

UK Financial Investments Ltd

UKFI BUSINESS PLAN: 2009/10 – 2013/14
JULY 2009

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1. Strategy and objectives

UKFI has been set up to manage the Government's investments in financial institutions. These investments currently comprise¹:

- ⌚ Holdings in The Royal Bank of Scotland Group plc;
- ⌚ Holdings in the Lloyds Banking Group plc; and
- ⌚ 100% ownership of Northern Rock and Bradford and Bingley

Our goal as we manage these investments is to develop and execute an investment strategy for disposing of the investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. This objective includes:

- ⌚ consistent with HM Treasury's stated aim that it should not be a permanent investor in UK financial institutions, maximising sustainable value for the taxpayer, taking account of risk;
- ⌚ maintaining financial stability by having due regard to the impact of its value realisation decisions; and
- ⌚ promoting competition in a way that is consistent with a UK financial services industry that operates to the benefit of consumers and respects the commercial decisions of the financial institutions.

In pursuing this goal we will operate like any other active, engaged shareholder to protect and create value, operating on a commercial basis and at arm's length from Government.

The *Shareholder Relationship Framework Document* (Annex 1), which has been drawn up between UKFI and its shareholder, HM Treasury, sets out the objectives for UKFI and the framework within which UKFI will pursue them.

This Business Plan is designed to recommend to HM Treasury a funding plan and management fee for UKFI which is appropriate to ensure the fulfilment of its role in relation to the aforementioned investments, and compliance with the associated obligations, as described in the *Framework Document*.

2. Control Framework

2.1. Oversight Committees

The Committees in place to oversee UKFI's corporate governance requirements are as follows:

¹ Note that these holdings are subject to change following the completion of the Government's most recent announcements on financial sector interventions

1. The Board of Directors
2. Audit Committee
3. Remuneration Committee
4. Nominations Committee
5. Executive Committee

The terms of reference for the above are detailed in UKFI's *Board Governance Manual*.

The Board shall, at least once a year, review its own performance, constitution and terms of reference to ensure it is operating at maximum effectiveness and recommend any changes it considers necessary to HM Treasury for approval.

2.2. Internal Policy and Procedures Documentation

We have implemented and maintain risk management policies and procedures, including procedures for risk assessment, which identify the risks relating to our activities, processes and systems. We also have arrangements, processes and mechanisms in place to manage our risks. Our 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 our compliance policies and procedures, which demonstrate that we are 'ready, willing and able' to conduct our business in compliance with the various rules and regulations and Board policies applicable to UKFI. The Compliance policies and procedures are particular to UKFI and the activities it undertakes.
- ⌚ *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.
- ⌚ *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 Oracle. The procurement procedures are particular to UKFI and the activities it undertakes.
- ⌚ *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 Oracle. These policies and procedures are particular to UKFI and the activities it undertakes.
- ⌚ *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.

The above manuals have all been submitted to, and approved by, the Board.

2.3. Outsourcing

The majority of our outsourced services will be obtained from HMT; these services and the associated arrangements in place are detailed in the Service Level Agreement between HMT and UKFI.

In taking outsourcing decisions, we will consider the operational risks that arise from reliance on a third party (including HMT) undertaking any operational functions that are critical for the delivery of our business strategy. In particular we will not outsource important operational functions if it might materially impair the quality of our internal control and the ability of our auditors to monitor our compliance with our obligations.

The *Compliance Manual* and the *Compliance Procedures Guide* outline key factors to consider when assessing the ability of an Outsource Provider to comply with UKFI Compliance policies. The *Procurement Policies and Procedures Manual* contains processes to ensure that appropriate controls are put in place to manage outsourced arrangements.

2.4. Internal Audit

UKFI are to have in place an agreed audit plan which will be used to assess the effectiveness of the design and implementation of internal controls. We have contracted Grant Thornton to provide us with an outsourced internal audit function for this purpose, and have agreed to involve HMT internal audit in an ongoing advisory capacity.

2.5. Business Continuity

UKFI's *Business Continuity Policy* contains our business continuity arrangements and processes. It aims to ensure, in the case of an interruption to our systems and procedures, that any losses are limited, that essential data and functions and our ability to carry out our other activities are preserved or, where this is not possible, the timely recovery of such data and functions and the timely resumption of activities.

2.6. Insurance

Under the terms of the Service Level Agreement between HMT and UKFI, HMT will provide UKFI with all necessary employment and professional indemnity insurance as if it were a directorate of HMT. If any claims are made against UKFI, any associated liabilities and/or legal fees will be settled by HMT. An Employer's liability exemption certificate is to be issued in accordance with Managing Public Money guidance.

2.7. Knowledge Management and Records

The *Compliance Manual* sets out UKFI's policy regarding knowledge management and records. Notably, lockable cupboards/drawers are used for sensitive information held in hard copy, and passwords and restricted-access controls are in place for electronic files.

2.8. Personal Controls

All UKFI staff are subject to controls regarding personal transactions and relationships with investee companies, as well as to controls regarding inducements, to manage potential conflicts of interest. These requirements are set out in the *Compliance Manual*, and will be monitored on an ongoing basis by the Compliance function.

2.9. Investment Management Procedures

In addition to the controls framework set out above, UKFI are developing further policies and procedures in relation to the administration of the Investments (e.g. custody arrangements).

3. Financial projections and resources

Financial information

3.1. Share Capital

UKFI's authorised share capital is £100, divided into 100 shares of £1 each. The holder of the one share issued is HMT.

3.2. Banking facilities or other loan or borrowing arrangements

None – as outlined in the *Framework Document*, UKFI is not allowed to incur any borrowings or enter into any similar financial transactions.

3.3. Any proposed guarantee or indemnity or charge or other security interest

Indemnities have been provided to the Directors as detailed in the board minutes.

3.4. Any other financial liabilities to which UKFI and its controllers are subject

None expected. There is a possibility that UKFI could be subject to legal action regarding its investment activities in the future.

3.5. Locations or premises where the books, records or computer files will be kept and maintained

UKFI's registered address is 2 Lambs Passage, London EC1Y 8BB; all statutory company records, including board minutes and company filings, are kept at this address in the care of Trusec, the appointed Company Secretary.

UKFI's operational address is 1 Horse Guards Road, London SW1A 2HQ; all day to day records are kept at this address, including financial books and records.

3.6. Accounting reference date and reporting standard

31 March 2009; subsequent periods will end on the same day and month in future years. The accounts will be produced in accordance with the Government Financial Reporting Manual (FRoM).

3.7. Auditors and reporting accountants

The board has appointed the Comptroller and Auditor-General (National Audit Office) as UKFI's auditor, with the agreement of Treasury. This decision is included in the minutes from the board meeting on 25 November 2008 at 4pm, and was supported by board paper UKFI-BP-1.

3.8. Details of any association between the auditor and any associated undertakings

None.

3.9. Principal bankers

Office of the HM Paymaster General
Room 3/30
1 Horse Guards Road
London
SW1A 2HQ

Financial projections and supporting data

3.10. Business plan and business forecasts

UKFI are currently operating under interim funding arrangements until 31 March 2009 which are subject to costs being no higher than the budgeted amount submitted on 25 November 2008, and to the provision of monthly budget updates.

Once Oracle functionality is provided to UKFI (expected in February 2009), we propose that a periodical management fee be paid to UKFI from HMT as consideration for the performance of ongoing obligations under the *Framework Document*. This fee is to be representative of the anticipated costs and expenses to be incurred by UKFI in effecting its investment strategy and otherwise fulfilling its obligations under the *Framework Document*.

UKFI has no intention of making a profit at any point; the financial projections have been produced on this basis.

3.11. Financial Projections

UKFI is projected to incur costs totalling £23.9m from the period 2009/10 to 2013/14:

2009/10	2010/11	2011/12	2012/13	2013/14
£4.5m	£4.7m	£4.8m	£4.9m	£5.0m

Of the £4.5m expenditure projected for 2009/10, £2.6m is attributable to staff costs; £1.2m is attributable to external contractors; £0.5m is attributable to costs associated with outsourcing and premises (including service fees charged by HMT); and £0.2m is attributable to miscellaneous costs (including external audit fee, travel and expenses).

Staff and external audit costs have been forecasted to rise by 2.5% per annum, with all other costs remaining at 2009/10 levels. The percentage breakdown between staff, contractor and miscellaneous costs in all years is projected to be consistent with 2009/10.

These projections assume that any transaction costs in relation to the investments managed by UKFI, for instance arising from a disposal, will be AME rather than DEL and are therefore not included in UKFI's budget. This assumption includes any transaction costs arising in the event that a transaction fails to complete. UKFI will keep HMT closely informed of any such costs as they arise, and will manage them to secure good value for money.

Any increase to the above projections will be immediately flagged and discussed with HMT.

It should be noted that this set of projections assumes no change in UKFI's operating remit. Additionally, these projections will require review when the full scope of the management of the Wholly-Owned Investments is determined.

Refer Annex 3 for Profit & Loss, Balance Sheet and Cashflow projections, along with a summary of assumptions used in drawing up these statements.

3.12. Board Remuneration

The Board's Remuneration is set out below:

Name	Positions Held	Fee
Michael Kirkwood	Chair of Remuneration Committee; Member of Nominations and Audit Committees	£40,000
Lucinda Riches	Member of Remuneration, Nominations and Audit Committees	£37,500
Peter Gibbs	Member of Remuneration, Nominations and Audit Committees	£37,500
Philip Remnant	Member of Nominations Committee	£32,500

UKFI are currently being recharged by HMT for the secondment of John Kingman; John's remuneration details will be published in UKFI's Annual Report.

3.13. Assets and Liability Matching

UKFI Finance staff will take responsibility for ensuring liabilities can be met when they fall due. To this end, the management fee will be set monthly to ensure that cash is managed effectively, and will be based on the projected cash outflows for the month ahead. Consequently, it is likely that the fee invoiced by UKFI will fluctuate month-to-month to reflect the expected cash need at a particular time.

3.14. Types of asset

The balance sheet is forecast to comprise of the following assets:

- ⌚ Accounts receivable (management fee from HMT);
- ⌚ Cash;
- ⌚ Prepayments.

Of the above, accounts receivable and cash are forecast to make up the vast majority of assets.

3.15. Proposed means of financing any cashflow deficit

For any large unexpected expenditure, the financial controller will complete a Miscellaneous Invoice Form. This will be approved by an authorised signatory of UKFI and will be sent to HMT along with the latest copy of the UKFI budget. Additionally, a float of c. £20,000 (equating to c. 5% of monthly expenses) will be maintained in the UKFI bank account to serve as a buffer. Refer 3.12 for details of how cash will be managed on an ongoing basis.

3.16. Details of any banking facilities that have been arranged to cater for any projected deficit or the contingency of unprojected deficit

None.

3.17. Proposed sources of capital

UKFI has allocated, called up and fully paid share capital of £1. HMT will provide all funding to service costs and expenses by way of the periodic management fee.

4. Risk Oversight

4.1. Description of process

We have put in place business and operational risk management arrangements so that the Board, and through them our stakeholders, can be reassured that we are operating within the risk tolerances set by the *Framework Document* and the *Investment Mandate*. Periodically we review the strategies and policies for taking up, managing, monitoring and mitigating the risks we are or may be exposed to, including those posed by the macroeconomic environment in which we operate. The requirement for UKFI to manage its strategic risks is set out in the *Framework Document*.

We define operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including reputational risk. We have implemented and maintain risk management policies and procedures, including procedures for risk assessment, which identify the risks relating to our activities, processes and systems. We also have arrangements, processes and mechanisms in place to manage our risks. We monitor the following:

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

We have considered the requirements for credit risk policies, processes and controls as well as those in relation to market risks and have determined that they would have very limited impact on UKFI delivering its business plan because our operations will be backed and supported by our parent, HM Treasury.

4.2. Internal Reporting and Escalation

- ⌚ Annual report for the Board detailing the effectiveness of the compliance arrangements;
- ⌚ Quarterly review of the Risk Log by the Board;
- ⌚ Summary report to each meeting of the Audit Committee detailing adherence to the monitoring plan and significant breaches;
- ⌚ Ongoing risk-based monitoring plan which will comprise reviews by Compliance.

4.3. External Reporting and Escalation

- ⌚ Board's assessment of the effectiveness of the Internal Controls and Systems for the Annual Report

4.4. KPIs/KRIs

Appropriate KPIs/KRIs have been considered and documented in the *Risk Log*, which is maintained by Compliance and will be reviewed annually by the Board. Individual KPIs/KRIs have been included in the following areas:

- ⌚ Staff-related
- ⌚ Operational
- ⌚ Strategic
- ⌚ Environmental
- ⌚ Conflicts of Interest
- ⌚ Budgetary
- ⌚ Investment-related
- ⌚ Reputational
- ⌚ Legal

5. Business Plan Submission

It may be necessary to revisit this business plan and its associated projections if UKFI's operating remit is amended.