

UK Financial Investments Ltd

**UKFI INVESTMENT MANDATE
OCTOBER 2010**

**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 1 October 2010 (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 20).
- 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" and "paragraphs" refer to the Sections, Parts and paragraphs 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 "disposal 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 "disposal and restructuring" transactions); and/or
- (B) "value-realisation" and "disposal and 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, the Loan Arrangements and the Guarantee Arrangements; (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,
- (A) the Investments to which this Investment Mandate applies are HM Treasury's shareholdings in Lloyds Banking Group plc ("**Lloyds**"), The Royal Bank of Scotland Group plc ("**RBS**"), UK Asset Resolution Limited (which wholly owns Northern Rock (Asset Management) plc ("**NRAM**") and Bradford & Bingley plc ("**B&B**") and Northern Rock plc ("**NR**"). "Shareholdings" with respect to 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 RBS's accession to the Government's Asset Protection Scheme (the "**Class B Shares**");
 - (B) the Loan Arrangements to which this Investment Mandate applies comprise the agreements under which loan facilities are made available by HM Treasury to NRAM and to B&B; and
 - (C) the Guarantee Arrangements to which this Investment Mandate applies are the guarantee arrangements put in place by HM Treasury in respect of NRAM, NR and B&B.
- 2.4 Pursuant to the UKFI Framework Document, UKFI is to comply with this Investment Mandate in managing the Investments, those aspects of the Loan Arrangements and the Guarantee Arrangements for which it has responsibility, 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, the Loan Arrangements, and the Guarantee Arrangements, 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 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;
 - (B) an outline of UKFI’s current investment strategy in respect of each of the Investments (including in relation to NRAM and B&B);
 - (C) an assessment of opportunities, or potential opportunities to:
 - (i) realise value with respect to the Investments in the Listed Investee Companies; and
 - (ii) implement disposal and restructuring transactions in respect of the Wholly-Owned 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” and “disposal and restructuring” transactions which have previously been discussed between UKFI’s representatives and HM Treasury);
 - (D) an assessment of the extent to which each 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 any Disposal and Restructuring Transaction (as defined in paragraph 11.1); and
 - (B) UKFI’s (and its third party advisers’) views on the design, development and execution of any Disposal Transaction or Disposal and Restructuring 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 D 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

The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf) monitor, report on and work to secure compliance with the applicable Investee Company Conditions. UKFI will engage with each Listed Investee Company on these conditions 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:
 - (i) are consistent with the ABI industry best practice code on remuneration; and
 - (ii) are at the leading edge of implementing:
 - (a) the G20 remuneration principles;
 - (b) any remuneration proposals from the Walker Review; and
 - (c) the Financial Services Authority remuneration code;
- (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**”).

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:
- (A) such approval is required by virtue of Section 5 or Part D; or
 - (B) the vote relates to the approval of any transaction pursuant to which the relevant Listed Investee Company is proposing to effect disposal of an asset or business which is required in order to comply with the conditions imposed in relation to any decision of the European Commission in relation to State Aid.

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 – WHOLLY-OWNED INVESTEE COMPANIES

11. Disposal and Restructuring Transactions

- 11.1 It is anticipated that a broad range of disposal and restructuring transactions ("**Disposal and Restructuring Transactions**") could be implemented in respect of each of the Wholly-Owned Investment Companies, in each case as part of the process of giving effect to the principles of the business plan of such Wholly-Owned Investment Company.
- 11.2 Subject to the remaining provisions of this Section 11 and to Part D, UKFI and its representatives may, as part of the development and updating of its investment strategy for each Wholly-Owned Investment Company:
- (A) design, develop and implement Disposal and Restructuring Transactions; and
 - (B) take such action as it considers to be necessary or desirable to effect or approve, or reject, proposed Disposal and Restructuring Transactions,
- any such action to be taken having regard to the Overarching Objective and UKFI's other obligations under the UKFI Framework Document.
- 11.3 With regard to any Disposal and Restructuring Transaction, UKFI and its representatives must obtain the prior approval of HM Treasury before taking action to effect or approve, or reject, such transaction, if such transaction:

- (A) involves a disposal by HM Treasury of some or all of the shares it holds in any Wholly-Owned Investee Company;
- (B) will, or is expected to, give rise to proceeds of more than £500 million;
- (C) will, or is expected to, give rise to a net profit impact upon the relevant Wholly-Owned Investee Company (or, in the case of UKAR, on an aggregated basis in respect of more than one or UKAR, B&B and NRAM) of more than £25 million or, in the case of NRAM or B&B a net profit impact of more than £25 million;¹ or
- (D) involves the disposal of assets at a discount or a premium which is not in line with discounts or premia (as relevant) current in the market for comparable assets.

11.4 Without prejudice to paragraph 11.3, UKFI will, in relation to any Disposal and Restructuring Transaction, comply with Part D and will also seek HM Treasury's views in relation to any such Disposal and Restructuring Transaction before entering into any substantive engagement with the relevant Wholly-Owned Investee Company (or its directors, officers, employees or advisers) with respect to the design, development or execution of any Disposal and Restructuring Transaction.

12. Business Plan

12.1 The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf) monitor and work to secure compliance with the Business Plans and Investee Company Conditions applicable to each Wholly-Owned Investee Company, and, under the relevant Framework Documents, UKFI has various responsibilities in relation to the Business Plan and strategy of each Wholly-Owned Investee Company (including, in the case of UKAR, with respect to the underlying investments in NRAM and B&B).

12.2 UKFI and its representatives must obtain the prior approval of HM Treasury before approving or rejecting any action taken by a Wholly-Owned Investee Company which:

- (A) may involve, or may reasonably be expected to give rise to, a requirement for HM Treasury to contribute additional capital to that Wholly-Owned Investee Company; or
- (B) may, or may reasonably be expected to, have a material effect upon the profile of the repayment, or period within which NRAM or B&B is required or is expected to satisfy its obligations with respect to the repayment of funds made available pursuant to the Loan Arrangements; or

¹ Note: See UKFI rights of approval in paragraph 30 of the UK Asset Resolution Limited and UK Financial Investments Limited: Relationship Framework Document and paragraph 24 of the Northern Rock plc (formerly Gosforth Subsidiary No.1 plc) and UK Financial Investments Limited: Relationship Framework Document.

- (C) may, or may reasonably be expected to, lead to a material change in the strategy of that Wholly-Owned Investee Company.

13. Remuneration

13.1 The Framework Document for each of the Wholly-Owned Investee Companies provides that UKFI will (on HM Treasury's behalf) have various responsibilities in respect of:

- (A) the approval of the remuneration packages and any incentivisation arrangements for the directors and senior management of that Wholly-Owned Investee Company (including, in the case of UKAR, such remuneration packages and incentivisation arrangements for directors and senior management of NRAM and B&B); and
- (B) the structure of the incentive schemes for other employees of that Wholly-Owned Investee Company (including, in the case of UKAR, the structure of incentive schemes for other employees of NRAM and B&B).

13.2 In its engagement with the Wholly-Owned Investee Company on remuneration issues UKFI will seek to ensure that:

- (A) remuneration incentives are designed to promote long-term, sustainable performance;
- (B) remuneration policies are compliant with the G20 remuneration principles and the FSA remuneration code;
- (C) where a director 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 are designed to enable them to attract and motivate high calibre individuals to drive the delivery of their business plan.

14. Governance

The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf), exercise the rights in relation to the board of directors of each Wholly-Owned Investee Company in accordance with the Framework Document for the relevant Wholly-Owned Investee Company (including, in the case of UKAR, with respect to the board of directors of NRAM and B&B).

15. Voting

15.1 UKFI will exercise the voting rights attaching to HM Treasury's Investments in each Wholly-Owned Investee Company.

- 15.2 In exercising voting rights on behalf of HM Treasury pursuant to paragraph 15.1, 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 11 in relation to Disposal and Restructuring Transactions;
 - (ii) in Section 12 in relation to matters pertaining to the Business Plan and strategy of each Wholly-Owned Investee Company;
 - (iii) in Section 13 in relation to matters pertaining to remuneration; and
 - (iv) in Section 14 in relation to matters pertaining to corporate governance; and
 - (C) seek to ensure that any votes are exercised in a manner which will:
 - (i) facilitate and ensure compliance with and delivery of the Business Plan for each Wholly-Owned Investee Company;
 - (ii) facilitate and ensure compliance with the applicable Investee Company Conditions; and
 - (iii) facilitate and ensure compliance with and delivery of decisions of UKFI in accordance with the UKFI Framework Document and this Investment Mandate.

16. Loan Arrangements and Guarantee Arrangements

The UKFI Framework Document provides that UKFI will (on HM Treasury's behalf), manage certain aspects of the Loan Arrangements and the Guarantee Arrangements in respect of each Wholly-Owned Investee Company.

17. Litigation and Claims Handling

17.1 The Framework Document for each Wholly-Owned Investee Company provides that UKFI will (on behalf of HM Treasury) have various responsibilities in respect of any material litigation or claims concerning that Wholly-Owned Investee Company.

17.2 UKFI will promptly inform Treasury Legal Advisers ("TLA") of the details of any material litigation in respect of any Wholly-Owned Investee Company of which it becomes aware, and will:

- (A) provide TLA with monthly updates in respect of all such litigation;

- (B) upon request provide TLA with any additional information that is in its possession in respect of such litigation;
- (C) request from the relevant Wholly-Owned Investee Company any information in respect of such litigation that TLA reasonably considers is relevant;
- (D) consult with TLA in relation to the appropriate handling of such litigation; and
- (E) if so requested by TLA, delegate to TLA some or all its rights in relation to the handling of such litigation.

18. Other Matters

- 18.1 UKFI will, as contemplated by the UKFI Framework Document, act as the principal liaison point with each Wholly-Owned Investee Company in respect of the matters outlined in Sections 11 to 17.
- 18.2 UKFI's responsibilities pursuant to paragraph 18.1 shall be conducted in accordance with the UKFI Framework Document and this Investment Mandate and its engagement with each Wholly-Owned Investee Company shall, in particular, be carried out in a manner similar to that in which a financial sponsor would engage with a wholly-owned portfolio company.

PART D – APPROVALS AND INSTRUCTIONS

19. Approvals and Instructions

UKFI's Obligations

- 19.1 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 matter for which HM Treasury's prior consent or approval is required under the terms of this Investment Mandate 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 matter for which HM Treasury's prior consent or approval is required under the terms of this Investment Mandate of which UKFI is aware.

Approvals from HM Treasury; Instructions from HM Treasury

- 19.2 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 and Disposal and Restructuring Transactions) may be sought either:
 - (i) in respect of a single proposed Disposal Transaction or Disposal and Restructuring Transaction; or
 - (ii) by reference to a general authority from HM Treasury to implement Disposal Transactions or Disposal and Restructuring Transactions within agreed parameters (including with respect to pricing and timing).

19.3 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) and any "disposal and restructuring" transactions with respect to the Wholly-Owned Investee Companies.

PART E - MISCELLANEOUS

20. Status of the Investment Mandate

- 20.1 It is envisaged that this Investment Mandate may be amended, supplemented or replaced by HM Treasury from time to time.
- 20.2 In the event of any conflict or inconsistency, the UKFI Framework Document takes precedence over this Investment Mandate.
- 20.3 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.

504752734