord Blackwell was appointed Chairman, with Sir Winfried Bischoff retiring in April. Juan Colombás was appointed executive director, and Dyfrig John was appointed as a non-executive director.

Remuneration

Remuneration in the banking sector remains a high-profile issue. UKFI's Framework Document states that we should not intervene in relation to individual remuneration decisions within Lloyds and RBS, except through our votes at the Annual General Meeting. As the largest shareholder in Lloyds and RBS, UKFI has worked closely with the boards to ensure that pay is aligned with the interests of shareholders and is appropriately focused on long-term performance. While both banks need to be sensitive to the wider economic and political 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 value for the taxpayer.

Following a process of thorough engagement with the Lloyds and RBS remuneration committees, UKFI concluded that both committees had exercised reasonable judgement in relation to their approach to total variable remuneration in 2013, both in relation to financial performance and the retention of key employees.

RBS announced a further reduction of its bonus pool awarded for 2013, in terms of both an overall reduction and a reduction per head. Lloyds' 2013 bonus pool increased by 8 per cent from the bonus pool awarded in 2012, which was against a backdrop of a significant improvement in statutory performance. Both bonus pools included downward adjustments to account for issues such as the continued cost of redress for sales of Payment Protection Insurance and other conduct issues. For the 2013 performance year, the RBS CEO, Ross McEwan, and RBS's most senior management agreed to waive their annual bonuses. At Lloyds, the Chief Executive, António Horta-Osório, was awarded an annual bonus subject to certain conditions including further disposal of the Government's shares in Lloyds or the price performance of those shares. Full details of these conditions can be found in the Lloyds Banking Group Annual Report for 2013.

Following European legislation, new rules relating to the ratio of fixed to variable pay came into force in January 2014, including the requirement for firms to seek shareholder approval to award variable pay in excess of 100 per cent of fixed remuneration for certain more senior employees, capped at 200 per cent. Lloyds published its intention to seek a maximum of 200 per cent of variable pay to fixed pay for certain staff members in its 2013 Annual Report and Accounts. RBS did not put a similar vote to shareholders in light of the Government's view that an increase to the bonus cap at RBS could not be justified at this time. RBS subsequently put forward a proposed pay policy that meets the requirements of a 1:1 bonus cap.

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

Following the re-classification of UKAR to central government by the Office of National Statistics, UKAR was consolidated with central government from an accounting and public finances perspective from 1 April 2013. As a result, it has been decided that their reporting year will coincide with the fiscal year. UKAR's annual report, published in June 2014, covered a 15-month period from 1 January 2013 to 31 March 2014 as part of the transition from the previous reporting period to the new one.

The 15-month period ended 31 March 2014 is the third full financial period for which UKAR produced consolidated results for the group. The combination of NRAM and Bradford & Bingley plc into UKAR has increased efficiency and shared capability in arrears management and treasury functions, which is expected to enhance the future repayment of government loans. We have continued to work closely with the company to develop a strategy to accelerate and enhance the value of the run-down of the balance sheets of the combined business.

At 31 March 2014, UKAR owed HM Treasury £38.3bn, an amount the company expects to repay in full. Total payments from UKAR to the taxpayer including repayments, interest, fees and corporation tax increased from £4bn in 2012 to £6.2bn in the 15-month period ending 31 March 2014.

In July 2013, UKAR sold a portfolio of unsecured personal loans for a sale price of £400m. All cash proceeds received from this sale were returned to the taxpayer. UKAR assessed market conditions and UKFI determined that we could achieve value for money for the taxpayer whilst enabling UKAR to increase its focus on its mortgage assets.

Lloyds and RBS disposals

Over the course of the year, UKFI executed the sale of two tranches of the Government's shares in Lloyds to institutional investors. The first sale took place in September 2013, and the second in March 2014. As a result of these two sales, the Government has sold a total of 9.84 billion shares at an average price of 75.3 pence per share, yielding £7.4bn in total proceeds. Overall this represents approximately 13.8 per cent of the issued share capital of Lloyds and 36 per cent of the original shareholding, reducing the Government's stake to less than 25 per cent of the company as at 31 March 2014.

On both occasions, the transactions were initiated following analysis conducted by UKFI and its advisors that covered a range of matters including Lloyds' share price performance and an assessment of fair value; wider market conditions (specifically equity market performance in the UK, Europe and the US); and investor sentiment, including whether institutions' risk appetite remained conducive to participating in a large accelerated share placing. On both occasions we concluded that the conditions were appropriate to enable us to achieve value for money for the taxpayer and to recommend launching a transaction to the Chancellor. HM Treasury estimates that the proceeds from both sales have reduced public sector net debt[1] by £1.374bn.

Further details about the sale of Lloyds' shares over the year and the Government's remaining holding in Lloyds are included in Chapter 3.

In December 2013 with the approval of the Prudential Regulation Authority, RBS announced that it had terminated the £8bn contingent capital facility with HM Treasury. In April 2014, the Government announced that it had reached an agreement with RBS, subject to the approval of RBS's independent shareholders, to retire the DAS in return for an initial dividend of £320m and a further dividend of at least £1.18bn (see Chapter 2 for details). The process of valuing and negotiating the sale of the DAS was led by HM Treasury, with UKFI providing technical expertise.

As set out by the CEO in February 2014, RBS is to embark upon a further period of restructuring, and so it is unlikely that there will be a near-term opportunity to launch a transaction to reduce the Government's shareholding and secure value for money. However, we remain prepared to execute a sale of RBS shares should an opportunity arise.

Notes

1. *Measure excluding the temporary effects of financial interventions.*

UKFI's 2014/15 objectives

The key objectives which UKFI has agreed with HM Treasury for the 2014/15 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, 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's wider policy interests in relation to the banking sector, in particular in relation to financial stability and competition.

ANNUAL REPORT AND ACCOUNTS
2013/14

02

The Royal Bank of Scotland Group plc

Summary of Government shareholding

As at the end of March 2014, the Government held a total of 4.0 billion ordinary shares in RBS, equivalent to 64 per cent of RBS's voting share capital. In addition, the Government held 51 billion B shares, which convert into ordinary shares in the ratio of 10:1 as a result of the share consolidation exercise in June 2012. In total, the Government's holding in RBS was equivalent to 80 per cent economic ownership. The 31 March 2014 share price of 311p implied a current market value of the Government's shareholding of £28.2bn.

Company overview

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

Company performance

The table below provides an overview of the key financial results for RBS from 2011 to 2013. Full details of the results, including for the first quarter of 2014, can be found on the company's website: www.investors.rbs.com/results_presentations.

Table 2.1: Key financial performance metrics

	2013	2012	2011
Risk measures (Group)			
Core tier 1 ratio[1]	10.9%	10.3%	9.7%
Fully loaded Basel III common equity tier 1 ratio	8.6%	7.7%	n/a
Loan to deposit ratio	94%	100%	108%
Short-term wholesale funding (<1 year)	£32bn	£42bn	£102bn
Liquidity portfolio[2]	£146bn	£147bn	£155bn
Basel III leverage ratio	3.5%	3.1%	n/a
Value drivers (Core Bank)			
Return on equity	4.6%	9.8%	10.5%
Cost to income ratio[3]	64%	59%	60%

(All figures from statutory accounts)

Notes

1. *Core tier 1 ratio ex-APS benefit.*
2. *Eligible assets held for contingent liquidity purposes including cash, Government-issued securities and other eligible securities with central banks.*
3. *Net of insurance claims.*

Commenting on the Group's performance in 2013, Ross McEwan, CEO, said:

> *'This bank has had an extraordinary five years. Cleaning up a £2.2 trillion balance sheet whilst addressing the many failings of the past has carried a very heavy cost, which shows in our results.*
>
> *Even by recent standards, 2013 was a difficult year. Regulatory fines, wide-ranging customer complaints, technology problems and public questioning of our integrity all weighed heavily, and bring into sharp focus the job we have at hand. For the full year, we reported a pre-tax loss of £8.2bn. The loss includes £3.8bn of legacy litigation, conduct and regulatory costs and £4.8bn of impairments and other losses relating to the establishment of RBS Capital Resolution (RCR).*
>
> *Looking at underlying performance, total income was down £2.3bn for the year, primarily reflecting lower revenues from the re-sized Markets business while costs were only down £0.5bn – pushing the cost:income ratio towards the worse end of our peer group at 67%.*
>
> *Returns varied across our businesses, but only UK Retail and Wealth delivered returns above the cost of equity. That said, the bank continued to make progress despite our financial performance.*
>
> *Our business milestones included completing the run-down of another £29bn of Non-Core assets ahead of plan and taking the total reduction since Non-Core was established to £230bn – setting up the RCR unit and reducing risk-weighted assets, and hence our risk profile, by £66bn, on a fully loaded Basel III basis.*
>
> *We also cancelled the £8bn Contingent Capital Facility with HM Treasury, reduced our stake in Direct Line Group to 28.5% – in line with our commitment to the EC – and we are in advanced discussions to restructure the Dividend Access share[1].*
>
> *It is clear that the underlying performance over the last year underlines the need for us to shift the emphasis from restoring the balance sheet to recharging our performance.'*

Notes

1. *This comment was made on 27 February 2014, which was before agreement to retire the DAS had been reached.*

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 £43,722m, equivalent to an average of 482p per share. Taking into account all fees received including the £2,500m APS exit fee the net cost is £41,222m, equivalent to an average of 455p per share.

Table 2.2: HM Treasury shareholdings in RBS

HM Treasury shareholdings in RBS		Shares[1]	Total investment	Investment per share	Value at 31 March[2]
		m	£m	p	£m
Initial recapitalisation	December 2008	2,285	14,969	655	7,108
Preference share conversion[3]	April 2009	1,679	5,058	318	5,222
APS B shares[4]	December 2009	5,100[5]	25,500	500	15,861
Total investment		**9,064[5]**	**45,527**	**502 (avg)**	**28,191**
Fees received[6]			(305)		
Total investment net of fees		**9,064**	**45,222**	**499 (avg)**	**-**
Initial DAS Retirement Dividend[7]			(320)		
Final DAS Retirement Dividend[8]			(1,180)		
Total investment net of fees and dividends		**9,064**	**43,722**	**482 (avg)**	**-**
APS exit fee[9]			(2,500)		
Total investment net of all fees and dividends received			**41,222**	**455 (avg)**	**-**

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. *Based on RBS share price of 311.0p as at 31 March 2014.*
3. *Total investment includes accrued dividends and redemption premiums received of around £270m.*
4. *Excludes value of the enhanced DAS, valued at £1.5bn as at 31 March 2014. See Box 2.1.*
5. *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 1 ordinary share.*
6. *Underwriting fees on transactions paid to HM Treasury, including the recapitalisation and preference share conversion. Excludes annual fees paid to HM Treasury in relation to the Asset Protection Scheme and contingent capital facility.*
7. *In April 2014, RBS and HM Treasury reached an agreement to provide for the future retirement of the DAS. Following approval of the agreement by the independent shareholders in RBS, RBS will make an initial DAS retirement payment to HM Treasury of £320m.*
8. *Following the initial DAS retirement payment, a further £1,180m will be payable to HM Treasury with the timing of the payment at the discretion of the Directors of RBS. Any unpaid portion of the DAS Retirement Dividend Amount will be subject to an increase of (a) 5 per cent per annum on any part that has not been paid before 1 January 2016 and (b) 10 per cent. per annum on any part of the balance that has not been paid before 1 January 2021.*
9. *In Q4 2012, RBS reached the full minimum payment of £2,500m for the implicit capital support provided by the APS since 2009.*

Figure 2.1: RBS's share price performance

BOX 2.1: B SHARES AND RETIREMENT OF THE DAS

In 2009, the Government subscribed to 51 billion B shares in RBS, together with one Dividend Access Share (DAS). The single DAS conferred the right to an enhanced dividend over and above the dividend entitlement of each ordinary and B share, providing the greater of 7 per cent of the B share nominal amount of £25.5bn, or 25 per cent of the ordinary share dividend multiplied by the number of B shares issued to HM Treasury.

In April 2014, RBS announced that it had reached an agreement with HM Treasury for the future retirement of the DAS, subject to approval by the independent shareholders of RBS at the RBS Annual General Meeting in June 2014. To retire the DAS, RBS will pay an initial DAS retirement payment of £320m following approval. A further £1.18bn shall be payable to HM Treasury in the form of one or more further DAS dividends, at the discretion of the directors as to timing, giving a total DAS retirement payment of £1.5bn. Any unpaid portion of the DAS Retirement Dividend Amount will be subject to an increase of (a) 5 per cent per annum on any part that has not been paid before 1 January 2016 and (b) 10 per cent per annum on any part of the balance that has not been paid before 1 January 2021. Once the DAS Retirement Dividend Amount has been paid in full, the DAS will lose its enhanced dividend rights and will become a single B share. The mechanism whereby the DAS preferential dividend rights fall away following a DAS Share Price Trigger will immediately be cancelled.

The DAS Retirement Agreement includes a provision removing the expectation (originally set out in the Acquisition and Contingent Capital Agreement in 2009) that RBS would repurchase B shares if 'prudent and practicable'. This repurchase expectation will be removed, providing greater capital flexibility. B shares continue to count towards the bank's common equity tier 1 capital and although they do not confer voting rights, they rank pari passu with ordinary shares. The market value of each B share is assumed to be equivalent to one tenth of the value of an ordinary share (reflecting the impact of the share consolidation).

The DAS was an important factor in the European Commission's assessment of the state aid RBS received and was part of the basis for its approval of that support in 2009. It was therefore necessary for the proposal for the eventual retirement of the DAS to be notified to the Commission by HM Treasury and this was done at the same time as the request for the extension of the deadline for the divestment of the Williams & Glyn business. The Commission concluded that the new arrangements for the eventual retirement of the DAS did not constitute new state aid and approved the changes to RBS's restructuring plan in its State Aid Amendment Decision of 9 April 2014.

Alongside the APS agreement the Government also provided an £8bn contingent capital facility, under which it would acquire further B shares in the event that RBS's core tier 1 ratio fell below 5 per cent. Following receipt of approval from the Prudential Regulation Authority, RBS announced on 16 December 2013 that it had terminated the contingent capital facility with HM Treasury, with the final annual fee of £320m no longer payable.

03

Lloyds Banking Group plc

Summary of Government shareholding

As at the end of March 2014, the Government held a total of 17.8 billion ordinary shares in Lloyds, equivalent to 24.9 per cent of the total issued share capital. The 31 March 2014 share price of 74.65p implied a market value of the Government's shareholding of £13,266m.

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 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.

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

Company performance

The table below provides an overview of the key financial results for Lloyds from 2011 to 2013. Full details of the results, including for the first quarter of 2014, can be found on the company's website at www.lloydsbankinggroup.com.

Table 3.1: Key financial performance metrics

	2013	2012	2011
Risk measures			
Core tier 1 ratio	14.0%	12.0%	10.8%
Pro forma fully loaded Basel III common equity tier 1 ratio	10.3%	8.1%	7.1%
Loan to deposit ratio	113%	121%	135%
Short-term wholesale funding (<1 year)	£44bn	£51bn	£113bn
Liquidity portfolio[1]	£195bn	£205bn	£202bn
Pro forma Basel III 2014 leverage ratio[2]	4.5%	n/a	n/a
Value drivers			
Return on equity	-2.0%	-3.3%	-6.7%
Cost: to income ratio	51%	55%	51%

(All figures from statutory accounts)

Notes

1. *Eligible assets held for contingent liquidity purposes including cash, Government-issued securities and other eligible securities with central banks.*
2. *Estimated in accordance with January 2014 revised Basel III leverage ratio framework.*

Commenting on the Group's performance over the course of 2013, António Horta-Osório, Chief Executive Officer, said:

'In 2013, we made substantial progress on our strategy to become the best bank for customers and to create a customer-focused, highly efficient, profitable and low-risk bank. We grew lending in our core business by 3 per cent to support our customers and help Britain prosper. We invested in our products and services for our customers, while further reducing costs and improving efficiency through our Simplification programme.

We significantly improved our financial performance, with Group underlying profit more than doubled to £6.2bn, and a statutory profit before tax of £415m. We substantially strengthened our balance sheet, despite a charge for legacy business provisions totalling £3.5bn, primarily relating to legacy Payment Protection Insurance business. We lowered risk by reducing non-core assets and our international presence, and by growing our customer deposits and reducing our reliance on funding from the wholesale markets. As a result, the UK Government began reducing its stake in the Group in September.'

Shareholding in Lloyds

The Government's investment in Lloyds 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 the fees received from Lloyds, including £2,500m in relation to the implicit capital support provided by the Asset Protection Scheme in 2009, the net cost is £17,433m, equivalent to 63.1p per ordinary share.

Table 3.2: HM Treasury shareholdings in Lloyds

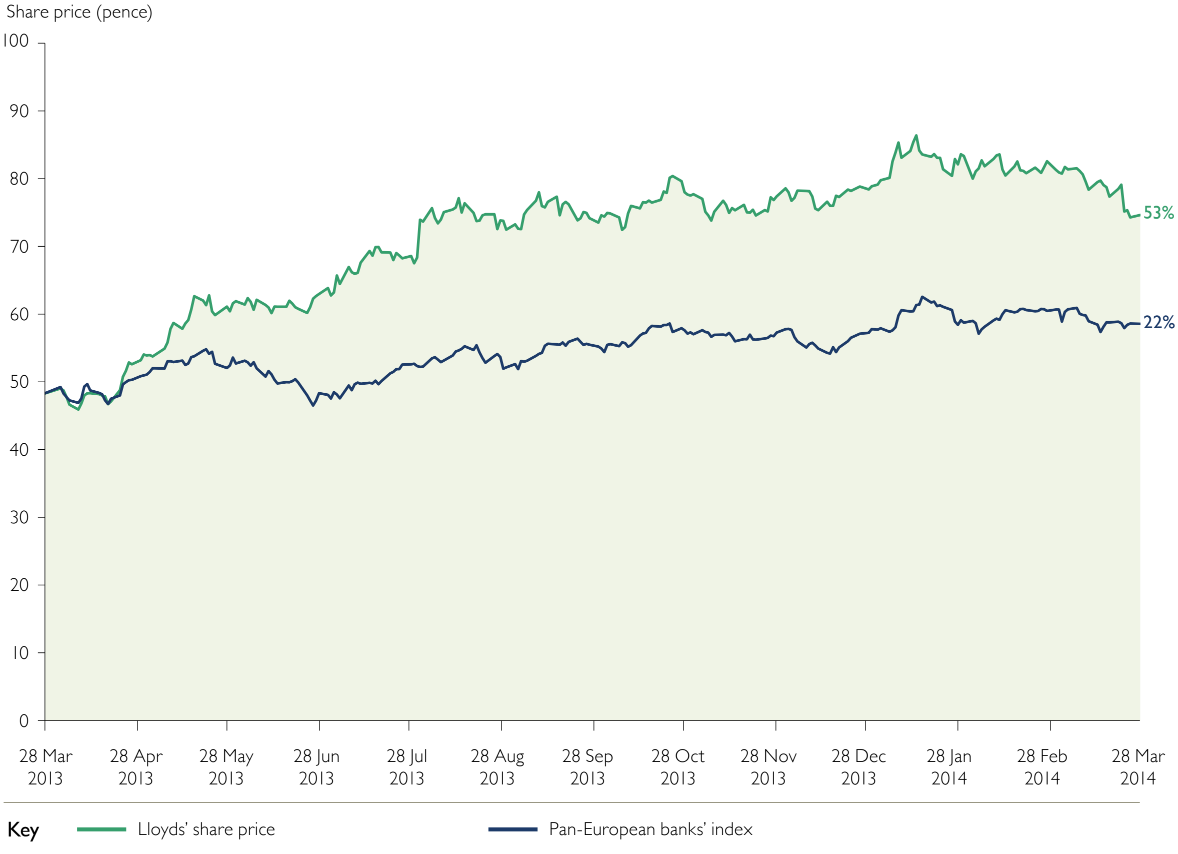
HM Treasury shareholdings in Lloyds Banking Group		Shares	Total investment	Investment per share
		m	£m	p
Initial recapitalisation[1]	January 2009	7,277	12,957	182.50
Preference share conversion[2]	June 2009	4,521	1,506	38.43
Rights issue	December 2009	15,810	5,850	37.0
Total investment		**27,609**	**20,313**	**73.6 (avg)**
Fees received[3]			(381)	
Total investment net of fees		**27,609**	**19,933**	**72.2 (avg)**
APS exit fee[4]			(2,500)	
Total investment net of all fees			**17,433**	**63.1 (avg)**
Total disposals to date (see Box 3.1 below)		(9,837)	(7,406)[5]	

(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. *Underwriting and commitment fees on transactions paid to HM Treasury, including in relation to the recapitalisation, preference share conversion and rights issue.*
4. *£2,500m paid by Lloyds for the implicit capital support provided by the APS in 2009.*
5. *Total proceeds raised to date.*

Figure 3.1: Lloyds' share price performance



BOX 3.1.: DISPOSALS OF SHARES IN LLOYDS

During the course of this financial year UKFI arranged and executed two sales on behalf of HM Treasury.

The first sale was completed in September and raised £3.2bn of proceeds with 4.28 billion shares sold at a price of 75 pence per share. This sale to institutional investors represented 6.0 per cent of the total issued share capital and just over 15 per cent of the taxpayers' shareholding in Lloyds at the time.

The sale reduced the Government's holding to just below 33 per cent of the issued share capital.

The National Audit Office judged that the Government's first sale of shares in Lloyds in September 2013 was managed effectively and provided value for money, in line with UKFI's stated mandate and core objectives.

Amyas Morse, Comptroller and Auditor General of the National Audit Office, commented on UKFI's first sale of shares:

'The programme of sales of the taxpayers' holdings of bank shares has got off to a good start. Sale options were reviewed thoroughly and UKFI looks to have got its timing right. The sale took place when the shares were trading close to a 12-month high and at the upper end of estimates for the fair value of the business. Furthermore, the share price in trading after the sale has remained steady.'

The full National Audit Office report on the first sale of shares in Lloyds can be found at: https://www.nao.org.uk/report/first-sale-of-shares-in-lloyds-banking-group/.

The second sale was completed in March 2014 and raised proceeds of £4.2bn with 5.55 billion shares sold at a price of 75.5 pence per share. This sale to institutional investors represented the largest accelerated placement in Europe and approximately 24 per cent of the taxpayers' residual shareholding in Lloyds.

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%	75p	3,212	32.7%
Institutional Accelerated Bookbuild	March 2014	5,555	7.78%	75.5p	4,194	24.9%

The Government's holding in Lloyds is now 24.9 per cent of total issued share capital. The share price of 74.65p as at 31 March 2014 implied a market value of £13,266 million for the Government's 17,771,118,604 shares.

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 plc, 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 Northern Rock (Asset Management) plc (NRAM) and Bradford & Bingley plc (B&B).

Following the split of Northern Rock on 1 January 2010, NRAM holds and services the closed mortgage book of the original Northern Rock. As of 31 March 2014, total assets of NRAM were £39.9bn, of which £31.0bn were loans and advances 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 to Abbey National plc, part of the Santander Group, including all of Bradford & Bingley's retail deposit accounts and its branch network. As of 31 March 2014, total assets of Bradford & Bingley were £35.2bn, of which £30.2bn were loans and advances to customers.

The ongoing focus of these businesses is an orderly run-down of their closed mortgage books and the repayment of Government funds. Neither of the companies holds deposits or offers additional mortgage lending.

UKAR provides common governance, management and operations to both subsidiaries although both remain as separate legal entities with their own balance sheet and 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 will enhance future repayment of Government loans.

In addition, on 8 October 2013, UKAR Corporate Services became responsible for the day-to-day administration of the Government's 'Help to Buy mortgage guarantee scheme' on behalf of HM Treasury.

The year ending 31 March 2014 is the third full financial year for UKAR in which it produced consolidated results for the group.

At 31 March 2014 UKAR owed HM Treasury £38.3bn, an amount which the company expects to repay in full.

Company performance

Table 4.1: UKAR key financials[1]

£m	2013/14[2]	2013/14[3]	2012/13[4]
Underlying net operating income	1,846.9	1,486.3	1,445.8
Operating expenses	(246.3)	(189.8)	(207.5)
Loan impairment (loss)	(95.1)	(46.6)	(200.2)
Underlying profit/(loss) before tax	1,523.2	1,259.1	1,073.6
Statutory profit/(loss) for the year	1,374.3	1,113.0	717.6
Loans from HM Treasury (year end)[5]	38,307.3	38,307.3	42,939.6
Shareholder funds (year end)	6,144.4	6,144.4	5,270.3

Notes

1. *UK Asset Resolution Ltd Annual Report & Accounts March 2014.*
2. *15-month period from 1 January 2013 to 31 March 2014.*
3. *12-month period from 1 April 2013 to 31 March 2014.*
4. *12-month period from 1 April 2012 to 31 March 2013.*
5. *Figures exclude accrued interest. Loans from HM Treasury at 31 March 2014 comprise: £14.9bn 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 £5.0bn HM Treasury Working Capital Facility to B&B.*

The underlying profit of the combined UKAR businesses increased from £1,073.6m in 2012/13 to £1,259.1m in 2013/14 (£1,523.2m 15-month figure). Total payments to the taxpayer including repayments, interest, fees and corporation tax increased from £4.0bn in 2012/13 to £5.6bn in 2013/14 (£6.2bn 15-month figure).

The number of customers in arrears by 3 months or more reduced from 25,581 at December 2012 to 15,483 at March 2014 as a direct consequence of proactive arrears management coupled with the continued benign interest environment in 2013/14. This contributed to the new provisions for loan impairment falling from £200.2m to £46.6m (£95.1m 15-month figure). UKAR reduced customer balances from £67.5bn at March 2013 to £61.2bn at March 2014 which enabled it to repay £4.6bn of Government loans (£5.1bn 15-month figure). Ongoing costs are being well controlled with operating expenses 9 per cent lower than 2012/13 at £189.8m (£246.3m 15-month figure).

In July 2013 UKAR published Deloitte's summary report into the issues found within a segment of NRAM Consumer Credit Act regulated loans. UKAR has fully accepted all of Deloitte's recommendations and has introduced plans to implement them.

In July 2013 UKAR also sold a portfolio of unsecured personal loans for a sale price of £400m. All cash proceeds received from this sale were returned to the taxpayer.

THE UKFI BOARD

James Leigh-Pemberton – Executive Chairman

James Leigh-Pemberton joined UKFI in October 2013 as Chief Executive. At the beginning of January 2014 James was appointed to the new role of Executive Chairman.

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 MA from Oxford University.

Peter Gibbs – Non-Executive Director

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

Peter retired from Merrill Lynch at the end of 2005. He currently serves as a Non-Executive Director of Resolution Limited, Aspect Capital Limited, Intermediate Capital Group plc and as Director of Bank of America Merrill Lynch (UK) Pension Plan Trustees Ltd.

Kirstin Baker – Non-Executive Director

Kirstin was appointed as HM Treasury's Finance and Commercial Director in January 2013. In this role she oversees HM Treasury's finances and corporate services and is a member of the HM 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 HM 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 appointed a Commander of the Order of the British Empire (CBE) in 2011 for her work during the financial crisis.

Michael Kirkwood – Non-Executive Director

Michael Kirkwood is an Economics and Industrial Engineering graduate of Stanford University and a Fellow of the Chartered Institute of Bankers. He joined the Board of Circle Holdings plc as Chairman in June 2012. He is additionally Senior Advisor (formerly Chairman) to Ondra Partners LLP and a Non-Executive Director of AngloGold Ashanti Limited and of Eros International plc.

Michael Kirkwood joined Citigroup in 1977 from where he retired as UK Head at the end of 2008. Prior to Citigroup, he spent a number of years in Asia with the Bowater-Ralli Group having started his career at HSBC. He was previously a Non-Executive Director of Kidde plc and Deputy Chairman of PricewaterhouseCoopers LLP's Advisory Board. He is a member of the Advisory Board of the Association of Corporate Treasurers and a Patron (former Chair) of poverty housing charity Habitat for Humanity.

During his City career he served as Deputy Chairman of the British Bankers Association, President of the Chartered Institute of Bankers, Chairman of the Association of Foreign Banks, Chairman of British American Business Inc. and as a member of the CBI's Financial Services Council. A former HM Lieutenant for the City of London in 2004, Michael was appointed a Companion of the Order of St. Michael & St. George (CMG) in 2003.

Philip Remnant – Non-Executive Director

Philip Remnant is the Senior Independent Director of the Prudential plc, 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.

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

Lucinda Riches – Non-Executive Director

Lucinda Riches is a Non-Executive Director of the Diverse Income Trust plc (appointed March 2011), a Non-Executive Director of the Graphite Enterprise Trust plc (appointed July 2011), a Non-Executive Director of the partnership board of King & Wood Mallesons LLP (formerly SJ Berwin LLP, since 2012), a Non-Executive Director of the British Standards Institution (appointed May 2012), having been an advisor to its Board since May 2011, and a Trustee of Sue Ryder (since 2008).

Lucinda was formerly an investment banker and has extensive experience in capital markets and privatisations. She began her career at Chase Manhattan Bank. Lucinda worked at UBS and its predecessor firms for 21 years until 2007. At UBS, she was 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.

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

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

Board membership	Current position	Committee membership
James Leigh-Pemberton (28/10/2013)	Executive Chairman	N (Chair), R
Kirstin Baker (31/01/2013)	Treasury-Appointed Non-Executive	A (Chair)
Peter Gibbs (18/01/2009)	Independent Non-Executive	N, R, A
Michael Kirkwood (18/01/2009)	Independent Non-Executive	N, R (Chair), A
Philip Remnant (11/03/2009)	Independent Non-Executive	N
Lucinda Riches (15/01/2009)	Independent Non-Executive	N, R, A

Former Board members		Committee membership
Robin Budenberg (01/01/2010 – 31/12/2013)	Chairman	N (Chair), R
Jim O'Neil (31/01/2012 – 20/09/2013)	Executive Director – Chief Executive	

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

During 2013/14 the membership of the Board changed with Jim O'Neil stepping down as an executive director and Robin Budenberg stepping down as a director. James Leigh-Pemberton became Executive Chairman on 1 January 2014.

During the year the terms of appointment for Peter Gibbs, Michael Kirkwood, Lucinda Riches and Philip Remnant expired, and these were all extended for a further six months.

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 22 times during this reporting period; some meetings were held as calls and were arranged at short notice.

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 having an Executive Chairman, which was agreed by the Board and HM Treasury to be appropriate given the size of the company, the nature of its business, and the level of Board oversight.

Board committees

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

Audit and Risk Committee

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

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

The Audit and Risk Committee is authorised by the Board to investigate any activity within its terms of reference as set out in the Framework Agreement and to seek any information it requires from any employee. The Board will ensure 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, the audit fee and any questions of dismissal of the auditors; 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.

Remuneration Committee

The Remuneration Committee has met four 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).

Nominations Committee

During the year UKFI went through an organisational restructuring. This included the replacement of the Chief Executive and Chairman with an Executive Chairman, so succession items were included for discussion by the main Board.

UKFI and its shareholders assessed that the role of Executive Chairman was most appropriate for the organisation as historically the Chief Executives and Chairmen worked in close partnership, dividing different aspects of the Company's operations between them. The division of responsibility, whilst ultimately lying with the Accounting Officer, is now delegated to members of senior management who attend the Board. The Board has a high degree of 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 with the exception of the Nominations Committee which is now under review.

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

The Nominations Committee worked to fulfil its responsibilities to adopt a formal, rigorous and transparent procedure for the appointment of new directors to the Board. It is responsible for considering and recommending to the Board and, through the Board, to HM Treasury where required by the

Framework Document, suitable candidates as directors. These directors need to have the time to commit to the Company and appropriate experience, qualifications, background and reputation, so that any such appointment will enhance the Board's ability to discharge its functions and responsibilities as set out in the Framework Document.

The Nominations Committee is not required to meet to approve the appointment to the Board of senior government officials nominated by HM Treasury.

Meetings

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

	Board	Audit	Remuneration	Nomination
Total number of meetings held in 2013/14[1]	22	2	4	0
Number of meetings attended in 2013/14				
James Leigh-Pemberton[2]	10	1	1	
Kirstin Baker	16	2		
Peter Gibbs	20	2	4	
Michael Kirkwood	20	1	4	
Philip Remnant	20			
Lucinda Riches	21	2	4	
Former directors				
Jim O'Neil[3]	9			
Robin Budenberg[4]	15	1	3	

Notes

1. *Due to the asset disposal programme, a number of Board meetings were scheduled at extremely short notice.*
2. *James Leigh-Pemberton was appointed to the Board on 31 October, having commenced employment on 28 October 2013.*
3. *Jim O'Neil stepped down as director on 20 September 2013.*
4. *Robin Budenberg stepped down as director on 31 December 2013.*

Risk and Internal Control Framework

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.

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.

As part of this, UKFI maintains a risk register to record the risks faced both by UKFI as an organisation and the risks posed by having shareholdings in the banking sector. This document is maintained by the Executive Chairman and 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 events were potential risk events during the year. UKFI identified these and took action to mitigate that risk.

1. The regulatory environment continued to evolve throughout the year, both domestically in the UK and also in Europe. In the UK, the Banking Reform Act was passed to implement ring-fencing and other domestic reforms. New European capital standards were implemented. UKFI has reviewed the proposed new regulatory rules, approaches and structures and has discussed with the investee companies how they might impact upon their operations.
2. Remuneration in the banking sector remains a high-profile issue, particularly in light of the continued costs of legacy issues, and the new European cap on variable pay. As in previous years, the UKFI banks continued to attract a high degree of attention and scrutiny. UKFI worked with the banks' remuneration committees on their approach to remuneration ensuring they pursue policies that promote long-term sustainable performance.
3. A number of banks in the UK and elsewhere faced additional costs from legacy regulatory issues throughout the year. This included increased costs of Payment Protection Insurance redress and Interest Rate Hedging Product misselling at both RBS and Lloyds. RBS is also subject to litigation in the US related to the sale of mortgage securities. There has been an increasing focus on the resilience of banks' operations and IT infrastructure, partly in response to some difficulties faced by RBS and Lloyds during the year and the ongoing separation of infrastructure required for the disposal of retail businesses. UKFI engaged closely with the management and boards of Lloyds and RBS to ensure that appropriate sanctions were applied to any culpable individuals where necessary and to ensure the development and maintenance of robust risk-management and controls systems to reduce the incidences of such failings in the future.
4. During the year UKFI undertook two share sales in Lloyds. Both of these sales were very large in nature compared to recent precedents and completed within a very short time frame. Placing shares on an accelerated basis is common-place in the UK and continental Europe. However, there are risks. Two key risks are that not enough demand will exist for the shares being offered or the price is unsatisfactory compared to an analysis of what the shares are worth on a fundamental basis or when compared to the relevant peer group. UKFI worked closely with both a strategic privatisation advisor and a capital markets advisor to ensure these risks were mitigated as far as possible.

5. UKFI has worked closely with UKAR in the past year to ensure that customers impacted by the Consumer Credit Act issue found within NRAM were fairly remediated whilst minimising any unnecessary cost to the taxpayer. UKFI will continue to work closely with UKAR to ensure that all customers impacted by these issues are treated fairly going forward.
6. UK economic data was encouraging during this financial year, but instability in global markets continues to provide challenges for the banks and for the ability of UKFI to fulfil its mandate. UKFI has engaged with management regularly to assess how they are adapting the performance of the business to the underlying economic situation.
7. During the year there were changes to the UKFI senior management, with the replacement of the Chief Executive and Chairman with an Executive Chairman and a new senior management team including the roles of Head of Banking, Head of Capital Markets and Chief of Staff.

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 expected to operate in discharging 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 financial year, none of which resulted in any leak of information.

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 the central Office for Government Commerce 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 10-day target set in November 2008. During 2013/14, UKFI made 95 per cent of all supplier payments within five days.

Review of effectiveness

The Audit Committee has decided that it is not economically viable to have an internal audit function operating within UKFI. HM Treasury has an Internal Audit department which can be used if the Audit Committee feels that there is a specific issue that should be investigated.

The review of the Compliance Procedures for UKFI was completed in 2013/14. The processes have now been agreed by the Audit Committee and the Board, and the procedures are now more formalised.

During the year the role of Accounting Officer was held by Jim O'Neil during his time as Chief Executive, by Robin Budenberg in the interim period between Jim's departure and James' arrival, and by James Leigh-Pemberton from 28 October 2013.

As Accounting Officer, the Executive Chairman has responsibility for maintaining and reviewing the effectiveness of the system of internal controls. He has confirmed that there were no significant control issues in the year under review.

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 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.

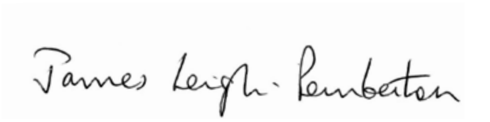
This report has been prepared in accordance with the special provisions of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 as set out in Statutory Instrument 2008/409.

This report has been approved by the Board of Directors and is signed by the Executive Chairman on behalf of the Board of Directors.

The Accounting Officer of HM Treasury has designated the Executive 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.



James Leigh-Pemberton
Executive Chairman

5 June 2014

06

Directors' Remuneration Report

Remuneration Chair's foreword

This year has seen a number of departures and new arrivals across UKFI. This includes the departure of the Chairman and Chief Executive, to be replaced by a newly created position of Executive Chairman. James Leigh-Pemberton joined on 28 October 2013 initially as Chief Executive, becoming Executive Chairman on 1 January 2014. There were also a number of appointments to the senior management team, including the Head of Banking, Head of Capital Markets and a Chief of Staff. The Remuneration Committee applied the standard treatment to those departing the organisation as has been outlined in previous years and which are outlined again in this report. New members of staff and directors were recruited in line with UKFI's stated policies. The Executive Chairman is not entitled to a bonus.

Full disclosure of decisions made on pay for both current and former directors is set out in this report.

The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 came into force on 1 October 2013. The aim of these regulations is, in part, to improve the transparency of how Directors' remuneration is reported and communicated. Whilst these regulations do not apply to UKFI, we wished to be as compliant as possible with the spirit of these regulations. The Directors' Remuneration Report has thus been re-structured in accordance with the regulations and where appropriate the specific requirements in terms of disclosure have been added. However, given the size of UKFI and the structure of our organisation, there are some aspects of the regulations where it would have been disproportionate for us to comply. We have therefore sought to comply with the relevant features of the regulations whilst keeping them proportionate to the size of the company and reflective of the fact that none of our current directors are paid any form of variable compensation.

Michael Kirkwood
Chair of the Remuneration Committee

5 June 2014

Remuneration Committee

The Remuneration Committee operates as a sub-committee of the UKFI Board. The membership of the Committee comprises the Chair of the Board and non-executive directors and shall consist of not less than three members. The Board is responsible for any new appointments to the Remuneration Committee. The current members of the Remuneration Committee are Michael Kirkwood (Committee Chair), James Leigh-Pemberton, Peter Gibbs and Lucinda Riches.

The Remuneration Committee meets a minimum of two times per year and on an ad-hoc basis as required. The Remuneration Committee met four 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;
  - the Chief Executive; and
  - any other Executive Director;
- review the executive recommendations on, and approve the remuneration of, any employee who is a member of the Executive Committee;
- monitor against the agreed Board policy:
  - the level and structure of total remuneration for senior management; and
  - the application of the policy across the whole organisation to ensure transparency, fairness and consistency;
- approve both the policy for and any compensation packages or arrangements following the severance of the employment contract applicable to the Chairman, the Chief Executive, any Executive Director or direct report to the Chief Executive (plus any other member of staff where the terms proposed are unusual or exceptional) with a view to ensuring that the individual is treated fairly, but that failure is not rewarded.

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, Business Plan and Investment Mandate.

UKFI operates a performance appraisal system and performance is reviewed semi-annually. Performance-related pay is awarded in relation to performance linked to 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 in general executive directors can be entitled to be considered for variable pay each year on the basis of their performance. However, at present the only executive director is the Executive Chairman who is not entitled to a bonus.

UKFI is a small organisation. At 31 March 2014, the number of full-time employees including the Executive Chairman was 15. The average over the 2013/14 period was 11 excluding non-executive directors, and 16 including non-executive directors. Therefore, it is important that the pay policy is flexible enough to respond to individual circumstances where necessary.

UKFI is not part of the civil service and the majority of posts are occupied by staff with directly relevant expertise from the private sector. UKFI recruitment procedures are based on the principles of fair and open competition and selection on merit.

Information on UKFI total remuneration can be found in the UKFI Financial Statements in Chapter 8.

Directors' remuneration policy

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

Element of Pay	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. Contributions made by employees are matched by UKFI between 3.5% 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.

Note:
** At present no executive directors are entitled to bonus payments as the only executive director is the Executive Chairman who is not entitled to a bonus or a pension.*

Fees for non-executive directors

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

Element of Pay	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

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.

Remuneration implementation

Staff profile

Due to the small number of staff in post throughout the year, 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.

During the year UKFI staff took an average of 10.7 (2012/13: 3.8) days of sickness absence. The rise in average sick leave was due to a long-term sickness absence.

Changes in year

Jim O'Neil left UKFI on 20 September 2013.

Robin Budenberg left UKFI on 31 December 2013.

James Leigh-Pemberton joined UKFI on 28 October 2013 initially as Chief Executive, becoming Executive Chairman on 1 January 2014.

Changes after the reporting period

At the time that this report was published, UKFI was in the process of a Board refresh exercise.

Bonuses awarded

A total of £90,514 was awarded as bonuses for the performance year 1 December 2012 – 30 November 2013, of which £27,000 was waived, £26,376 was paid out and £37,138 was retained because UKFI bonuses are deferred over 3 years and subject to clawback in line with current practice at major UK banks, including the investee banks. The total award not waived represents 4.8 per cent of staff costs incurred over the same period.

In the previous performance year (1 December 2011 – 30 November 2012) a total of £77, 923 was awarded, representing 5.4 per cent of staff costs for the same period, of which £31,487 was paid out and £46,436 retained. This year £47,779 was paid out relating to deferred bonuses which were awarded during previous years.

Directors' remuneration

Service contracts for 2013/14

In 2013/14 the non-executive director appointments were extended for a period of six months due to UKFI undertaking a Board refresh process. Although the Executive Chairman was only appointed for a period of 12 months, his appointment to the Board will last for the duration of his employment at the Company.

The service contracts for each of the current directors are set out below:

Director	Appointment Date	Expiry Date
James Leigh-Pemberton	31 October 2013	30 October 2014
Peter Gibbs	13 January 2014	12 July 2014
Michael Kirkwood	13 January 2014	12 July 2014
Lucinda Riches	13 January 2014	12 July 2014
Philip Remnant	12 March 2014	11 September 2014
Kirstin Baker	31 January 2014	30 July 2014

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.

Executive directors – single figure disclosure

The table below reports the total remuneration of executive directors which were in post for the period ending 31 March 2014.

Single total figure of remuneration for executive directors	Salary (£)		Bonus payments (£)		Pension (£)		Total (£)	
	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13	2013/14	2012/13
James Leigh-Pemberton (from 28 October 2013)	76,935 (Full-year equivalent: 180,000)	0	0	0	0	0	76,935	0
Jim O'Neil (until 20 September 2013)	85,000 (Full-year equivalent: 180,000)	180,000	0	0	12,750 (Full-year equivalent: 27,000)	27,000	97,750	207,000

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 table below reports the salary for each non-executive director for the period ending 31 March 2014 and has been audited by the Company's auditors. The value of non-cash benefits is zero, and salary therefore includes only gross salary.

Single total figure of remuneration for non-executive directors	Salary (£)	
	2013/14	2012/13
Robin Budenberg (until 31 December 2013)	56,250 (Full-year equivalent: 75,000)	75,000
Peter Gibbs	35,625	35,625
Michael Kirkwood	38,000	38,000
Lucinda Riches	35,625	35,625
Philip Remnant	30,875	30,875
Kirstin Baker (from 31 January 2013)*	0	0

Note:
** Kirstin Baker was a member of the Board as an employee of HM Treasury and did not receive remuneration for her services.*

The ratio between the highest paid director and the median pay of UKFI of £41,976 is 4.3 (2012/13: ratio of 4.9 between the highest paid director and the median pay of £46,300).

Directors' remuneration – performance-related pay

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

The appraisal year for UKFI runs from 1 December – 30 November. Any awards made for the period December 2013 – November 2014 ('2014') will be determined by the Remuneration Committee in line with the annual performance timetable in January 2015.

For the 2012/13 ('2013') appraisal year Jim O'Neil was awarded a bonus of £27,000 but made the decision to waive this performance-related pay.

Expenses

Director	Expenses (£) Year ended 31 Mar 2014	Expenses (£) Year ended 31 Mar 2013
James Leigh-Pemberton	70	0
Robin Budenberg	0	0
Peter Gibbs	0	0
Michael Kirkwood	0	0
Lucinda Riches	0	0
Philip Remnant	0	0
Kirstin Baker	0	0
Jim O'Neil	904	1,164

Directors' pension arrangements

None of the non-executive directors, Robin Budenberg or James Leigh-Pemberton received a pension from the Company.

Jim O'Neil participated in the UKFI Pension Scheme which is provided by Standard Life until he left. UKFI match individual contributions up to 15 per cent of salary.

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

Michael Kirkwood
Chair of the Remuneration Committee

5 June 2014

07

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 2014 which comprise the Income Statement, the Statement of Financial Position, the Statement of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards as adopted by the European Union.

Respective responsibilities of 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 Annual 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 2014 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.

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 prescribed by the Companies Act 2006

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

Matters on which I report by exception

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

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

Bryan Ingleby
Senior Statutory Auditor

6 June 2014

For and on behalf of the
Comptroller and Auditor General (Statutory Auditor)
National Audit Office
157–197 Buckingham Palace Road
London
SW1W 9SP

08

UKFI Financial Statements

Income statement for the year ended 31 March 2014

	Note	2013/14 £000	2012/13 £000
Revenue	4	2,757	2,199
		2,757	**2,199**
Expenses and fees incurred on the sale of Northern Rock plc		0	159
Expenses and fees incurred on asset disposals		733	0
UKFI administrative expenses		2,024	2,040
		2,757	**2,199**
Profit/(loss) before corporation tax	2–7	**0**	**0**
Taxation	3(f)	0	0
Profit/(loss) for the period		**0**	**0**

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.

The notes on pages 56 to 66 are an integral part of these Financial Statements.

Statement of financial position as at 31 March 2014

	Note	31 Mar 2014 £000	31 Mar 2013 £000
Non-current assets			
Property, plant and equipment	8	3	6
Intangible assets	9	0	0
Total non-current assets		**3**	**6**
Current assets			
Trade and other receivables	10	712	214
Cash and cash equivalents	11	226	131
Total current assets		**938**	**345**
Total assets		**941**	**351**
Equity			
Share capital	12	0	0
Retained earnings		0	0
Total equity		**0**	**0**
Liabilities			
Current liabilities			
Trade and other payables	13	894	299
Total current liabilities		**894**	**299**
Non-current liabilities			
Trade and other payables	14	47	52
Total non-current liabilities		**47**	**52**
Total liabilities		**941**	**351**
Total equity plus liabilities		**941**	**351**

These Financial Statements were approved by the Board of directors on 5 June 2014 and were signed on its behalf by:

James Leigh-Pemberton
Executive Chairman

UKFI Company Number 6720891

The notes on pages 56 to 66 are an integral part of these Financial Statements.

Statement of cash flows for the year ended 31 March 2014

	Note	31 Mar 2014 £000	31 Mar 2013 £000
Cash flows from operating activities			
Profit/(loss) for the period		0	0
Adjustments for:			
Depreciation	8	3	52
Amortisation	9	0	7
Loss/(gain) on disposal of assets		0	24
		3	**83**
Decrease/(increase) in trade and other receivables	10	(498)	140
(Decrease)/increase in trade and other payables	13	590	(384)
Net cash from operating activities		**95**	**(161)**
Cash flows from investing activities			
Acquisition of property, plant and equipment		0	0
Acquisition of intangible assets		0	0
Net cash used in investing activities		**0**	**0**
Net increase/(decrease) in cash and cash equivalents		95	(161)
Cash and cash equivalents at 1 April		131	292
Cash and cash equivalents at 31 March		**226**	**131**

The notes on pages 56 to 66 are an integral part of these Financial Statements.

Notes to the Financial Statements

1. Reporting entity

UK Financial Investments Limited (the 'Company') is a Company domiciled in the UK. The address of the Company's registered office is 27–28 Eastcastle Street, London W1W 8DH. The Company operates as an investment management business under the terms of the Companies Act 2006.

2. Basis of preparation

(a) Statement of compliance

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

These Financial Statements are prepared in accordance with the Government's Financial Reporting Manual (FReM) where this exceeds the requirements of the Companies Act 2006.

The Financial Statements were authorised for issue by the Board of Directors on 5 June 2014.

(b) Basis of measurement

The Financial Statements have been prepared on the historical cost basis.

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

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

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

(c) Functional and presentation currency

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

(d) Use of estimates and judgements

The preparation of the Financial Statements in conformity with 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.

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. Monetary assets and liabilities denominated in foreign currencies at the balance asset 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.

(b) Property, plant and equipment and intangible assets

(i) Recognition and measurement

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

(ii) Subsequent costs

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

(c) Leased assets

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

(d) Employee benefits

(i) Defined contribution plans

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

(ii) Short-term employee benefits

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

(e) Revenue

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

(f) Corporation tax

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

(g) VAT

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

(h) Trade receivables and trade payables

Trade receivables and other receivables, trade payables and other payables are all stated at cost.

(i) Cash and cash equivalents

Cash and cash equivalents are comprised solely of cash balances.

(j) Financial assets and financial liabilities

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

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

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

Notes to the Financial Statements (continued)

(k) 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 2014, and have not been applied in preparing these Financial Statements. None of these is expected to have an effect on the Financial Statements of the Company.

(l) Segmental reporting

UKFI has three reportable segments: the operation of UKFI, the sale of Northern Rock relating to 2012/13 and the disposal of HM Government's assets in 2013/14. The budget updates are provided to the Chief Operating Decision-Maker, which is UKFI's Board. Expenses and income associated with the Northern Rock sale and asset sales are disclosed in the income statement.

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

4. Income

	2013/14 £000	2012/13 £000
Investment management fees	2,024	2,040
Reimbursement of fees relating to the sale of Northern Rock plc	0	159
Reimbursement of fees relating to asset disposals	733	0
Total	**2,757**	**2,199**

5. Remuneration of directors

	2013/14 £000	2012/13 £000
Directors' emoluments	414	496
Total	**414**	**496**

The decrease in remuneration is due to the decrease in the number of executive directors on the Board.

6. Personnel expenses

The average number of people working at the Company during the period was 16 (2012/13: 16). This figure includes directors and long-term inward secondees.

The aggregate payroll costs of these people were as follows:

	2013/14 £000	2012/13 £000
Wages and salaries	1,101	1,033
Social security contributions	134	108
Defined contribution plans	50	67
Contributions to other pension plans	32	28
Agency staff	0	19
Total	**1,317**	**1,255**

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

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

A bonus amount of £90,514 was awarded, of which £27,000 was waived, in respect of the period 1 December 2012 to 30 November 2013. Bonuses awarded and not waived represent 4.8 per cent of staff costs incurred over the same period. In respect of the previous performance year, £47,779 was paid out this year in deferred bonuses.

7. Profit before tax

Profit before tax is stated after charging:

	2013/14 £000	2012/13 £000
Auditors' remuneration: audit of these Financial Statements	12	11

Notes to the Financial Statements (continued)

8. Property, plant and equipment

2013/14	IT £000	Furniture & fittings £000	Total £000
Cost or valuation			
At 1 April 2013	103	6	109
Additions	0	0	0
Disposals	0	0	0
At 31 March 2014	**103**	**6**	**109**
Depreciation			
At 1 April 2013	(100)	(3)	(103)
Charged in year	(2)	(1)	(3)
At 31 March 2014	**(102)**	**(4)**	**(106)**
Carrying value at 31 March 2014	**1**	**2**	**3**
Carrying value at 31 March 2013	3	3	6

2012/13	IT £000	Furniture & fittings £000	Total £000
Cost or valuation			
At 1 April 2012	103	125	228
Additions	0	0	0
Disposals	0	(119)	(119)
At 31 March 2013	**103**	**6**	**109**
Depreciation			
At 1 April 2012	(71)	(76)	(147)
Charged in year	(29)	(23)	(52)
Disposals	0	96	96
At 31 March 2013	**(100)**	**(3)**	**(103)**
Carrying value at 31 March 2013	**3**	**3**	**6**
Carrying value at 31 March 2012	32	49	81

9. Intangible assets

2013/14	Software £000	Total £000
Cost or valuation		
At 1 April 2013	0	0
Additions	0	0
At 31 March 2014	**0**	**0**
Amortisation		
At 1 April 2013	0	0
Charged in year	0	0
At 31 March 2014	**0**	**0**
Carrying value at 31 March 2014	**0**	**0**
Carrying value at 31 March 2013	0	0

2012/13	Software £000	Total £000
Cost or valuation		
At 1 April 2012	26	26
Additions	0	0
Disposals	(26)	(26)
At 31 March 2013	**0**	**0**
Amortisation		
At 1 April 2012	(18)	(18)
Charged in year	(7)	(7)
Disposals	25	25
At 31 March 2013	**0**	**0**
Carrying value at 31 March 2013	**0**	**0**
Carrying value at 31 March 2012	8	8

10. Trade receivables and other current assets

	31 Mar 2014 £000	31 Mar 2013 £000
Prepayments	20	22
Trade receivables due from related parties	692	192
Total	**712**	**214**

Notes to the Financial Statements (continued)

11. Cash and cash equivalents

	31 Mar 2014 £000	31 Mar 2013 £000
Government Banking Service, Commercial Banks	226	131
Cash in hand	0	0
Total	**226**	**131**

12. Called up share capital

	31 Mar 2014 £	31 Mar 2013 £
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

	31 Mar 2014 £000	31 Mar 2013 £000
Amounts falling due within one year		
Trade and other payables due to related parties	111	0
Other trade payables	6	9
Non-trade payables and accrued expenses	596	193
Taxation and social security	181	97
Total	**894**	**299**

14. Non-current liabilities

	31 Mar 2014 £000	31 Mar 2013 £000
Amounts falling due after more than one year		
Trade and other payables due to related parties	0	0
Non-trade payables and accrued expenses	41	46
Taxation and social security	6	6
Total	**47**	**52**

15. Operating leases

Operating lease rentals are payable as follows:

	31 Mar 2014 £000	31 Mar 2013 £000
Obligations under operating leases for the following periods comprise:		
Buildings		
Less than one year	195	141
Between two and five years	130	235
More than five years	0	0
Total	**325**	**376**

£156,000 was recognised as an operating lease expense during 2013/14.

16. Dividends

UKFI has no intention of making a profit at any point, and does not intend to declare a dividend at any point. No dividend was declared or paid during the period (2012/13: Nil).

17. Financial instruments

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

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

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

UKFI's financial liabilities are: trade and other payables due to related parties, other trade payables, non-trade payables and accrued expenses and taxation and social security. All are classified as '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 14).

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

Market risk

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

Credit risk

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

Liquidity risk

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

Notes to the Financial Statements (continued)

18. Contingent liabilities

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

In accordance with the Resale Rights Agreement with the Investee Banks, UKFI is accounting for and receiving cash payments for expenditure relating to asset disposal costs incurred as permitted under the agreement. In the event a disposal does not occur, UKFI may be liable to repay the Investee Bank for the expenditure incurred, which may be material.

19. Related parties

As at 31 March 2014, the Company is a wholly-owned subsidiary undertaking of Her Majesty's Treasury, which is registered in England and Wales and operates in the UK.

Christopher Fox, UKFI's Head of Banking, is a non-executive director of B&B, NRAM and UKAR.

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

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

	31 Mar 2014 £000	31 Mar 2013 £000
Trade receivables due from related parties		
HM Treasury	154	192
Lloyds	538	0
Total	**692**	**192**

	31 Mar 2014 £000	31 Mar 2013 £000
Trade and other payables due to related parties		
HM Treasury less than one year	111	5
HM Treasury more than one year	0	0
Total	**111**	**5**

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

	31 Mar 2014 £000	31 Mar 2013 £000
HM Treasury – provision of investment management services	2,024	2,040
HM Treasury – expenses and fees for the sale of Northern Rock plc	0	159
HM Treasury – expenses for asset disposals	195	0
Lloyds – expenses and fees for Lloyds disposals	538	0
Total	**2,757**	**2,199**

Design: www.bluegoose.co.uk

ISBN 978-1-4741-0549-1