

UK Financial Investments Ltd

**UKFI INVESTMENT MANDATE
OCTOBER 2009**

**UK FINANCIAL INVESTMENTS LIMITED:
INVESTMENT MANDATE**

PART A - GENERAL

1. Introduction

- 1.1 This investment mandate ("**Investment Mandate**") has been prepared by HM Treasury for UK Financial Investments Limited ("**UKFI**").
- 1.2 This Investment Mandate constitutes the "Investment Mandate" approved by HM Treasury for the purposes of the framework document drawn up by UKFI and HM Treasury which sets out the objectives for UKFI and the framework within which UKFI will pursue them (the "**UKFI Framework Document**").
- 1.3 This Investment Mandate is effective from 25 September 2009 (the "**Effective Date**") and will continue in force until such time as it is amended, supplemented or replaced by HM Treasury in accordance with the UKFI Framework Document (including as contemplated by Section 12).
- 1.4 Unless otherwise stated: (i) capitalised expressions used in this Investment Mandate have the meanings given to them in the UKFI Framework Document; and (ii) references to "Sections", "Parts", "paragraphs" and "Annexes" refer to the Sections, Parts, paragraphs and Annexes of this Investment Mandate.

2. Purpose and scope of Investment Mandate

- 2.1 The UKFI Framework Document provides that the implementation of "value-realisation" transactions (in respect of the Listed Investee Companies) and "restructuring" transactions (in respect of the Wholly-Owned Investee Companies), and certain other specified actions and decisions, shall be subject to the prior consent of, or shall remain the responsibility of, HM Treasury, except where HM Treasury has, pursuant to the Investment Mandate or otherwise, delegated authority to UKFI to implement:
- (A) certain types of decisions (including decisions in respect of types of "value-realisation" and "restructuring" transactions); and/or
- (B) "value-realisation" and/or "restructuring" transactions below a specified financial threshold or satisfying certain other specified criteria.
- 2.2 The purpose of this Investment Mandate is to describe: (i) the scope of UKFI's decision-making responsibilities with respect to its management of the Investments in the Listed Investee Companies; (ii) the extent to which decision-making requires the prior approval of HM Treasury before being taken or implemented; and (iii) the anticipated dialogue between UKFI and HM Treasury in relation to UKFI's responsibilities under this Investment Mandate.
- 2.3 As from the Effective Date, the Investments to which this Investment Mandate applies are HM Treasury's shareholdings in Lloyds Banking Group plc ("**Lloyds**") and The Royal Bank of Scotland plc ("**RBS**"). "Shareholdings" with respect to Lloyds and RBS

includes both the ordinary shares held by HM Treasury on the Effective Date and any Class B shares issued to HM Treasury in connection with the applicable financial institution's accession to the Government's Asset Protection Scheme (the "**Class B Shares**").

- 2.4 Pursuant to the UKFI Framework Document, UKFI is to comply with this Investment Mandate in managing the Investments, and otherwise pursuing the objectives set out in the UKFI Framework Document. This Investment Mandate is, in particular, intended to provide a framework which will enable UKFI to develop and execute its investment and management strategy, as contemplated by the UKFI Framework Document.
- 2.5 UKFI is free to manage the Investments in the Listed Investee Companies and to effect its investment and management strategy, in its discretion but in accordance with this Investment Mandate and the UKFI Framework Document.

3. **UKFI's approach to managing the Investments**

In managing the investments, UKFI will (on behalf of HM Treasury) follow best institutional shareholder practice. This includes compliance with the Institutional Shareholders' Committee's Statement of Principles together with any developments to best institutional shareholder practice arising from recommendations or guidance contained in the Walker Review or elsewhere.

4. **Decision-making by UKFI; Engagement between UKFI and HM Treasury**

- 4.1 The UKFI Framework Document contemplates that representatives of HM Treasury and the board of directors of UKFI (the "**UKFI Board**") or other UKFI representatives will meet from time to time to review the strategic options available in formulating and implementing the Investment Mandate, and in delivering the objectives set out in the UKFI Framework Document and the UKFI Business Plan.
- 4.2 The meetings referred to in paragraph 4.1 are to be held quarterly as part of the dialogue provided for in the UKFI Framework Document (referred to in this Investment Mandate as the "**quarterly relationship meetings**") and will focus on UKFI consulting and engaging with HM Treasury on actions and decisions taken, or proposed to be taken, in connection with UKFI's responsibilities under this Investment Mandate and providing:
 - (A) an assessment of market conditions and how they are affecting each of the Investments in the Listed Investee Companies;
 - (B) an outline of UKFI's current investment strategy in respect of each of the Investments in the Listed Investee Companies;
 - (C) an assessment of opportunities, or potential opportunities to realise value with respect to the Investments in the Listed Investee Companies in accordance with the Overarching Objective outlined in the UKFI Framework Document (such assessment to include an update on the design, development or implementation

of any “value-realisation” transactions which have previously been discussed between UKFI’s representatives and HM Treasury);

- (D) an assessment of the extent to which each Listed Investee Company is complying with the applicable Investee Company Conditions; and
- (E) an update on actions and decisions which UKFI has taken, or is proposing to take, to give effect to its obligations under the UKFI Framework Document and this Investment Mandate.

4.3 In addition to the quarterly relationship meetings, UKFI will keep HM Treasury informed as to:

- (A) the status of any Disposal Transaction (as defined in paragraph 5.1); and
- (B) UKFI’s (and its third party advisers’) views on the design, development and execution of any Disposal Transaction.

PART B – LISTED INVESTEE COMPANIES

5. Value realisations

Introduction

- 5.1 In relation to the Listed Investee Companies, it is anticipated that value realisations deriving from the Investments will principally result from a decision relating to the disposal, exchange or conversion of, or other dealing in, all, or a portion of, the Investments in a Listed-Investee Company, or any rights over or in respect of those Investments (including: (i) any such disposal effected pursuant to a buy-back programme initiated by the relevant Listed-Investee Company; and (ii) any election to convert the Class B Shares into ordinary shares in accordance with their terms) (a “**Disposal Transaction**”).
- 5.2 In connection with Disposal Transactions which may be initiated by HM Treasury (or by UKFI in its capacity as manager of the Investments in each Listed Investee Company), HM Treasury has entered into registration and resale rights agreements with each of the Listed Investee Companies which will enable the shares and other securities held by HM Treasury in each such financial institution (and the rights over and in respect of those shares and other securities) to be sold in such jurisdictions and in such manner as HM Treasury may determine (each, an “**RRA**”). Each RRA requires the relevant Listed Investee Company, amongst other things, to provide such assistance to HM Treasury with respect to due diligence, marketing and the preparation of documentation (including offering memoranda) as HM Treasury may reasonably require.
- 5.3 Without prejudice to UKFI’s obligations to consult with, and obtain the approval of, HM Treasury with respect to the design, development and implementation of Disposal Transactions (as further outlined in the remainder of this Section 5), UKFI shall act as

the principal liaison point with each Listed Investee Company with respect to any such transaction (or proposed transaction).

Disposal Transactions

- 5.4 Subject to paragraph 5.5, UKFI and its representatives may, as part of the development and updating of its investment strategy for the Investments in Listed Investee Companies, design, develop and implement Disposal Transactions.
- 5.5 UKFI will, in relation to any Disposal Transaction, comply with Part C and will also:
- (A) seek HM Treasury's views in relation to any such Disposal Transactions before entering into any substantive engagement with the relevant Listed Investee Company (or its directors, officers, employees or advisers) with respect to the design, development or execution of any Disposal Transaction and including, in particular, where such engagement will or may require the exercise by UKFI (on behalf of HM Treasury) of rights or powers under an RRA; and
 - (B) obtain HM Treasury's approval before taking any action to effect, approve or reject any Disposal Transaction.

6. Monitoring Listed Investee Company Compliance

- 6.1 The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf) monitor and work to secure compliance with:
- (A) any conditions attaching to any decisions of the European Commission or national regulatory authorities in relation to the business plans of the Listed Investee Companies;
 - (B) the non-lending conditions attached to the accessing by RBS and Lloyds of the Government's bank recapitalisation fund and any other financial institutions accessing the fund; and
 - (C) any other conditions attaching to any decisions of the European Commission or national regulatory authorities in relation to state aid or merger control and any commitments given by HM Treasury in that context, as notified by HM Treasury to UKFI.
- 6.2 UKFI will engage with each Listed Investee Company on the conditions outlined in paragraph 6.1 and shall take such action as it considers to be necessary or desirable to fulfil its obligations in respect of these conditions.

7. Remuneration

- 7.1 The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf) monitor and work to secure compliance by the Listed Investee Companies with the Investee Company Conditions. These Investee Company Conditions include constraints

and requirements relating to remuneration. UKFI will, therefore, as part of its active engagement with the Listed Investee Companies on their remuneration policies, seek to ensure compliance with these Investee Company Conditions, and otherwise act in a manner consistent with its obligations under the UKFI Framework Document.

7.2 In its engagement with Listed Investee Companies on remuneration issues UKFI will seek to ensure that:

- (A) remuneration incentives at Listed Investee Companies are designed to promote long-term, sustainable performance;
- (B) remuneration policies at all Listed Investee Companies are consistent with the ABI industry best practice code on remuneration and any code of practice published by the Financial Services Authority in relation to remuneration;
- (C) where a director of a Listed Investee Company loses the confidence of the board of directors of that company, they should be able to be dismissed at a cost that is reasonable and fair (no rewards for failure); and
- (D) remuneration policies at Listed Investee Companies are designed to enable them to attract and retain the staff needed to advance UKFI's objective of protecting and creating value for the taxpayer,

(together, the "**Remuneration Principles**").

7.3 Any remuneration conditions for bank executives relating to the banks' lending commitments will remain the responsibility of HM Treasury.

8. Governance

8.1 The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf), and consistent with the agreements reached with the Listed Investee Companies, work with the board of directors of each of these financial institutions to strengthen their membership through the appointment of suitably qualified, independent non-executives.

8.2 UKFI will also engage with each Listed Investee Company with respect to board composition more generally, consistent with the principles set out in this Investment Mandate and the UKFI Framework Document.

9. Voting

9.1 UKFI will exercise the voting rights attaching to HM Treasury's Investments in the Listed Investee Companies (including, in particular, in respect of ordinary course resolutions proposed at each such financial institution's annual general meeting and any resolutions in respect of any Disposal Transactions).

9.2 In exercising voting rights on behalf of HM Treasury pursuant to paragraph 9.1, UKFI will:

- (A) have regard to the Overarching Objective and UKFI's other obligations under the UKFI Framework Document;
- (B) adhere to the specific restrictions and requirements outlined:
 - (i) in Section 5 in relation to Disposal Transactions;
 - (ii) in Section 7 in relation to matters pertaining to remuneration; and
 - (iii) in Section 8 in relation to matters pertaining to corporate governance;
- (C) seek to ensure that any votes are exercised in a manner which will facilitate and ensure compliance with the Investee Company Conditions; and
- (D) adhere to the principles and requirements outlined in Section 3, such that UKFI will (amongst other things):
 - (i) (on behalf of HM Treasury) vote all the shares wherever practicable to do so;
 - (ii) inform the relevant Listed Investee Company in advance of its voting intentions; and
 - (iii) disclose how it has voted.

9.3 UKFI will seek HM Treasury's approval before exercising the voting rights attaching to HM Treasury's Investments in the Listed Investee Companies where such approval is required by virtue of Section 5 or Part C.

10. Other matters

10.1 UKFI will, as contemplated by the UKFI Framework Document, act as the principal liaison point with each Listed Investee Company but only with respect to HM Treasury's role as shareholder in these institutions.

10.2 UKFI's responsibilities pursuant to paragraph 10.1 shall be conducted in accordance with the UKFI Framework Document and this Investment Mandate and its engagement with each Listed Investee Company shall, in particular, be carried out in accordance with best institutional shareholder practice.

PART C – APPROVALS AND INSTRUCTIONS

11. Approvals and Instructions

UKFI's obligations

11.1 In carrying out its responsibilities under this Investment Mandate and the UKFI Framework Document, UKFI (and its representatives):

- (A) will refer all requests relating to any:
 - (i) matter for which HM Treasury's prior consent or approval is required under the terms of this Investment Mandate; or
 - (ii) other matter for which HM Treasury remains responsible,

promptly to HM Treasury, together with any information or documents pertaining to such requests which are in UKFI's possession; and
- (B) will inform HM Treasury promptly of any information, or any approaches to or from third parties, pertaining to any:
 - (i) matter for which HM Treasury's prior consent or approval is required under the terms of this Investment Mandate; or
 - (ii) other matter for which HM Treasury remains responsible,

of which UKFI is aware.

Approvals from HM Treasury; Instructions from HM Treasury

11.2 It is envisaged that any approval of HM Treasury required pursuant to this Investment Mandate:

- (A) will ordinarily be sought at one of the quarterly relationship meetings or as part of HM Treasury's approval of the UKFI Business Plan (without prejudice to UKFI's right to seek separate approval where it considers it to be necessary or desirable having regard to its Overarching Objective); and
- (B) (in respect of Disposal Transactions) may be sought either:
 - (i) in respect of a single proposed Disposal Transaction; or
 - (ii) by reference to a general authority from HM Treasury to implement Disposal Transactions within agreed parameters (including with respect to pricing and timing).

11.3 The foregoing provisions of this Investment Mandate shall be without prejudice to HM Treasury's right to instruct or require UKFI:

- (A) to implement (or delay or cease the implementation of); or
- (B) to approve or reject,

any "value realisation" transactions with respect to the Investments in the Listed Investee Companies (including any Disposal Transaction).

PART D - MISCELLANEOUS**12. Revision of the Investment Mandate**

It is envisaged that this Investment Mandate will be amended, supplemented or replaced by HM Treasury to reflect UKFI's responsibility for managing HM Treasury's Investments in Bradford & Bingley plc ("**B&B**") and Northern Rock plc ("**NR**"), the Loan Arrangements with B&B and NR and the Guarantee Arrangements put in place by HM Treasury in respect of B&B and NR.

13. Status of the Investment Mandate

13.1 In the event of any conflict or inconsistency, the UKFI Framework Document takes precedence over this Investment Mandate.

13.2 This Investment Mandate should be interpreted in the light of UKFI's memorandum and articles of association and English company law and is without prejudice to the statutory and other rights and obligations of HM Treasury or UKFI.