UK Financial Investments Ltd

UK FINANCIAL INVESTMENTS LIMITED (UKFI)
ANNUAL REPORT AND ACCOUNTS 2009/10

UK FINANCIAL INVESTMENTS LTD ANNUAL REPORT AND ACCOUNTS 2009/10

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CHAIRMAN'S FOREWORD

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UKFI's primary mission is to manage the stakes in the UK banks that were acquired by HM Treasury during the 2007/9 financial crisis. In 2008 and 2009, during the dramatic deterioration of economic conditions, the focus of our operations was to assist in stabilising the financial system.

Over the past year we have seen some signs of improvement across the economy and in the financial sector. Whilst serious challenges remain, stability has increased, and activity has resumed in capital markets.

A good deal of regulatory change is now under way which we will follow with interest, in particular the findings of the Independent Commission on Banking.

In the year under review, we have advised the Government on alternatives to the Asset Protection Scheme and on further liability management. The potential scale of the Government's investments in Lloyds and RBS was reduced by over £12 billion as a result.

During the last financial year, UKFI took on management of the taxpayer's investment in Bradford & Bingley, Northern Rock (Asset Management) and Northern Rock plc, alongside stewardship of the Government's shareholding in Lloyds and RBS. We have worked with these Wholly-Owned companies on substantial restructuring to improve their efficiency and capability to enhance future repayment of Government loans.

We have also worked with all our companies in the active, engaged shareholder role which we were created to fulfil. Our interactions include work to help improve governance, and to help ensure the banks are devising and implementing strategies that build shareholder value for the taxpayer. We have emphasised the importance of a robust approach to risk, and we have agreed pay structures and levels which are fair and appropriate whilst allowing the companies to attract and retain staff of the calibre necessary to protect and build the value of the taxpayer's investment.

All our investee companies have started to benefit from the actions their management have taken: they are now well capitalised and have set out clear plans for recovery. Lloyds and RBS have announced that they expect their impairments levels to have peaked, and the Wholly-Owned companies (Northern Rock plc, Northern Rock (Asset Management) and Bradford & Bingley) have made good progress in cost control and arrears management.

The year under review has been extremely active for UKFI, assisting in the stabilisation of the financial system and the recovery of the banks for which we have responsibility. We will continue to focus on our vitally important stewardship role as an active and engaged shareholder as well as on the significant corporate restructuring of our Wholly-Owned companies. We will also be preparing for value realisation.

At the same time, we focus hard on our costs which will continue to be substantially below the levels published in our original Business Plan. In this regard, all members of the Board have volunteered to take a five percent reduction in remuneration in response to the Government's commitment to cutting the cost of the public sector.

Completing our task will not be quick or easy. It will require professionalism and patience. We do not underestimate the importance of our challenge and remain completely focused on delivering the objectives set out in this report.

I am grateful to Glen Moreno for acting as Chairman of UKFI for the period between Sir Philip Hampton's departure and my appointment of 1 August 2009. The UKFI Board and executive team valued, and were grateful for, the leadership, advice and support that he gave during this period.

At the end of last year John Kingman resigned as Chief Executive after a year when UKFI and its investee banks were rarely out of the headlines. He provided invaluable leadership during this period and built a small but capable team to manage UKFI and its considerable responsibilities. We are indebted to him for all he did and wish him well at Rothschilds. I was delighted to appoint Robin Budenberg to succeed John. His very positive impact on the business is already well established.

I am very grateful to all the team at UKFI and to my board colleagues for their efforts to create an organisation that could take on these heavy responsibilities as well as responding to the many pressures from all the stakeholders in our business. We are now located outside HM Treasury in our own office where the team has established a clear sense of purpose. I have been consistently pleased with their performance and the quality of the team's work.

David Cooksey
Chairman
13 July 2010

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01

Chief Executive's Review

UKFI's Remit

UK Financial Investments (UKFI) was created 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), together the "Market Investments". UKFI is also responsible for managing the Government's 100 percent shareholdings in Northern Rock plc, Northern Rock (Asset Management) plc (the original Northern Rock having split on 1 January 2010), and Bradford & Bingley plc, collectively the "Wholly-Owned companies".

Our overarching objective is to manage these shareholdings commercially to create and protect value for the taxpayer as shareholder and provider of financial support, with due regard to financial stability and competition, and to devise and execute a strategy for disposing of the Government's investments in an orderly and active way over time.

UKFI's ownership approach

UKFI's role is to be an active, engaged shareholder and provider of financial support, and to manage the Government's investments for value.

For RBS and Lloyds, our approach respects the interests of other shareholders. As financial institutions with private as well as Government investors, RBS and Lloyds are run by their own independent boards and management teams who have legal and fiduciary responsibilities to all their shareholders. UKFI takes a commercial and active approach to managing the Market Investments, working alongside other investors with an interest in these companies.

We believe that value will be re-established in the banks themselves under the leadership of their own management and boards. Our role as an engaged shareholder is therefore to ensure that the banks have sound long-term strategies, and that they are effectively managed and properly governed.

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

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

Performance

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

We set out below a summary of our investee banks' performance over the year. Whilst the banks' share price and financial performance will be closely watched, we do not believe that these alone are an adequate test of UKFI's effectiveness in managing its investments as they are influenced by a range of factors outside UKFI's control. Ultimately, our performance as an organisation will be judged on the success of our stewardship and disposals. Accordingly, we have set out in the following section a range of factors where we have engaged with the banks to discharge our stewardship of the investments.

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Investee bank performance

A brief summary of the Government's investments' share price and financial performance is set out below.

Table 1.1: Investment and financial performance measures[1,2]

	Market Investments		Wholly Owned	
	Lloyds	RBS	Northern Rock[3]	Bradford & Bingley plc
Share price (pence)				
as at 31 March 2010	62.8	44.0	n/a	n/a
as at 31 March 2009	35.1	24.5	n/a	n/a
Change	**79%**	**80%**	**n/a**	**n/a**
(Year to 31 December 2009)				
Profit/(Loss) before tax	(1,042)	(2,595)	(258)	(196)
after impairment losses of	(16,673)	(14,950)	(1,045)	(594)
Core Tier 1 Capital Ratio	**8.1%**	**11.0%***	**n/a****	**7.0%**

Notes

* *This includes the benefit of the APS.*

** *Northern Rock was granted a waiver from the restriction that total Tier 2 capital must not exceed total Tier 1 capital during the period 31 July 2008 to 30 June 2009 and from 28 October 2009 until 31 December 2009.*

All the investee banks reported significant losses before tax for 2009 after taking account of high levels of impairment losses. Lloyds and RBS have announced the expectation of significantly reduced impairment losses in 2010, which, combined with significant management actions, are expected to result in an improved financial performance. During 2009, the Wholly-Owned companies made good progress in cost control and arrears management.

Further details of investment and financial performance for all investee companies are set out in Chapters 2-5.

[1] *Extracted from Bloomberg and the Companies' Annual Reports and Accounts 2009. Figures for all companies are on a statutory basis, pro forma results for RBS and Lloyds can be found in Chapters 2 and 3.*

[2] *The Government support for Northern Rock, Bradford & Bingley, RBS and Lloyds impacts the public finances as set out for instance in the 24 March 2010 Budget (www.hm-treasury.gov.uk). The long–term impact of the financial interventions on the public finances will be determined by the eventual net profit or loss on these interventions. The investments are also accounted for in Treasury's departmental accounts under IFRS and through the parliamentary estimates process.*

[3] *The Northern Rock data reflects the performance of the original Northern Rock shareholding prior to split.*

Table 1.2: Relative share price performance[4]

The pan-European banks index, a capitalisation-weighted index of European companies that are involved in the bank sector, has increased by 79 percent from 31 March 2009 to 31 March 2010. Both the RBS and Lloyds share price have performed in line with this over the same period, with a particularly strong performance since the start of 2010. The RBS share price has increased from 24.5p to 44.0p, an increase of 80 percent from 31 March 2009 to 31 March 2010, whilst Lloyds has increased from 35.1p to 62.8p.

[4] *Bloomberg.*

UKFI performance

This section provides an account of our performance during the year under review across a range of activities which we consider to be important for the performance of our role. We have grouped our activities over the past year into the following headings:

- restructuring the investment in our investee banks;
- improving governance in our investee banks;
- monitoring investee bank strategies;
- reforming risk management;
- changing the approach to remuneration;
- our role as active shareholder;
- accountability to the public and Parliament; and
- internal UKFI governance.

Restructuring the investment in our investee banks

The Asset Protection Scheme (APS) provides participating institutions with insurance against future credit losses in exchange for a fee. During the year under review, UKFI advised HM Treasury from a shareholder perspective on the implementation of alternatives to the APS, and on liability management more widely.

The revised agreement on the APS in November 2009 enabled RBS to pass the Financial Services Authority's stress tests, and also provided a clear mechanism for exit from the APS when the insurance support is no longer required. For Lloyds, successful capital raising measures, totalling £22.5 billion from both public and private sources of capital, provided an alternative to participation in the APS. This reduced the Government's ownership from a potential 62 percent shareholding to 43 percent. The Government received a fee from Lloyds of £2.5 billion, reflecting the implicit support Lloyds had received from the APS in 2009.

Taken together, these arrangements allowed for a substantial reduction in the potential scale of the Government's shareholdings in the two banks compared to initial plans, and were therefore a priority focus for UKFI. The in-principle commitments on the Asset Protection Scheme agreed with RBS and Lloyds in early 2009 would have increased the Government's equity investments above £78 billion. Under the finalised agreements with Lloyds and RBS, the Government investments were over £12 billion lower than this, totalling £65.8 billion.

UKFI worked with HM Treasury and Northern Rock to split the company into an ongoing bank (Northern Rock plc) and a closed mortgage bank (Northern Rock Asset Management) which marked a major milestone for the company. The ongoing operational separation of the businesses will position Northern Rock plc to be returned to the private sector in due course and will allow Northern Rock (Asset Management) to focus on the orderly run-down of its closed book and repayment of Government funds.

In addition, UKFI has initiated and worked with HM Treasury and the companies on the plan for integrating Northern Rock (Asset Management) and Bradford & Bingley under a single holding company, which is expected to realise efficiencies through common governance and management and other economies of scale to enhance future repayment of Government loans.

Improving governance in our investee banks

During the financial year under review, four new appointments were made to the RBS Board and four to the Lloyds Board. UKFI has now exercised its rights, which were conditions of the recapitalisations, to work with the banks' boards on the appointment of new independent non-executive directors, two in the case of Lloyds and three in the case of RBS. Since UKFI took control of the Government's stakes, the Boards of both companies have been restructured, including the appointment of new Chairmen for both banks and a new Chief Executive for RBS.

As 100 percent shareholder, UKFI has agreed all appointments to the new boards of Northern Rock plc, Northern Rock (Asset Management) and Bradford & Bingley, which now include directors who bring the appropriate retail banking, risk and operational experience. UKFI is either represented or is in attendance at board meetings of all the Wholly-Owned companies.

UKFI has engaged with all investee banks to help ensure they put themselves at the forefront of early implementation of the recommendations of the Walker Report on bank governance.[5]

UKFI has also interacted with the relevant committees of the banks to ensure they are taking account of wider governance issues, including social and environmental ones, in taking their businesses forward.

Monitoring investee bank strategies

UKFI has closely monitored, in consultation with management, the development and implementation of the strategies of all the investee banks to ensure they are building shareholder value, including:

- The detail underpinning RBS's new strategy, which targets more than 15 percent sustainable returns on equity by 2013, driven by market-leading businesses and a stable AA category risk profile and balance sheet.
- Lloyds' progress to its stated goal of being recognised as the UK's best financial services business. UKFI has focused particularly on the progress of integrating HBOS into the enlarged group.
- Work with HM Treasury and management of the relevant banks to develop business plans for Northern Rock Plc and Northern Rock (Asset Management) which gained European Commission approval in October 2009.
- Developing, in conjunction with Bradford & Bingley and Northern Rock (Asset Management), the strategic and financial rationale for the integration of the two banks.

Reforming risk management

UKFI takes a close interest in all our investee banks' approach to managing risk, engaging with the banks' boards and Chief Risk Officers to ensure that their new risk metrics have, where necessary, improved their approach to risk. Each of the Government's investee banks is at the forefront of implementing the Walker Report recommendations in this area. The Lloyds Risk Committee continues to focus on the roll-out of Lloyds' risk management standards across the combined Group, and RBS and the Wholly-Owned companies have each established new Risk Committees separate from the relevant Audit Committees and chaired by members of the banks' boards.

We have worked with all our investee banks to ensure that remuneration structures do not encourage excessive risk-taking, and both RBS and Lloyds have Long-Term Incentive Plans in place which will not pay out unless specific risk measures are met, with overall performance against any metrics assessed with the full involvement of and input from the banks' new Risk Committees.

[5]*A review of corporate governance in UK banks and other financial industry entities, Final recommendations, Sir David Walker, 26 November 2009.*

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Changing the approach to remuneration

UKFI has agreed remuneration structures for 2009 with all our investee companies which are at the forefront of current international and domestic guidelines. These include significant levels of deferral and clawback and discourage excessive risk-taking, but allow the banks to continue to attract, retain and motivate employees to deliver superior performance for shareholders including the taxpayer.

UKFI carried out a detailed independent assessment of the quantum of 2009 bonus payments in RBS before giving its consent to the proposal as part of the Accession Agreement in relation to the UK Asset Protection Scheme. UKFI gave its consent following confirmation from the RBS Board that the proposals represent the minimum necessary to retain and motivate staff and therefore to protect the value of the taxpayer's substantial investment in the bank. The revenue pay-out ratio in the RBS investment bank for 2009 was amongst the lowest of any such reported ratio for other major investment banks in 2009, and the RBS board reduced bonuses to take account of support from the taxpayer, the recent financial performance of the Group and the Bank Payroll Tax (brought into effect in the Finance Act 2010).

Our role as active shareholder

UKFI is committed to an active, engaged shareholder role, following in full the Statement of Principles of the Institutional Shareholders' Committee. Over this financial year UKFI has voted all the Government's shares wherever we have been eligible to do so (i.e. on all resolutions other than where UKFI has been a related party). We have informed the relevant bank in advance of our intentions and rationale, and we have disclosed on our website how we have voted on each resolution for Lloyds and RBS.

We have held over 100 meetings with other institutional shareholders since our inception in November 2008. Our aims in these meetings include explaining our remit and the arm's-length nature of our relationship with Government, and hearing other investors' views, to ensure that investors are clear that the banks are being run on a commercial basis, and so that we are aware of and responsive to the wider shareholder consensus on our investee banks.

Accountability to the public and Parliament

Pursuant to our commitment to being accountable and transparent, UKFI representatives attended a number of Parliamentary Committee hearings during the year, including hearings held by the House of Commons Treasury Select Committee, the Scottish Parliament's Economy, Energy and Tourism Committee, the House of Lords Economic Affairs Committee, and the House of Commons Environmental Audit Committee. UKFI also holds regular meetings with our shareholder, HM Treasury, as set out in our Framework Document and Investment Mandate.

Since inception, UKFI has responded to over 35 requests under the Freedom of Information Act 2000, and to over 750 letters and e-mails from members of the public, MPs, and other stakeholders.

Internal UKFI governance

The UKFI Board, supported by three sub-committees, takes all major, strategic decisions for the company. The directors provide the company with the appropriate experience and expertise to manage the Government's investment commercially. This year the Board underwent its first independently run Board Effectiveness Review to further enhance Board performance. More detail on the UKFI Board is set out in Chapter 6.

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

UKFI has produced an unqualified set of accounts for both years of its operation. Our direct administration expenditure for the year under review was £3.7 million, below planned expenditure given some delays in recruiting and building out the full team which is now under way, of which personnel expenses were £2 million.

Disposal strategy

Market Investments

At the heart of our mission for Market Investments is the development and implementation of a disposal strategy. In the *UKFI Strategy: Market Investments and Annual Report and Accounts* published in July 2009, we set out in detail our approach to this task and the circumstances under which UKFI might recommend the sale of shares in the banks. This remains the approach we will deploy to fulfil our remit.

As set out in UKFI's Investment Mandate, the decision to proceed with any transaction rests with HM Treasury. Any recommendation for sale by UKFI to the Treasury will be based on value, taking into account competition and financial stability, not the cost of investment. The development of value is a function of economic and market conditions, which UKFI will continue to keep under close review.

Given the need to respond to financial conditions, we have no pre-defined timetable for the exit programme. Nor have we ruled out any options for sale, and will continue to explore a range of possible alternatives, including public offers for sale. To be ready to capitalise on opportunities as they emerge, we have made progress in preparations to ensure efficient transactions, including the pre-qualification of appropriate investment banking advisers. Given the scale of the investments, we expect to complete the exit strategy through several transactions over time.

Wholly-Owned companies

For Northern Rock Asset Management and Bradford & Bingley, we are examining options to accelerate and/or enhance repayment of the Government's debt, for example:

- short-term options could include incentivising borrowers to repay loans more quickly;
- medium-term options could include selected sales of mortgage assets; and
- longer-term options could include refinancing the Government loans.

In line with Government policy and state aid conditions, it is our intention to exit Northern Rock plc, the new mortgage and savings bank, from temporary public ownership and we are examining a variety of options to fulfil this commitment subject to value for money and competition considerations. We have, however, no set target date for sale.

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Future outlook

Our investee banks have faced substantial challenges and losses over the past year. These have been in the context of the inevitable effects of the global recession, and in the face of significant legacy losses. Part of UKFI's role against this backdrop has been to support the stabilisation of the British banking system through working with our investee companies and HM Treasury on substantial restructuring in our investee banks.

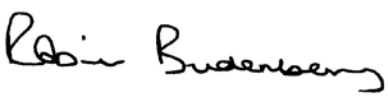
The economic environment remains uncertain, but with some signs of improvement, and our investee companies are starting to benefit from external economic factors and from the actions their management have taken. Against this backdrop, we will continue to work with the banks on their governance, restructuring and long-term strategies, but will also be preparing plans to release value for the taxpayer, including examining options for sale of shares and enhanced repayment of loans from the Wholly-Owned companies.

For example, in June 2010 UKFI worked actively alongside the Wholly-Owned companies to facilitate successful junior debt buy-backs for Northern Rock (Asset Management) and Bradford & Bingley, generating significant gains for the taxpayer.

The UKFI team

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

On a personal note, I would like to say that I am privileged to have taken responsibility for an organisation which has established itself with such credibility under the leadership of my predecessor, John Kingman. There have been some recent changes in the senior management of UKFI, and I would like to thank the whole of last year's executive committee, John Crompton, Keith Morgan, Tim Sykes, and Sam Woods, for their substantial contribution to the important work carried out by UKFI in the period under review.



Robin Budenberg

Chief Executive
13 July 2010

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02

The Royal Bank of Scotland Group plc

Summary of Government shareholding

The Government currently holds a total of 90.6 billion shares in RBS, including 51 billion non-voting B shares and the enhanced dividend access share issued in connection with RBS's participation in the APS. This is equivalent to 68 percent of voting share capital and 83 percent of total share capital.

Company overview

The Royal Bank of Scotland Group plc is the holding company of a large global banking and financial services group. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its two principal subsidiaries, RBS and NatWest. Both RBS and NatWest are major long-established UK clearing banks. In the United States, the Group's subsidiary, Citizens, is a large commercial banking organisation.

The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers in over 50 countries.[6]

Change in Government ownership

In December 2008 and in April 2009, HM Treasury took on ownership of 70 percent of the voting share capital of the company with total capital investment of £20 billion.

In November 2009, the Government announced the conclusion of the agreement with RBS on participation in the Asset Protection Scheme (APS).

As part of this support, HM Treasury subscribed for an additional 51 billion non-voting B shares, together with one enhanced dividend access share, through further capital investment of £25.5 billion. This increased Government's economic ownership to 84 percent of total share capital, with voting ownership remaining at 70 percent.

On 25 March 2010, RBS announced a liability management exercise aiming to generate core Tier 1 capital through repurchases and an exchange offer. Announced alongside this were two additional RBS capital management transactions which increase the RBS total share count and change the Government's percentage ownership position. The Government currently holds 68 percent of voting share capital and 83 percent of total share capital.[7]

[6] *Drawn from the Business Review, p53 RBS Annual Report and Accounts 2009.*

[7] *The RBS capital management transactions were the conversion of US$ 9.118% Preference Shares into ordinary shares and the issuance of ordinary shares to fund the deferred 2009 employee awards.*

Company performance

Table 2.1: RBS key financials

	Q1 2010[8]				Full Year 2009[9]			
	Pro forma		Statutory		Pro forma		Statutory	
	31 March 2010 (£m)	31 December 2009 (£m)	31 March 2010 (£m)	31 December 2009 (£m)	2009 (£m)	Restated 2008 (£m)	2009 (£m)	Restated 2008 (£m)
Total income (1)	8,954	7,540	8,523	7,199	29,425	20,599	38,690	25,868
Operating expenses (2)	(4,430)	(4,473)	(4,717)	(2,867)	(17,401)	(16,188)	(21,478)	(54,202)
Impairment losses	(2,675)	(3,099)	(2,675)	(3,099)	(13,899)	(7,432)	(14,950)	(8,072)
Operating (loss)/profit before tax (3)	(21)	134	(5)	(88)	(1,928)	(8,296)	(2,595)	(40,836)
Loss attributable to ordinary and B shareholders	(248)	(765)	(248)	(765)	(3,607)	(24,306)	(3,607)	(24,306)

Notes

The statutory results for 2008 have been restated for the amendment to IFRS 2 "share-based payment". This has resulted in an increase in staff costs amounting to £169 million in both the pro forma and statutory results.

(1) Q1 Excluding strategic disposals and Asset Protection Scheme credit default swap – fair value changes.

(2) Q1 Excluding purchased intangibles amortisation, write-down of goodwill and other intangible assets, integration and restructuring costs, bonus tax and gains on pensions curtailment.

(3) Q1 Operating profit before tax, purchased intangibles amortisation, integration and restructuring costs, strategic disposals, bonus tax, Asset Protection Scheme credit default swap.

The table above provides an overview of the key financial results for RBS in Q1 2010 and for the full year to December 2009. The full RBS Q1 results and 2009 Annual Report and Accounts can be found on the RBS website: www.rbs.com. Commenting on the Group's performance and on business performance over Q1, Stephen Hester, Chief Executive said:

"Last year we began implementing one of the most significant corporate restructurings ever undertaken. We said the Plan would take five years to implement. We set out transparently where the milestones would be along the way. And we explained how, if implemented properly, the Plan would turn RBS from a problem into an opportunity for all our constituencies.

RBS's Retail and Commercial businesses are beginning to recover and should drive our growth over the next few years. While we have taken decisive management actions to improve these businesses, the pace of recovery will also be affected by the rate at which credit conditions change and when interest rates return to more normal levels, giving some relief to liability margins.

Global Banking & Markets, our investment bank, is on track with a seasonally strong first quarter, though significantly below the unusual conditions of a year previously. GBM was radically restructured 15 months ago and is the area with greatest people retention challenges, so we are pleased with progress in this important Division.

[8]RBS Interim Management Statement, Q1 2010. Pro forma results have been prepared to include only those business units of ABN AMRO that will be retained by RBS.

[9]Summary consolidated income statement for the year ended 31 December 2009, p73, RBS Annual Report and Accounts 2009.

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Figure 2.1: RBS share price performance

HM Treasury ordinary shareholding in Royal Bank of Scotland		Shares	Total Investment	Investment per share	Value at 31 March*
		m	£m	p	£m
Initial Recapitalisation	December 2008	22,854	14,969	65.5	10,056
Preference Share conversion**	April 2009	16,791	5,058	31.75	7,388
APS B shares***	December 2009	51,000	25,500	50.0	22,440
Total investment		**90,645**	**45,527**	**50.2 (avg)**	**39,884**

Notes

* *Based on RBS share price of 44.0p as at 31 March 2010.*

** *Total investment includes accrued dividends and redemption premiums received of around £270 million.*

****Excludes valuation of the enhanced dividend access share, valued as £2.5 billion as at 31 March 2010.*

Investment in RBS

The Government's investment in RBS has been made at three different prices:

- **Initial Recapitalisation:** The October 2008 recapitalisation was at a cost to the Government of 65.5p per share.
- **Preference Share conversion:** The redemption of the preference shares agreed in January 2009 was financed by the issuance of new ordinary shares at 31.75p per share.
- **Asset Protection Scheme:** The Government has subscribed for 51 billion B shares and one enhanced dividend access share at an aggregate cost of £25.5 billion, equivalent to an aggregate cost per share of 50p.

The weighted average of these investment prices is 50.2p per share. This represents the cost per ordinary share of the Government's total investment in RBS.

The Government has received underwriting fees of £305 million associated with the recapitalisation and preference share conversion. The cost of the Government's investment in RBS net of these fees is £45,222 million, equivalent to 49.9p per ordinary share.

BOX 2.1: B SHARES AND THE DIVIDEND ACCESS SHARE

In connection with RBS's accession to the Asset Protection Scheme in 2009, the Government subscribed for 51 billion B shares, together with one enhanced dividend access share. The £25.5 billion investment in the form of B shares counts towards core capital, and has therefore strengthened the capital position of the bank. B shares are non-voting shares which otherwise rank pari passu with ordinary shares. Convertible into ordinary shares at the Government's option, the market value of each B share is equivalent to the value of an ordinary share.

The Government has agreed not to convert B shares into ordinary shares to the extent that its holding of ordinary shares would represent more than 75 percent of the bank's issued ordinary share capital. The Government has also given a commitment to acquire an additional £8 billion of B shares by way of contingent subscription if certain conditions are met.

The single dividend access share is the right to an enhanced dividend over and above the ordinary dividend entitlement of each B share. It is payable at the discretion of the RBS Board, and expires when the RBS ordinary share price equals or exceeds 65p per share over a certain period. If paid, it is the greater of 7 percent of the B share nominal amount of £25.5 billion or, if higher, 2.5 times dividends paid on ordinary shares.

There is no market price for the dividend access share. However, its value can be estimated using financial models on the basis of market-based assumptions. This has a value which diminishes as the RBS share price rises to the 65p expiry trigger. As at 31 March 2010, the enhanced dividend rights have been valued as £2.5 billion.

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Lloyds Banking Group plc

Summary of investments

The Government currently holds a total of 27.6 billion ordinary shares in Lloyds, including 15.8 billion shares taken up in Lloyds' rights issue. This is equivalent to 41 percent of total share capital.

Company overview

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

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS by Lloyds TSB. The main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. The new Group also operates an international banking business with a global footprint in over 30 countries.

The Group is the largest UK retail bank and has a large and diversified customer base. Services are offered through a number of well recognised brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and Cheltenham & Gloucester, and via a unique distribution capability comprising the largest branch network in the UK and intermediary channels.[10]

Change in Government ownership

Following the Government's intervention to provide financial support as announced in October 2008, HM Treasury took on ownership of 43 percent of total share capital of the company with total capital investment of £17 billion.

In total, through the course of 2009, Lloyds has raised £26.5 billion of investments, with a £4 billion placing and open offer in June and a £22.5 billion capital raising exercise in December. Of this total, £19 billion was successfully raised from the private sector. This was important both in demonstrating the ability of the Group to attract private capital and reducing the size of the investments managed by UKFI, with the redemption of the Government's £4 billion preference shares and exit from the Asset Protection Scheme (APS).

The capital raising exercise in December that provided an alternative to the APS included a £13.5 billion rights issue, the largest ever rights issue undertaken in the UK at the time. The Government took up its rights pro rata with its 43 percent ownership, with additional investment of £5.85 billion in ordinary shares instead of the £15.6 billion B share investment that would have been made as part of the APS.

Had Lloyds entered the Asset Protection Scheme on the terms set out in March, the Government's shareholding would have increased to 62 percent of total share capital. Through the alternative capital raising measures taken in 2009, the Government's shareholding has not increased. Following completion of the exchange offers in February 2010 and liability management exercises in May and June 2010, the Government's ownership has reduced to 41 percent of total share capital.

[10]*Lloyds Banking Group Annual Report and Accounts 2009.*

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Company performance

Table 3.1: Lloyds key financials[11]

	Pro forma		Statutory	
	2009 (£m)	Restated 2008 (£m)	2009 (£m)	Restated 2008 (£m)
Total income	24,601	21,836	45,297	7,009
Operating expenses	(11,609)	(12,236)	(15,984)	(6,100)
Impairment	(23,988)	(14,880)	(16,673)	(3,012)
Profit (loss) before tax	(6,300)	(6,713)	1,042	760

Note
2008 amounts have been restated for IFRS 2.

The table above provides an overview of the key financial results for Lloyds Banking Group (Lloyds) in 2009. The full Lloyds Annual Report and Accounts can be found on the Lloyds Banking Group website: www.lloydsbankinggroup.com. On the Group's performance over 2009, Eric Daniels, Chief Executive, commented:

"Our significant achievements in 2009 will shape the future of the Lloyds Banking Group. We strengthened our franchise, attracting new customers and building deeper relationships. We have made excellent progress with the integration of HBOS, which we acquired in January 2009. The Group's capital is robust and our funding profile was strengthened considerably during the period.

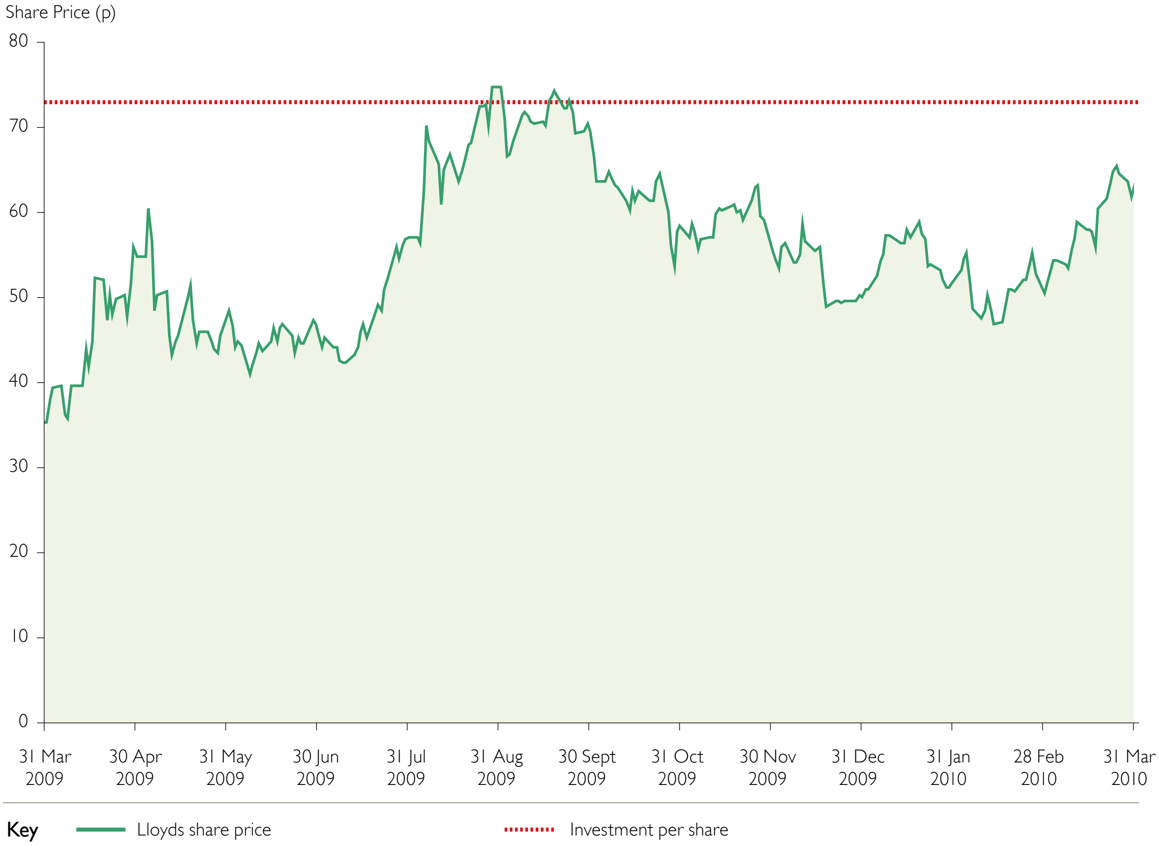
The management team implemented a number of programmes that have resulted in positive trends in margins, costs and impairments. Given the momentum we have already developed in these areas, and with the stabilising economy, we believe the Group is well positioned to deliver a strong financial performance in the coming years.

On a statutory basis, the Group delivered a profit before tax of £1 billion for 2009. This result includes an £11.2 billion negative goodwill gain associated with the purchase of HBOS, given we acquired the business at half book value in anticipation of the likely losses resulting from their troubled asset portfolios.

On a combined businesses basis, the Group reported a £6.3 billion loss for the year, compared to a £6.7 billion loss in 2008. Our total income rose 12 percent, whilst costs fell 5 percent. The higher income and lower costs drove a substantial uplift in the trading surplus, which increased by 35 percent, and our cost:income ratio improved to 48.4 percent. As guided last August, there was a significant increase in impairments, which rose to £24 billion from £14.9 billion in 2008, principally due to the HBOS portfolios and their high level of exposure to commercial property."[12]

[11] *Lloyds consolidated income statement, p127, and reconciliation of reported basis to statutory results, p151, Lloyds Banking Group Annual Report and Accounts, 2009.*
[12] *Group Chief Executive's Review, p11, Lloyds Annual Report and Accounts 2009.*

Figure 3.1 Lloyds share price performance[13]



HM Treasury ordinary shareholding in Lloyds Banking Group		Shares	Total Investment	Investment per share	Value at 31 March*
		m	£m	p	£m
Initial Recapitalisation**	January 2009	7,277	12,957	182.5	4,568
Preference Share conversion***	June 2009	4,521	1,506	38.43	2,838
Rights issue	December 2009	15,810	5,850	37.0	9,924
Total investment		**27,609**	**20,313**	**73.6 (avg)**	**17,330**

Notes

* *Based on LBG share price of 62.8p as at 31 March 2010.*

** *Includes Lloyds Banking Group capitalisation issue on 11 May 2009 (177 million shares).*

*** *In price adjusted to include accrued dividends and redemption premiums of around £230 million.*

[13] *Bloomberg.*

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Investment in Lloyds

The Government's investment in Lloyds has been made at three different prices:

- **Initial Recapitalisation:** The October 2008 recapitalisation was at a cost to the Government of 173.3p per Lloyds TSB share and 113.6p per HBOS share.
- **Preference share conversion:** The redemption of the preference shares agreed in March 2009 was financed by the issuance of new ordinary shares at 38.43p.
- **Rights issue:** The shares taken up in the December 2009 rights issue were priced at 37p per share.

The weighted average of these investment prices is 73.6p per share. This represents the cost per ordinary share of the Government's total investment in Lloyds Banking Group.

The Government has received underwriting and commitment fees of £381 million associated with these transactions. The cost of the Government's investment in Lloyds net of these fees is £19,933 million, equivalent to 72.2p per ordinary share.

For the implicit capital support provided by the in-principle terms of the APS in March, Lloyds has made a payment to the Government of £2,500 million. Taking into account this fee, the net cost of the Government's capital support for Lloyds is £17,433 million, equivalent to 63.1p per ordinary share.

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04

Northern Rock plc and Northern Rock (Asset Management) plc

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Summary of Government shareholding

During 2009, it was agreed that UKFI would take over management of the Government's 100 percent shareholding in Northern Rock on behalf of HM Treasury. Following the legal and capital restructuring which split Northern Rock's businesses between two separate companies on 1 January 2010, UKFI became responsible for the management of the Government's 100 percent shareholdings in the two separate entities, Northern Rock plc and Northern Rock (Asset Management) plc.

Company overview

On 22 February 2008, following financial difficulties, Northern Rock was brought into temporary public ownership by way of a Transfer Order. Northern Rock revised its business plan in 2009 in close consultation with the Government as shareholder, and successfully applied for State Aid approval from the European Commission, which was granted on 28 October 2009 to restructure the business into two legal entities, both of which remain in public ownership. The split:

- established, through Northern Rock plc, a well capitalised, deposit-taking and mortgage-providing bank with the intention of returning this to the private sector in due course, recovering value for the taxpayer; and
- restructured the old Northern Rock into Northern Rock (Asset Management), a separate, capital efficient financial institution, focused on repaying the Government loan and other creditors as the mortgage book reduces/repays.

The companies now operate as separate legal entities, with distinct management teams, boards and strategies. The companies continue to share an operational platform, although a programme is under way to effect an operational split during 2010.

New board structures for each company were developed with additional Non-Executive Directors bringing significant retail banking, risk and operational experience.

Northern Rock plc

Northern Rock plc is a new savings and mortgage bank that holds and services all pre-existing customer savings accounts and some pre-existing mortgage accounts. As of 1 January 2010, total assets of the company were £22.5 billion, of which £10.3 billion were mortgages. Northern Rock plc is authorised and regulated as a deposit taker by the Financial Services Authority and offers savings and mortgages products. The Government injected £1.4 billion of equity to capitalise the bank at inception.

Recognising that Northern Rock plc is now a strongly capitalised and highly liquid bank with an independent future, on 24 February 2010, HM Treasury announced a three-month notice period for the lifting of the Government guarantee arrangements relating to Northern Rock's retail deposits.[14] The change took effect at close of business on 24 May 2010. Going forward, all Northern Rock retail savers will continue to be covered by the Financial Services Compensation Scheme, which provides protection up to £50,000 per person, the same as for other bank and building societies.

The release of the deposit guarantee, and the ongoing operational separation of the business will position Northern Rock plc to be returned to the private sector in due course, with the proceeds returning to HM Treasury.

[14] *Excluding pre-existing fixed rate deposits which remain guaranteed until maturity.*

Northern Rock (Asset Management) plc

Northern Rock (Asset Management) plc now holds and services the "closed mortgage book". As of 1 January 2010, total assets of the company were around £75 billion, of which £54 billion were mortgages and unsecured loans to customers. The company does not hold deposits and offers no additional mortgage lending. Although the Loan-to-Value ratio of the mortgage book remains high compared to the market, more than 90 percent of the mortgages held are fully performing and not in arrears.

The portfolio includes those mortgages allocated to the Granite securitisation and to Northern Rock's covered bond programme. Northern Rock (Asset Management) plc's liabilities include the former Northern Rock's pre-existing wholesale funding, subordinated debt instruments, and the loan from the Government. As of 1 January 2010, the Government loan stood at £22.8 billion. Northern Rock (Asset Management) plc is authorised and regulated as a mortgage administrator by the Financial Services Authority and continues its work on the orderly run-down of its closed book and repayment of Government funds.

Northern Rock (Asset Management) plc and Bradford & Bingley plc integration and balance sheet restructuring

On 24 March 2010, as a result of an assessment undertaken by UKFI as to the best way to manage Northern Rock (Asset Management) plc and Bradford & Bingley plc, the Chancellor confirmed the intention to integrate Northern Rock (Asset Management) plc and Bradford & Bingley plc under a single holding company. The single holding company will combine Northern Rock (Asset Management) plc and Bradford & Bingley plc under common governance and management. Both companies will remain as separate legal entities under the new holding company, each with its own balance sheet and Government support arrangements. There will be no changes to existing liability structures.

Northern Rock (Asset Management) plc and Bradford & Bingley plc are similar companies, engaging in the orderly wind-down of their respective closed mortgage books. Integrating these companies will create a larger entity, enjoying significant economies of scale. Increased efficiency and shared capability in arrears management and treasury functions will enhance future repayment of Government loans. The single holding company for these entities was incorporated on 1 July 2010.

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Company performance

Table 4.1: Northern Rock key financials[15]

£m	2009	2008
Total income	1,107	254
Operating expenses	(326)	(448)
Loan impairment loss	(1,045)	(894)
Loss before taxation	(258)	(1,356)
Loss for the year	**(277)**	**(1,310)**

The above financials reflect the performance of Northern Rock (original shareholding) prior to split.

Over the last year (to year end 31 December) Northern Rock has shown some improvement in performance despite deterioration in loan impairments.

- Total income saw a significant increase of £853 million to reach £1,107 million, primarily driven by the beneficial impact on net interest margin of the lower interest rate paid on the Government loan.
- Operating expenses fell by £122 million to reach £326 million, benefiting from good control of costs and significant reduction in exceptional operating expenses from those incurred in 2008.
- Loan impairment loss increased to £1,045 million reflecting increased unemployment and a worsening house prices. However, there were signs of an improvement in both of these indicators during the last few months of 2009, resulting in a reduced loan impairment charge in the second half of the year.
- Statutory loss before tax reduced to £258 million in 2009. This is £1,098 million lower than the loss of £1,356 million in 2008, despite incurring a loan impairment loss of £1,045 million (£894 million in 2008).
- The gross Government loan was reduced from £15.6 billion at 31 December 2008 to £14.3 billion at 31 December 2009. A subsequent injection of £8.5 billion was made into Northern Rock at split to fulfil the new funding and capital requirements of the two new companies, bringing the Government loan up to £22.8 billion in Northern Rock (Asset Management) plc, with £1.4 billion of equity in Northern Rock plc.

[15] *Northern Rock Annual Report and Accounts 2009 (to year end 31 December 2009).*

05

Bradford & Bingley plc

Summary of Government shareholding

In July 2009, management of the 100 percent shareholding in Bradford & Bingley plc was transferred to UKFI to manage on behalf of HM Treasury.

Company overview

On 29 September 2008, following financial difficulties, Bradford & Bingley plc was brought into public ownership by way of a Transfer Order. The Transfer Order also included the sale of the UK and Isle of Man retail deposit business to Abbey National plc, part of the Santander Group, including all Bradford & Bingley plc's retail deposit accounts and its branch network. The rest of the business was taken into public ownership by the Government. The remaining business now holds and services a "closed mortgage book".

As of 1 January 2010, total assets of the company were £49.4 billion, of which £39 billion were mortgages to customers. The company offers no additional mortgage lending and although it currently retains its deposit taking permission, it does not accept deposits from customers. The current portfolio includes the mortgages allocated to the Aire Valley securitisation and to its covered bond programme in addition to wholesale funding and subordinated debt instruments.

As of 1 January 2010, the Government working capital facility stood at £8.5 billion. Bradford & Bingley plc has an additional £18.4 billion statutory debt comprising £15.8 billion owed to the Financial Services Compensation Scheme (FSCS) (via a loan from HM Treasury) and £2.6 billion owed directly to HM Treasury, reflecting the value of the retail deposits which were transferred to Abbey National plc.

The ongoing focus of the business is an orderly run-down of its closed book and repayment of FSCS and Government funds.

On 24 March 2010, UKFI announced that it intended to integrate Northern Rock (Asset Management) plc and Bradford & Bingley plc under a single holding company (as described in Chapter 4 above). The new holding company was incorporated on 1 July 2010.

Company performance

Table 5.1: Bradford & Bingley plc key financials[16]

£m	2009	2008
Net operating income	623	887
Operating expenses[17]	(137)	(253)
Loan impairment loss	(594)	(508)
Profit/(loss) before tax	(196)	134
Profit/(loss) for the year	(98)	18

[16] *Bradford & Bingley plc Annual Report and Accounts 2009.*
[17] *Ongoing expenses only, excludes any restructuring fees.*

Over the past year (to year end 31 December) Bradford & Bingley plc has shown some improvement in performance despite deterioration in loan impairments.

- Net operating income saw a fall of £264 million to reach £623 million in 2009, primarily driven by a £196 million adjustment to net interest income due to the lengthening of expected lives of mortgage accounts.
- Operating expenses fell by £116 million to £137 million in 2009, driven by the sale of the retail deposit business to Abbey National plc and a restructuring and rationalisation of the residual business to reflect the revised strategic priority of orderly wind-down.
- Loan impairment loss increased by £86 million to £594 million in 2009, reflecting an increase in the arrears and prudent provisioning for suspicious or fraudulent cases.
- Statutory loss before tax for 2009 was £196 million. This is £82 million lower than the comparable loss of £278 million in 2008. (The reported 2008 statutory profit of £134 million was positively impacted by two significant items: the £216 million one-off gain on the sale of the retail deposit business to Abbey, and the £196 million adjustment to net interest income due to the lengthening of expected lives of mortgage accounts.)
- The Bradford & Bingley plc working capital facility increased from £2.3 billion on 31 December 2008 to £8.5 billion at 31 December 2009 due to a reduction in deposits by banks and a reduction in debt securities in issue. The statutory debt remained broadly constant at £18.4 billion.

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THE UKFI BOARD AND SENIOR MANAGEMENT

David Cooksey – Chairman

Sir David Cooksey joined UK Financial Investments as Chairman in August 2009. He is also Chairman of London & Continental Railways Ltd and of Bechtel Ltd. He retired as Chairman of Eurasian Natural Resources Corporation plc in August 2009 having guided its IPO on the London Stock Exchange and its entry into the FTSE 100. David started his career as an industrial engineer and held a number of management positions in business before forming Advent Venture Partners, one of the first private equity/venture capital firms in the UK, in 1981 which he chaired until 2006.

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

Robin Budenberg – Chief Executive

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

Peter Gibbs – Non-Executive Director

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

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

Michael Kirkwood – Non-Executive Director

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

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

Lucinda Riches – Non-Executive Director

Lucinda Riches is a senior equity capital markets banker with extensive experience in privatisations. After a brief spell at Chase Manhattan Bank, Lucinda joined SG Warburg in 1986 where she pursued a career spanning 21 years in SG Warburg and its successor firms, ultimately UBS. She became involved in its equity capital markets business in 1988. During the late 1980s and 1990s she worked on a large number of IPOs and equity sales for a range of clients, including privatisations for a number of Governments around the world including Deutsche Post, Telia, Statoil and Telstra.

Lucinda became European Head of Equity Capital Markets in 1995 and Global Head of Equity Capital Markets in 1999. In 2001 she joined the board of UBS Investment Bank, with personal responsibility for the equity capital markets strategy within the investment bank. She chose to step down from her UBS role in 2007. Lucinda has an MA in Philosophy, Politics and Economics from Brasenose College, Oxford and an MA in Political Science from the University of Pennsylvania.

Philip Remnant – Non-Executive Director

Philip Remnant is Chairman of the Shareholder Executive, which was formed in 2003 to improve the Government's performance as a shareholder in government-owned businesses. He was appointed to the Northern Rock Board as a Non-Executive Director in February 2008, and is a Senior Adviser of Credit Suisse's investment banking division in Europe. Philip sits on the board of Northern Rock (Asset Management).

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. 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.

Louise Tulett – Non-Executive Director

Since June 2007, Louise Tulett has been Director of Finance, Procurement and operations for the Treasury Group. She is a professionally qualified accountant, and member of the Chartered Institute of Public Finance and Accounting (CIPFA).

Louise joined HM Treasury in June 2000 following a 24-year career in public sector finance in local government and the Health Service. She was responsible for the successful introduction of resource accounting to the Treasury itself, as part of the Government-wide initiative to adopt resource accounting and budgeting. From March 2004, Louise led the Treasury's Finance and Procurement team, overseeing its merger with the OGC finance and procurement function within a new Group Shared Service structure from August 2006.

In 2010 Louise was awarded the Commander of the Order of British Empire (CBE).

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Keith Morgan – Head of Wholly-Owned companies

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

06

Directors' Report

UKFI Board

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

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

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

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

During 2009/10 the membership of the Board changed as some members stepped down from the Board.

Former Board Members		Committee Membership
Glen Moreno (16.01.2009 – 01.08.2009)	Chairman	N (Chair), R
John Kingman (25.11.2008 – 07.12.2009)	Chief Executive	

The Board has put in place arrangements to manage any conflicts of interest. As part of this, each director has disclosed, at the outset of their term as a director, any direct or indirect conflicts of interest they are aware of and may have in connection with being appointed a director of the Company. In addition, all Board members have updated these disclosures during 2009/10.

The Board meets a minimum of nine times a year, and on an ad-hoc basis as required. The Board met 16 times during this reporting period.

Board Committees

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

Audit and Risk Committee

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

All members of the Audit and Risk Committee are non-executive directors. The current members of the Committee are Louise Tulett (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 meets a minimum of three times a year, and on an ad-hoc basis as required.

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

Remuneration Committee

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

Nominations Committee

The Nominations Committee met twice during this reporting period.

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

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

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Diversity and sustainability

UKFI seeks to actively promote a culture that values difference and diversity. As an employer, UKFI seeks to be open and inclusive in its management policies and processes and seeks to recruit and develop a diverse and talented workforce, from across the private and public sector, that is representative of the society it serves. Given that UKFI is such a small organisation of 16 staff, we do not report a detailed breakdown of diversity statistics as the release of such data would enable personal information on individual staff to be identified which individual staff would have no reasonable expectation of being disclosed.

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

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

Disclosure of information to auditors

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

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

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

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

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

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

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

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

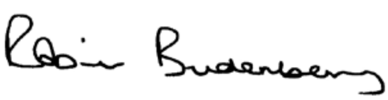
This report has been prepared in accordance with the special provisions of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 as set out in Statutory Instrument 2008/409.

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

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

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

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



Robin Budenberg
Chief Executive

13 July 2010

ANNUAL REPORT AND ACCOUNTS
2009/10

07

Directors' Remuneration Report

Remuneration Committee

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

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

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

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

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

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Remuneration policy

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

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

UKFI has a policy to recognise those staff that have performed well in their roles through the payment of bonuses. Performance-related pay is awarded in relation to performance linked to the annual staff appraisal. Information on UKFI remuneration can be found in the UKFI financial statements 2009/10 in Chapter 11.

Any UKFI performance-related pay is calculated as a fraction rather than multiple of salary. A total of £198,000 was awarded in respect of the period 3 November 2008 to 30 November 2009, of which £75,000 has been paid out and £123,000 retained because UKFI bonuses are deferred over three years and subject to clawback in line with the arrangements now in place at our investee banks. The total award represents 11.8 percent of staff costs incurred over the same period. This figure reflects the intensity of our activities during the recapitalisation phase of the bank crisis and the necessity of hiring staff with specific commercial expertise, and will be lower in future years.

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

Staff profile

UKFI is a small organisation. At 31 March 2010, the number of full-time employees including the Chief Executive was 16. The average over the 2009/10 period was 12 excluding non-executive directors, and 18 including non-executive directors. UKFI is not part of the Civil Service, and the majority of posts are occupied by staff with directly relevant expertise from the private sector. UKFI recruitment procedures are based on the principles of fair and open competition and selection on merit.

UKFI's executive team is comprised of:

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

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

UKFI staff have taken an average of 2.5 days of sickness absence.

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

Service contracts

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

Directors' remuneration

This information is subject to audit.

The table below reports the remuneration of each director for the period ending 31 March 2010 and has been audited by the Company's Auditors. Salary includes gross salary, performance pay, expenses, and bonuses paid during the period.

Director*	Salary and full year equivalent (FYE) (£) Year ended 31-3-2010	Salary and full year equivalent (FYE) (£) 10-10-2008 to 31-3-2009
David Cooksey	66,700 (100,000 FYE)	-
Robin Budenberg	38,750 (155,000 FYE)	-
Peter Gibbs	37,500 (37,500 FYE)	6,000 (37,500 FYE)
Michael Kirkwood	40,000 (40,000 FYE)	6,000 (40,000 FYE)
Lucinda Riches	37,500 (37,500 FYE)	6,000 (37,500 FYE)
Philip Remnant	32,500 (32,500 FYE)	0 (32,500 FYE)
Louise Tulett	0 (0 FYE)	0 (0 FYE)
John Kingman**	95,333 (143,000 FYE)	58,000 (143,000 FYE)
Glen Moreno***	0	0

Notes

* *All directors have volunteered to reduce their remuneration by five percent effective from July 2010 (effective May 2010 for Robin Budenberg).*

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

****Glen Moreno waived his entitlement to remuneration.*

Director	Expenses (£) Year ended 31-3-2010	10-10-2008 to 31-3-2009
David Cooksey	0	-
Robin Budenberg	215	-
Peter Gibbs	0	0
Michael Kirkwood	598	0
Lucinda Riches	92	0
Philip Remnant	0	0
Louise Tulett	0	0
John Kingman	1,173	196
Glen Moreno	0	0

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Directors' pension arrangements

None of the directors of UKFI receive a pension from the Company. John Kingman was a member of the Principal Civil Service Pension Scheme through his employment contract with HM Treasury. During his tenure as CEO of UKFI he was on secondment to UKFI. This information is provided for the purposes of clarity:

John Kingman	Year ended 31-3-2010 £	10-10-2008 to 31-3-2009 £
Real increase in the accrued pension benefits and related lump sum at age 60 during the period	0-2,500	0-2,500
Value of the accrued pension benefits at the end of the reporting period and the related lump sum at age 60	5,000-10,000	95,000-100,000
Value of the cash equivalent transfer value at the beginning of the period	310,000	290,000
Value of the cash equivalent transfer value at the end of the period	360,000	310,000
Real increase in the cash equivalent transfer value during the period	24,000	6,000

Performance pay is awarded in arrears based on performance during the year. None of the directors of UKFI are eligible for UKFI performance related pay, and the value of their non-cash benefits is zero.

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

Michael Kirkwood
Chair of Remuneration Committee

13 July 2010

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Statement on Internal Control

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Scope of responsibility

The Board has responsibility for maintaining a sound system of internal control that supports UKFI's policies and the achievements of its objectives, whilst safeguarding the public funds and assets for which the Board is collectively responsible.

Context

This period has comprised the first full year of UKFI's existence, and from a control perspective most effort has therefore been focused on further formalising robust governance, compliance and risk procedures. A rigorous control framework has been developed with respect to these areas, and appropriate account of best practice has been taken. For instance, although UKFI's activities do not require FSA authorisation, the Board has decided that UKFI should adopt policies and procedures that would meet the standard expected of a wholesale-market firm operating in the financial services market. The principles of Managing Public Money are being followed to manage the Company's resources.

The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in UKFI for the year ended 31 March 2010 and up to the date of approval of the annual report and accounts, and accords with central Treasury guidance.

The risk and control framework and the capacity to handle risk

Oversight Committees

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

The Audit and Risk Committee has responsibility for oversight of UKFI's governance, internal control, risk management processes and behaviours. It also has responsibility for agreeing internal and external audit work programmes and overseeing the reports associated with these programmes.

The Remuneration Committee has responsibility for approving and agreeing the remuneration levels for UKFI directors and those who report directly to the CEO, and approving UKFI's broad policy relating to remuneration for all UKFI employees.

The Nominations Committee has responsibility for adopting a formal, rigorous and transparent procedure for the appointment of new directors to the Board.

The Executive Management Committee provides operational leadership for the risk management process and is accountable to the Board.

Internal Policies and Procedures

The Company has implemented and maintains risk management policies and procedures, including procedures for risk assessment, which identify the risks relating to our activities, processes and systems. The policies, procedures and mechanisms are encompassed in the following documents:

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

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

Internal Audit

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

Training

All UKFI staff are required to undertake mandatory training which ensures awareness of the major risks associated with UKFI's day-to-day operating environment. All existing staff had completed this by 27 May 2010.

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Risk oversight

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

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

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

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

Risks to data and information held by UKFI are owned and managed by individuals and collectively by the Company as a whole. UKFI has appointed a Senior Risk Officer who is a member of the Executive Management Committee.

Notable events during the year

During the year, UKFI advised the Government from a shareholder perspective on the implementation of the Asset Protection Scheme (APS), alternatives to the APS, and on liability management. The revised arrangements surrounding the APS, combined with Lloyds' recapitalisation exercise during the year, allowed for a substantial reduction in the potential scale of the Government's investments in RBS and Lloyds, and were therefore a priority focus for UKFI.

UKFI worked with HM Treasury and Northern Rock to split the bank into an ongoing bank (Northern Rock plc) and a closed mortgage bank (Northern Rock Asset Management). In addition, UKFI has initiated and worked with Government and the respective banks on integrating Northern Rock Asset Management and Bradford & Bingley under a single holding company, which will realise efficiencies through common governance and management and other economies of scale.

As set out in Chapter 1 of this report, UKFI has also continued to be involved in improving governance in the investee banks, in monitoring investee bank strategy, reforming risk management and changing the approach to remuneration.

The Company has processes in place to manage effectively the succession risk associated with operating a small team. Additionally, arrangements were put in place to manage possible conflicts arising during the departure of senior staff members during the year. UKFI's internal auditors have reviewed the steps taken in the case of John Kingman's departure (ex-CEO), and have concluded that these were appropriate.

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As set out in the Framework Document, the general rule is that UKFI will seek to fulfil its obligations without becoming insiders, although the Framework Document allows UKFI to become an insider if it is considered necessary or appropriate. At certain times in the period, such as during the capital raisings of the Market Investments, UKFI staff members have become insiders in order to discharge the Company's responsibilities under the Framework Document. UKFI's management is currently putting in place new arrangements with respect to inside information to reflect the move into more of a steady-state phase.

In line with a recommendation from the Treasury Select Committee, and also to reinforce our arm's-length relationship with HMT and reduce administrative costs, UKFI moved out of the Treasury building into self-contained offices elsewhere on the Government estate during December 2009. The Company continues to maintain strict physical access control to premises and property. An outsourced IT management provider was appointed in March 2010, which resulted in UKFI moving off HMT's IT infrastructure. The new system complies with the security standards expected of both Government and commercial financial services entities.

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

Review of effectiveness

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

Ongoing review of the effectiveness of the control and risk management system of UKFI is provided by:

- The UKFI Board, which met 16 times during the period;
- The Audit and Risk Committee, which met six times during the period;
- The Remuneration Committee, which met five times during the period;
- The Nominations Committee, which met twice during the period;
- Internal Audit, who have thus far performed reviews of:
  - Governance arrangements;
  - Compliance arrangements;
  - Payments process;
  - Arrangements put in place to manage the departure of John Kingman (ex-CEO);
  - Investment Administration; and
  - IT.

- External Audit, who have considered UKFI's control framework during the course of the audit of this document;
- A Board effectiveness review which was conducted by an independent firm;
- The Senior Risk Officer, who is responsible for maintaining UKFI's risk register; and
- The Senior Information Risk Officer who is the Chief Operating Officer.

Significant control issues

UKFI's Framework Document was published in February 2009 but its Investment Mandate was only finalised in September 2009. In the absence of an agreed Investment Mandate there was a risk of uncertainty over the limits of UKFI's remit and the actions it should take.

This did not present a major obstacle as specific delegations had been provided for specific decisions. However, UKFI's management appreciated the need for the Investment Mandate to be finalised, and worked with HMT to address this on a timely basis.

Robin Budenberg

Chief Executive
13 July 2010

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Independent Auditor's Report to the shareholders of UKFI

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UK Financial Investments Limited

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

I have audited the financial statements of UK Financial Investments Limited for the period ended 31 March 2010 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 directors and auditors

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

Scope of the audit of the financial statements

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

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

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the company's affairs as at 31 March 2010 and of its result for the period then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the 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 have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which I am required to report by exception

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

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

Amanda Measures (Senior Statutory Auditor) **Date: 14 July 2010**

for and on behalf of the

Comptroller and Auditor General (Statutory Auditor)

157-197 Buckingham Palace Road

Victoria

London

SW1W 9SP

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UKFI Financial Statements

Income Statement for the year ended 31 March 2010

	Note	2010 £000	10-10-2008 to 31-3-2009 £000
Revenue	3(e)	3,745	1,242
Other operating income – amounts recharged to Investee companies	3(f)	199	0
		3,944	**1,242**
UKFI administrative expenses		3,745	1,242
Amounts incurred on behalf of Investee companies		199	0
Profit before corporation tax	2-7	**0**	**0**
Taxation	3(g)	0	0
Profit for the period		**0**	**0**

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

All activities are classified as continuing.

The notes on pages 63 to 72 are an integral part of these financial statements.

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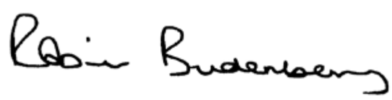
Statement of financial position as at 31 March 2010

	Note	31 Mar 2010 £000	31 Mar 2009 £000
Non Current Assets			
Property, plant and equipment	8	215	0
Intangible Assets	9	25	0
Total Non-current assets		**240**	**0**
Current Assets			
Trade and other receivables	10	481	677
Cash and cash equivalents	11	129	239
Total Current Assets		**610**	**916**
Total Assets		**850**	**916**
Equity			
Share capital	12	0	0
Retained earnings		0	0
Total Equity		**0**	**0**
Liabilities			
Current Liabilities			
Trade and other payables	13	736	916
Total Current Liabilities		**736**	**916**
Non Current Liabilities			
Trade and other payables	14	114	0
Total Non-current Liabilities		**114**	**0**
Total Liabilities		**850**	**916**
Total Equity plus Liabilities		**850**	**916**

These financial statements were approved by the Board of Directors on 13 July 2010 and were signed on its behalf by:

Sir David Cooksey
Director



Robin Budenberg
Director

UKFI Company Number 6720891

The notes on pages 63 to 72 are an integral part of these financial statements.

Statement of cash flows for the year ended 31 March 2010

	Note	2010 £000	10-10-2008 to 31-3-2009 £000
Cash flows from operating activities			
Profit for the period		0	0
Adjustments for:			
Depreciation	8	13	0
Amortisation	9	1	0
		14	**0**
Change in trade and other receivables	10	196	(677)
Change in trade and other payables	13,14	(66)	916
Net cash from operating activities		**144**	**239**
Cash flows from investing activities			
Acquisition of property, plant and equipment	8	(228)	0
Acquisition of intangible assets	9	(26)	
Net cash used in investing activities		**(254)**	**0**
Net decrease/(increase) in cash and cash equivalents		**(110)**	**239**
Cash and cash equivalents at 1 April	11	239	0
Cash and cash equivalents at 31 March	**11**	**129**	**239**

The notes on pages 63 to 72 are an integral part of these financial statements.

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Notes to the financial statements

1. Reporting entity

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

2. Basis of preparation

(a) Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). These are the Company's first financial statements prepared in accordance with IFRSs and IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied.

The transition to IFRS has not affected the reported financial position, financial performance or cash flows of the Company.

These financial statements are prepared in accordance with the Government 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 13 July 2010.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis. The accounts 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 presented in euro has been rounded to the nearest thousand.

(d) Use of estimates and judgements

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

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

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. As this is the Company's second reporting period, an opening IFRS statement of financial position at 10 October 2008 for the purposes of the transition to IFRSs has not been presented.

(a) Foreign currency

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

(b) Property, plant and equipment and intangible assets

(i) Recognition and measurement

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

(ii) Subsequent costs

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

(iii) Depreciation and amortisation

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

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

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

Furniture, fixtures and fittings	5 to 10 years
Computer and telecom hardware, software and licences	3 to 10 years

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

(c) Leased assets

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

(d) Employee benefits

(i) Defined contribution plans

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

(ii) Short-term employee benefits

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

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Notes to the financial statements (continued)

(e) Revenue

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

(f) Other operating income

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

(g) Corporation tax

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

(h) VAT

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

(i) Trade receivables

Trade and other receivables are stated at cost.

(j) Trade payables

Trade and other payables are stated at cost.

(k) Cash and cash equivalents

Cash and cash equivalents comprise solely of cash balances.

(l) Financial Assets and Financial Liabilities

(i) Recognition

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

(ii) De-recognition

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

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

(iii) Classification and measurement

Financial assets are categorised as "Loans and receivables".

Financial liabilities are categorised as "Other financial liabilities".

(iv) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments which are not quoted in an active market. They are included in current assets. UKFI's loans and receivables comprise: cash at bank and in hand, accrued income owed by group undertakings, prepayments and "other debtors".

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

(v) Other financial liabilities

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

(m) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 March 2010, 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.

4. Income

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
Investment management fees	3,745	1,242
Adviser fees recharged to Investee companies	199	0
Total	**3,944**	**1,242**

5. Remuneration of directors

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
Directors' emoluments	348	76
Total	**348**	**76**

6. Personnel expenses

The average number of persons working at the Company during the period was 18. This figure includes directors and long-term inward secondees.

The aggregate payroll costs of these persons were as follows:

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
Wages and salaries	1,614	317
Social Security contributions	180	34
Contributions to defined benefit plans	98	6
Contributions to other pension plans	70	31
Total	**1,962**	**388**

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

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

A bonus amount of £198,000 was awarded in respect of the period 3 November 2008 to 30 November 2009, representing 11.8 percent of staff costs incurred over the same period.

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Notes to the financial statements (continued)

7. Profit before tax

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
Profit before tax is stated after charging:		
Auditors' remuneration: Audit of these financial statements	18	18

8. Property, plant and equipment

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

9. Intangible Assets

	Software	Total
Cost or valuation		
At 1 April 2009	0	0
Additions	26	26
At 31 March 2010	**26**	**26**
Amortisation		
At 1 April 2009	0	0
Charged in year	1	1
At 31 March 2010	**1**	**1**
Net Book Value at 31 March 2010	**25**	**25**
Net Book Value at 1 April 2009	0	0

10. Trade receivables and other current assets

	31-3-2010 £000	31-3-2009 £000
Trade receivables due from related parties	318	674
Other trade receivables	163	3
Total	**481**	**677**

11. Cash and cash equivalents

	31-3-2010 £000	31-3-2009 £000
Office of HM Paymaster General, Commercial Banks and cash in hand	129	239
Total	**129**	**239**

12. Called up share capital

	31-3-2010	31-3-2009
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

	31-3-2010 £000	31-3-2009 £000
Amounts falling due within one year		
Trade and other payables due to related parties	135	476
Other trade payables	424	337
Non-trade payables and accrued expenses	81	87
Taxation and social security	96	16
Total	**736**	**916**

Notes to the financial statements (continued)

14. Non-current liabilities

	31-3-2010 £000	31-3-2009 £000
Amounts falling due after more than one year		
Non-trade payables and accrued expenses	101	0
Taxation and social security	13	0
Total	**114**	**0**

15. Operating leases

Operating lease rentals are payable as follows:

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
Less than one year	218	0
Between one and five years	155	0
More than five years	0	0
Total	**373**	**0**

The Company leases an office under an operating lease, which is due to expire in December 2012. During the year ended 31 March 2010 an amount of £280,000 was recognised as an expense in profit or loss in respect of operating leases (2009: £102,000).

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 (2009: nil).

17. Financial Instruments

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

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

Market risk

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

Credit risk

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

Liquidity risk

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

17.1 Financial Assets

	31-3-2010 £000	31-3-2009 £000
Denominated in Sterling		
Gross financial assets	850	916
Total	**850**	**916**

17.2 Financial Liabilities

	31-3-2010 £000	31-3-2009 £000
Denominated in Sterling		
Gross financial assets	850	916
Total	**850**	**916**

Notes to the financial statements (continued)

17.3 Financial assets and liabilities by category

Financial assets	31-3-2010 £000 Total	31-3-2010 £000 Loans & Receivables
Property, plant and equipment	215	215
Intangible assets	25	25
Trade receivables due from related parties	318	318
Other trade receivables	163	163
Cash at bank and in hand	129	129
Total	**850**	**850**

Financial assets	31-3-2009 £000 Total	31-3-2009 £000 Loans & Receivables
Trade receivables due from related parties	674	674
Other trade receivables	3	3
Cash at bank and in hand	239	239
Total	**916**	**916**

Financial liabilities	31-3-2010 £000 Total	31-3-2010 £000 Other financial liabilities
Trade and other payables due to related parties	135	135
Other trade payables	424	424
Non-trade payables and accrued expenses	182	182
Taxation and social security	109	109
Total	**850**	**850**

Financial liabilities	31-3-2009 £000 Total	31-3-2009 £000 Other financial liabilities
Trade and other payables due to related parties	476	476
Other trade payables	337	337
Non-trade payables and accrued expenses	87	87
Taxation and social security	16	16
Total	**916**	**916**

17.4 Maturity of Financial Liabilities

	31-3-2010 £000	31-3-2009 £000
Less than one year	736	916
More than one year	114	0
Total	**850**	**916**

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

18. Related parties

As at 31 March 2010, the Company is a wholly owned subsidiary undertaking of HM Treasury, which is registered in England and Wales and operates in the United Kingdom.

Philip Remnant, a UKFI non-executive director, and Keith Morgan, UKFI's Head of Wholly-Owned Investments, are both non-executive directors of Northern Rock (Asset Management) plc.

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

	31-3-2010 £000	31-3-2009 £000
Trade receivables due from related parties – HM Treasury	257	674
Trade receivables due from related parties – Northern Rock (Asset Management) plc	90	0
Total	**347**	**674**

	31-3-2010 £000	31-3-2009 £000
Trade and other payables due to related parties – HM Treasury	135	476
Total	**135**	**476**

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

	For the year ended 31-3-2010 £000	10-10-2008 to 31-3-2009 £000
HM Treasury – provision of investment management services	3,745	1,242
Northern Rock (Asset Management) plc – recharge of adviser fees	90	0
Total	**3,835**	**1,242**

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