UK Financial Investments Ltd

UK FINANCIAL INVESTMENTS LIMITED (UKFI)
ANNUAL REPORT AND ACCOUNTS 2012/13

UK FINANCIAL INVESTMENTS LTD ANNUAL REPORT AND ACCOUNTS 2012/13

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

Ordered by the House of Commons to be printed on 15 July 2013.

HC 562 LONDON: THE STATIONERY OFFICE £16.00

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

This document is also available from our website at www.ukfi.co.uk/publications .

ISBN: 9780102985696

Printed in the UK for The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office

ID 2570585 07/13

Printed on paper containing 75% recycled fibre content minimum.

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UKFI'S REMIT

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

UKFI is responsible for managing the Government's shareholdings in The Royal Bank of Scotland Group plc and Lloyds Banking Group plc. UKFI is also responsible for managing the Government's 100 per cent shareholding in and loans to UK Asset Resolution Ltd. UKAR was formed in October 2010 to integrate the activities of Northern Rock (Asset Management) plc and Bradford & Bingley plc.

UKFI's overarching objective is to manage these shareholdings commercially to create and protect value for the taxpayer as shareholder and to devise and execute a strategy for realising value for the Government's ownership stakes in an orderly and active way over time within the context of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and acting in a way that promotes competition.

More detail on UKFI's role, remit and ownership approach is set out in our Framework Document and Investment Mandate with HM Treasury, which can be found at www.ukfi.co.uk

CHAIRMAN'S FOREWORD

Over the course of the year, financial market conditions in Europe have improved from a period of extreme volatility, thanks in part to the actions of the European Central Bank (ECB). In the UK, recent months have seen more positive signs in the domestic economy. The regulatory landscape has also become more certain.

Against this backdrop, Lloyds Banking Group (Lloyds) and the Royal Bank of Scotland Group (RBS) have continued to deliver on their safety and soundness agenda, primarily on non-core run-down and capital. However, last year was another loss making year for both banks, driven by high funding costs, continued losses in non-core units and costs of regulatory conduct issues. The planned State aid divestments of branches at both Lloyds and RBS have been set back following the withdrawal of the original buyers.

In terms of executing UKFI's core mandate of disposing of the stakes in Lloyds and RBS, Lloyds is now quite advanced in its path to normalisation which has been reflected in a 45 per cent increase in its share price over the year under review. If economic conditions in the UK show durable improvement and financial market conditions are stable, it is reasonable to expect that potential opportunities to sell Lloyds shares may arise at prices which represent value for money for the taxpayer. There is no fixed timetable for disposals of the shares.

Initiating the privatisation of RBS would require continued clarification of its business model and prospects for a sustained return to profitability. During the year, UKFI has engaged extensively with RBS over the shape of its Markets business and the future of Citizens. The Chancellor has recently announced a review into the possible establishment of a "bad bank" to remove assets from RBS. He has also recognised the need to address the Dividend Access Share (DAS) which would be an important step on the path to privatisation. It is a matter for the Government to conclude if creating a bad bank and addressing the DAS would be in the interests of taxpayers and the wider economy, but UKFI will contribute to this process with a focus on its mandate to protect value for the taxpayer as shareholder and to create an orderly path to privatisation.

On 13 May 2013, Lloyds announced that its Chairman, Sir Winfried Bischoff, will be retiring. I would like to thank Sir Win, who has overseen a significant strengthening of the Group's position since his appointment in 2009. On 12 June 2013, RBS announced that Stephen Hester will step down from his position as Group Chief Executive later this year. I would like to thank Stephen for his instrumental role in the de-risking of RBS over the last five years in the face of challenging market conditions. The Boards of both banks will lead the process to identify successors for these roles and UKFI will be consulted before final appointments are made.

UK Asset Resolution Ltd (UKAR) continued its good progress in managing the orderly run-down of Northern Rock (Asset Management) plc (NRAM) and Bradford & Bingley plc (B&B). In the year ended 31 December 2012, UKAR's underlying profit increased to £1,097 million despite an exceptional cost of £271 million, reflecting required remediation in respect of a segment of NRAM Consumer Credit Act regulated loans. Total customer balances were reduced from £75.3 billion to £68.7 billion, with total payments to the taxpayer, including loan repayments, interest, fees and corporation tax increasing to £4.0 billion. UKAR also undertook a further portfolio sale and liability repurchase generating further value and loan repayments for the taxpayer.

The Chancellor recently announced at the Spending Round that UKAR has agreed to undertake the role of administrator for the Help to Buy mortgage guarantee scheme.

In his Mansion House speech on 19th June, 2013, the Chancellor rejected a recommendation by the Parliamentary Commission on Banking Standards that UKFI be wound up and its resources absorbed into HM Treasury. The Commission had been concerned about the level of Government involvement in the running of Lloyds and RBS. The Chancellor has made it clear that he believes it is his duty to represent the views of the taxpayer on the direction of the banks. We believe that our stand-alone status and clear investment mandate help enable the Boards to run the banks on a commercial basis and also to help us advise the Chancellor on the impact of broader policy issues on value for the taxpayer as shareholder and the path to privatisation.

I am very grateful to all the team at UKFI and to my Board colleagues for their continued dedication and work in pursuing our objectives. In particular, I would like to thank Jim O'Neil who is stepping down from his role as CEO later in the year. Jim's depth of expertise in banking and financial markets has been crucial for UKFI during a rather turbulent three year period. I wish him the very best in his new role. We are currently in the process of recruiting his successor. Julian Kelly has also left the Board being replaced by Kirstin Baker, his successor as HM Treasury Finance Director. Julian has made an invaluable contribution during his two years on the Board. I am pleased that Christopher Fox has joined us with responsibility for the UK Asset Resolution portfolio, the management of which continues to be one of UKFI's highest priorities.

Robin Budenberg
Chairman

8 July 2013

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01

Review of the past year and objectives for 2013/14

Introduction

This opening chapter provides an overview of UKFI's activities in managing the Government's shareholdings in the banks, structured around the following three sections:

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

More detailed information on the financial performance of each of the investee banks over the past year is provided in Chapters 2 to 4.

Chapters 5 and 6 provide further information on UKFI's internal governance and remuneration policies. The UKFI Board, supported by three sub-committees, takes all major strategic decisions for the company. The directors provide the company with the appropriate experience and expertise to manage the Government's shareholdings on a commercial basis.

Chapters 7 and 8 provide the Independent Auditor's Report and UKFI's Financial Statements for 2012/13. UKFI has produced an unqualified set of accounts for the four years of its operation. Our direct administration expenditure for the year under review was £2.0 million (down from £2.5 million in 2011/12), of which staff costs were £1.3 million.

UKFI's role as an active and engaged shareholder

Under the framework set by the Government, UKFI is required to manage the shareholdings on a commercial basis, actively engaging at a strategic level rather than intervening in day-to-day management decisions. This approach aims to ensure that value is re-established in the banks under the leadership of their own Boards and management teams, to the ultimate benefit of taxpayers. Our level of involvement varies between the partly and wholly owned institutions:

- in the case of UKAR, in which the Government is a 100 per cent shareholder, UKFI works with the Boards and management teams in a manner similar to that in which a financial sponsor would engage with a wholly owned portfolio company. For example, UKFI appoints the Chairman of the Board, is required to approve Board nominations, is represented at Board meetings and has approval rights over the companies' business plans.
- in contrast, UKFI takes a more arm's length approach to its interactions with Lloyds and RBS, recognising that, as listed companies, their directors have fiduciary duties under the Companies Act 2006 to act in the commercial interests of all shareholders, not just the largest. UKFI therefore operates in line with best practice for institutional shareholders, exercising its voting rights and engaging actively with the Boards and senior management on key strategic issues, while preserving their independence and freedom to determine their own commercial policies and business plans.

For all the investee companies our engagement is focussed on ensuring that their business strategies, performance, governance and risk management processes are aligned to the goal of building sustainable value for the taxpayer as shareholder. This approach is consistent with the best practice set out in the Financial Reporting Council's UK Stewardship Code for Institutional Investors, which aims to enhance the quality of engagement between shareholders and companies. Further details of how we act in accordance with this Code are available on our website.

Our approach to the stewardship of the shareholdings is also informed by active dialogue with a wide range of other institutional investors, with whom UKFI holds regular meetings.

Engagement with the wholly owned companies

Jim O'Neil, CEO of UKFI, is a member of the Board of UKAR and Keith Morgan has remained on the Board as one of the UKFI representatives. During 2012/13, UKFI has worked closely with the Board of UKAR to assess options for accelerating and enhancing the value of the rundown of the balance sheets of its combined business.

UKFI has also engaged closely with UKAR's Board on the remediation of a segment of NRAM Consumer Credit Act regulated loans. This was to ensure that any actions taken were consistent with UKAR's Treating Customers Fairly (TCF) obligations, whilst minimising costs to the taxpayer.

Engagement with Lloyds and RBS

Over the past year, the focus of our engagement with both Lloyds and RBS has been on the continued implementation of their restructuring plans, where both banks are nearing the end point in terms of their original objectives. For example, we engaged with the management of RBS on the further reduction in the size of its investment banking arm and the decision to prepare for an initial IPO of Citizens, both of which were announced at the Group's full-year 2012 results in February. We have also engaged on the prospects for a return to sustained profitability and a clear path towards reinstatement of dividends for both banks. In this regard, the reduction in RBS' core bank operating profit for the first quarter of 2013 is a setback. We will continue to engage on these key issues throughout next year and to ensure that both banks have the appropriate strategies to respond to changing market, economic and regulatory environments.

We have discussed the evolving regulatory environment with both banks, focusing on the stricter requirements on capital, liquidity and funding being introduced in the UK, the EU and internationally. This has included an examination of the effect these changes will have on overall business models given their impact on particular investment banking business lines.

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

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

While it is for the Boards of Lloyds and RBS to make decisions on the appointment of directors, as a large shareholder, we are consulted and seek to ensure that suitably qualified, independent non-executives are recruited to maintain the strength and balance of the Boards. During the reporting year we were consulted on the non-executive appointments of Lord Blackwell, Carolyn Fairbairn and Nicholas Luff at Lloyds. No new non-executive directors were appointed to the RBS Board over the course of the year.

Remuneration

Remuneration in the banking sector remains a high profile issue. UKFI's Framework Document states that we should not intervene in relation to individual remuneration decisions within Lloyds and RBS, except in relation to directors, through our vote on the Directors' Remuneration Report at the Annual General Meetings (AGM). As the largest shareholder in Lloyds and RBS, UKFI has worked closely with the Boards to ensure that pay is aligned with the interests of shareholders and is appropriately focussed on long-term performance. This engagement was conducted against the backdrop of the regulatory conduct issues experienced at RBS relating to the London Interbank Offered Rate (LIBOR) settlement. While both banks need to be sensitive to the wider economic and political environment in which they operate, it is also essential that they are able to offer remuneration packages that are adequate to attract and retain staff with the talent and experience needed to oversee the complex restructuring challenges they face.

Following a process of thorough engagement with the Lloyds and RBS Remuneration Committees, UKFI concluded that both Committees had exercised reasonable judgement in relation to their approaches to total variable remuneration this year, both in relation to financial performance and the retention of key employees. This resulted in continued reductions in total variable pay, particularly at RBS in the light of its decision to recoup the cost of the U.S. element of its LIBOR settlement from employee remuneration past, present and future. UKFI voted in favour of the Directors' Remuneration Reports at both the Lloyds and RBS AGMs.

For the 2012 performance year, the RBS Chief Executive, Stephen Hester, forewent his annual bonus owing to the IT issues the company experienced during 2012. At Lloyds, the Chief Executive, António Horta-Osório, was awarded an annual bonus subject to certain conditions concerning either the disposal of the Government's shares in Lloyds or the price performance of those shares.

Disposals strategy

UKFI is responsible for devising and recommending to HM Treasury a strategy for returning the banks to private ownership, and for executing the chosen strategy. Further details of how we are approaching this task for each of the investee institutions are set out below.

Northern Rock plc

The sale of Northern Rock plc to Virgin Money Holdings (UK) Limited (Virgin Money) took place on 1 January 2012. In July 2012, UKFI confirmed that HM Treasury has received from Virgin Money further cash consideration of £73 million in addition to the £747 million received on completion of the sale of Northern Rock plc. This takes the total cash consideration received on the sale of Northern Rock plc to £820 million, and the Government has the potential to receive over £1 billion in total once all the final terms of the transaction are completed.

UKAR

The year ending 31 December 2012 is the second full financial year for which it consolidated results for the group were produced. The combination of NRAM and B&B into UKAR has increased efficiency and shared capability in arrears management and treasury functions, which should enhance the future repayment of government loans. Alongside this, we have continued to work closely with the company to develop a strategy to accelerate and enhance the value of the rundown of the balance sheets of the combined business.

At 31 December 2012, UKAR owed HM Treasury £43.5 billion, an amount that the company expects to repay in full. Total payments from UKAR to the taxpayer, including repayments, interest, fees and corporation tax, increased from £2.8 billion in 2011 to £4.0 billion in 2012. In May 2012, UKFI and HM Treasury secured increased interest payments from UKAR by requesting an increase in the margin over Bank Base Rate on the government loan to NRAM. This followed a similar request in August 2011, which increased the margin over Bank Base Rate on the Working Capital Facility that HM Treasury provides to B&B.

Following the re-classification of UKAR to central government by the Office for National Statistics (ONS), UKAR will be consolidated with central government from an accounting and public finances perspective from 1 April 2013. This means that its reporting year will now coincide with the fiscal year, running from 1 April to 31 March. Therefore, UKAR's next annual report will be published alongside those of central government departments around June/July 2014, and will cover the 15-month period from 1 January 2013 to 31 March 2014 as part of the transition from the previous reporting period to the new one.

In 2012, UKAR undertook tender offers in respect of securitised notes issued by B&B and NRAM securitisation structures, resulting in the purchase of notes with a face value of £537 million, generating a profit of £143 million. This takes the total gains generated for the taxpayer to over £2.2 billion from liability management programmes undertaken by UKAR over the past three years.

In July 2012, NRAM announced the sale to Virgin Money of £465 million of loans to customers, at par.

Our separate report in February 2012 set out UKFI's assessment of the expected cash flows from the Government's intervention in B&B, NRAM and the creation and sale of Northern Rock plc. We have since updated the expected returns from the interventions, which are not expected to be materially different from our previous assessment.

Lloyds and RBS disposals

A number of the external factors that will form important parts of any decision to recommend initiating disposals have seen improving trends over the course of the year: market volatility has decreased; equity market performance has improved; and there have been more encouraging recent economic data in the UK.

There has been increasing certainty regarding aspects of prudential regulation and structural change in the UK banking system, for example through the Government's proposals for ring-fencing banks set out in the Banking Reform White Paper, and the move from the old Financial Services Authority (FSA) regime to the new architecture of the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA). As noted previously, however, the combination of regulatory reforms and shifts in the domestic and international market environment since 2009, are likely to have a permanent impact on the profitability and return on equity of large and complex banks like Lloyds and RBS, which will be reflected in the value of the taxpayer's stakes in these institutions.

Both Lloyds and RBS have continued to make good progress in restructuring their balance sheets, particularly on the safety and soundness agenda. Non-core assets across both banks were reduced by a total of £66 billion; liquidity buffers were improved; and RBS successfully exited the Asset Protection Scheme (APS) in October with no claim being made under the scheme and having paid £2.5 billion in fees to the Exchequer.

For Lloyds, the combination of these factors, with improving outlook for profitability recovery, has driven its share price significantly higher over the last year to trade close to its tangible book value. Whilst a number of factors meant that the past year was not the right time to recommend to the Government the commencement of the sale of shares in Lloyds, the prospects for commencing a broad-based sell-down of the shareholding are much better than at this point last year. In the first instance, an institutional placing of some of the shares in Lloyds is likely to deliver better value whilst minimising market risk.

RBS has continued to make progress on its re-structuring plan, though the prospects for beginning the disposal of the Government's RBS shares are less clear. There are still questions over the business model and it still needs to demonstrate its capability to return to sustained profitability. In his recent Mansion House speech, the Chancellor announced a review of whether establishing a bad bank to include some of RBS' assets would support the UK economy, be in the best interests of taxpayers and accelerate RBS' return to private ownership. As commercial shareholders we would, of course, be interested in any proposals which could result in the banks being re-privatised more quickly than would otherwise be the case. Issues such as good bank/bad bank split are wider public policy matters and therefore within the purview of Government rather than UKFI. However, we will participate in this review with a focus on our mandate to protect value for the taxpayer as shareholder and to create an orderly path to privatisation.

Within this context, UKFI's focus is on working with the banks to ensure that potential investors have the confidence to participate in future share sales, either in the public equity markets or through strategic placements, and whether over a near or medium-term time horizon. We will continue to monitor market developments so we are ready to capitalise on suitable disposal opportunities as they emerge. We also maintain a dialogue with a wide range of investors, to inform both our stewardship function and our approach to potential disposals.

There has been much speculation recently that the sell-down of Lloyds and RBS will begin as soon as the share price of each bank reaches the level at which it is recorded in the public finances by the ONS. For Lloyds, this is 61p per share. The equivalent share price recorded in the public finances for RBS is 407p, which includes a valuation of the DAS from 2009. Consistent with UKFI's Investment Mandate, the ultimate decision to proceed with any share disposal transaction rests with HM Treasury. We will make our recommendations to Ministers on the basis of our core objective of maximising the realisation of value for the taxpayer as shareholder, paying due regard to financial stability and competition issues (although the latter is only likely to be a relevant factor in this context if another incumbent bank was seeking to acquire a controlling stake in one of the businesses). These share price benchmarks should not therefore be regarded as automatic trigger points for the commencement of the sell-down. In particular, our assessment of the value for money of individual transaction proposals will focus on two primary considerations:

- whether it secures fair value for the shares based on a realistic assessment of the banks' earnings prospects using the information we have available at the time; and
- the likely impact on the value achieved in the overall disposals programme, recognising that it is likely to require multiple transactions over a number of years to dispose fully of the Government's substantial shareholdings, and a well executed sale can boost the prospects for subsequent offerings by building investor momentum and increasing the trading liquidity of the shares.

UKFI’s 2013/14 objectives

The key objectives that UKFI has agreed with HM Treasury for the 2013/14 reporting year are set out below.

Lloyds and RBS

1. To engage with the Boards and management teams of both banks to ensure that their strategies, performance and leadership remain appropriate to build sustainable shareholder value in the context of the evolving operating environment, underpinned by high standards of customer conduct, risk management and regulatory compliance.
2. To develop and maintain a strategy for the effective disposal of the shareholdings, taking into account relevant market developments, and to work with HM Treasury to ensure that we have robust analytical frameworks in place to assess the value for money and wider policy, operational and legal implications of individual transaction proposals.
3. To maintain an ongoing dialogue and communication with both existing and prospective investors in Lloyds and RBS, to inform our approach to both the stewardship and disposal of the shareholdings.

UKAR

4. To actively engage with UKAR in the ongoing orderly run-down of its closed mortgage books with a focus on maximising value for the taxpayer. This includes:
   - ongoing review of its business plan and balance sheet optimisation strategy;
   - working with the company to execute balance sheet transactions as appropriate; and
   - monitoring its approach to arrears management, impairment and cost efficiency.

All banks

5. To ensure that strong governance and leadership are maintained at these institutions to oversee the successful development and implementation of the agreed strategies.
6. To engage actively with the remuneration committees of these institutions in striking an appropriate balance between incentives and restraint.
7. To provide input and expertise where appropriate to support HM Treasury’s wider policy interests in relation to the banking sector, for example in relation to financial stability and competition.

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The Royal Bank of Scotland Group plc

Summary of Government shareholding

As at the end of March 2013, the Government held a total of 4 billion ordinary shares in RBS, equivalent to 65 per cent of RBS's voting share capital. In addition, the Government held 51 billion B shares, which are convertible into ordinary shares at a ratio of 10:1 as a result of the share consolidation exercise in June 2012, and the enhanced Dividend Access Share (see Box 2.1 below). In total, the Government's holding in RBS was equivalent to 81 per cent economic ownership.

Company overview

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

Company performance

The table below provides an overview of the key financial results for RBS from 2009 to 2012. Full details of the results, including for the first quarter of 2013, can be found on the company's website at www.investors.rbs.com/results_presentations

Table 2.1: Key financial performance metrics

	2012	2011	2010	2009
Risk measures (Group)				
Core tier 1 ratio[1]	10.3%	9.7%	9.4%	9.4%
Loan: deposit ratio	100%	108%	117%	135%
Short-term wholesale funding	£42bn	£102bn	£130bn	£216bn
Liquidity portfolio[2]	£147bn	£155bn	£155bn	£171bn
Value drivers (core bank)				
Return on equity	9.8%	10.4%	13.5%	13.5%
Cost: income ratio[3]	59%	60%	56%	53%

(All figures from statutory accounts)

Notes

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

Commenting on the Group's performance in 2012, Stephen Hester, Chief Executive, said:

> "2012 saw landmark achievements in our restructuring plan. It saw sustained customer lending support.
>
> The critical task of financial stabilisation passed milestones as RBS recommenced preference share dividends, completed the repayment of all crisis liquidity facilities from public authorities and exited the UK Government £282 billion Asset Protection Scheme without making any claim under it. The notable flotation of Direct Line Group represented the third of four EU state aid conditions and offset the disappointment of Santander withdrawing from its agreed purchase of 315 branches from RBS.

"Underlining this progress, RBS 5 year bonds traded at c.1 per cent credit spreads compared to their wide levels earlier in the year of c.4.5 per cent. The resultant own-credit accounting charge of £4.6 billion reflects this huge improvement in the perceived credit quality of RBS.

Core Bank operating profits were £6.3 billion of which Retail and Commercial businesses were £5.3 billion (excluding Ulster Bank) and Markets £1.5 billion. Non-core losses declined again (32 per cent to £2.9 billion) and non-core assets also fell ahead of target to £57 billion. We expect to slow the pace and cost of the remaining run-down once we hit the £40 billion asset target for the end of 2013. Exceptional charges in relation to Payment Protection Insurance claims, LIBOR settlements and interest rate hedging product redress, together with the own credit adjustment, resulted in a loss before tax of £5,165 million."

Shareholding in RBS

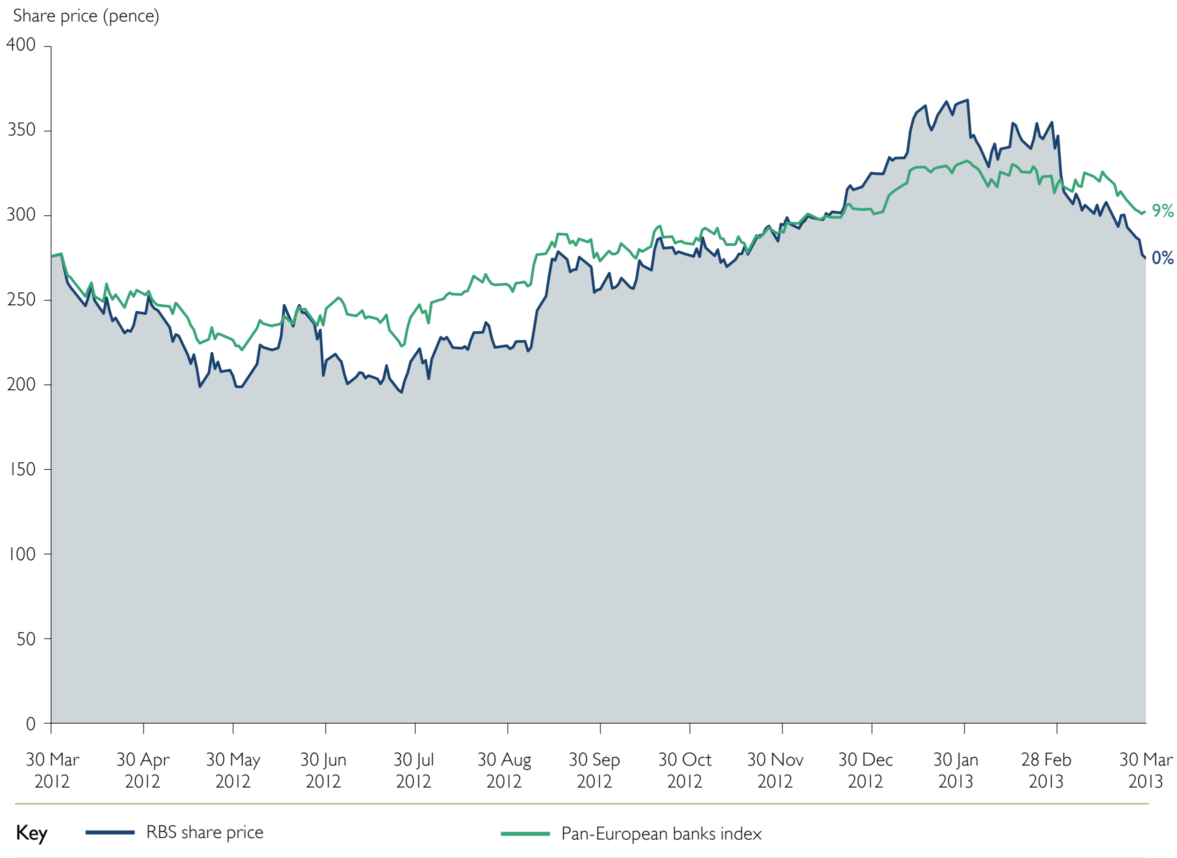
The Government's capital injection in RBS has been made in three different tranches, as summarised in the table below. Taking into account fees received, including £2.5 billion in relation to the implicit capital support provided by the APS from 2009 until the fourth quarter of 2012, the net cost of the Government's capital injection in RBS is £42,722 million, equivalent to an average of 471p per share. HM Treasury has informed us that the price at which the Government's stake in RBS is recorded in the public finances is the equivalent of 407p per share[1], including a valuation of the Dividend Access Share (DAS) from 2009.

HM Treasury shareholdings in RBS		Shares[2]	Total capital injection	Per share	Value at 31 March[3]
		m	£m	p	£m
Initial recapitalisation	December 2008	2,285	14,969	655	6,296
Preference share conversion[4]	April 2009	1,679	5,058	318	4,626
APS B shares[5]	December 2009	5,100[6]	25,500	500	14,051
Total		**9,064[6]**	**45,527**	**502 (avg)**	**24,973**
Fees received[7]			(305)		
Total, net of fees		**9,064**	**45,222**	**499 (avg)**	-
APS exit fee[8]			(2,500)		
Total, net of all fees			**42,722**	**471 (avg)**	

Notes

1. *The 407p average share valuation in the public finances includes an estimated value to the Government of the Dividend Access Share (DAS) at the time of purchase. If the DAS were to be bought back, or retired, for less (or more) than its original valuation then this would have a corresponding effect on the public finances, including the valuation of the RBS shares.*
2. *On 6 June 2012, RBS executed a share consolidation exercise, the effect of which was to divide the ordinary share count by 10 and multiply the unit price by the same factor. The impact of this exercise is factored into the figures provided in this table.*
3. *Based on RBS share price of 275.5p as at 28 March 2013.*
4. *Total capital injection includes accrued dividends and redemption premiums received of around £270 million.*
5. *Excludes theoretical valuation of the enhanced DAS, valued at £1.5 billion as at 31 March 2013. See Box 2.1.*
6. *Share count of the total stake shown includes consideration of 51 billion B shares, because after the share consolidation exercise in June 2012, 10 B shares convert into one ordinary share.*
7. *Underwriting fees on transactions paid to HM Treasury, including the recapitalisation and preference share conversion. Excludes annual fees paid to HM Treasury in relation to the APS and contingent capital facility.*
8. *In the fourth quarter of 2012, RBS reached the full minimum payment of £2,500 million for the implicit capital support provided by the APS since 2009.*

Figure 2.1: RBS share price performance



BOX 2.1: B SHARES AND THE DIVIDEND ACCESS SHARE

As part of the arrangements for RBS's participation in the Asset Protection Scheme (APS) in 2009, the Government subscribed to 51 billion B shares, together with one enhanced Dividend Access Share (DAS). The £25.5 billion capital injection in the form of B shares counts towards the bank's core tier 1 capital. B shares do not confer voting rights, but otherwise rank on an equal footing with ordinary shares. The market value of each B share is therefore assumed to be equivalent to a tenth of the value of an ordinary share, post the share consolidation exercise.

The B shares are convertible into ordinary shares at the Government's option (subject to certain parameters agreed with the European Commission). However, the Government has agreed not to convert B shares to the extent that its holding of ordinary shares would represent more than 75 per cent of the bank's total ordinary share capital. Since the share consolidation exercise in June 2012, 10 B shares convert into one ordinary share.

Alongside the APS agreement, the Government also provided an £8 billion contingent capital facility, under which it would acquire further B shares in the event that RBS' core tier 1 ratio falls below 5 per cent.

The single DAS confers the right to an enhanced dividend over and above the dividend entitlement of each ordinary and B share, providing the greater of 7 per cent of the B share nominal amount of £25.5 billion, or 250 per cent of the ordinary share dividend. DAS dividends are payable at the discretion of the RBS board, but must be paid if a dividend is awarded on ordinary shares. The DAS expires when the RBS ordinary share price equals or exceeds 650p for 20 days in any 30 day period.

There is no market price for the DAS. Therefore, its theoretical value is estimated using an option based valuation model on the basis of market-observable and non-observable data and assumptions, further details of which are provided in HM Treasury's Annual Report and Accounts (available at www.gov.uk/government/organisations/hm-treasury). Given the expiration trigger noted above, the value of the DAS diminishes as the share price approaches 650p.

Using this financial model, the DAS was valued at £1.5 billion at 31 March 2013. It should be noted that this theoretical valuation does not necessarily reflect the ultimate value that may be realised by the Government from resolving the DAS.

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Lloyds Banking Group plc

Summary of Government shareholding

As at the end of March 2013, the Government held a total of 27.6 billion ordinary shares in Lloyds Banking Group, equivalent to 39 per cent of total share capital.

Company overview

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

Lloyds Banking Group plc was formed in January 2009 following the acquisition of Halifax Bank of Scotland by Lloyds TSB. The main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

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

Company performance

The table below provides an overview of the key financial results for Lloyds Banking Group from 2009 to 2012. Full details of the results, including for the first quarter of 2013, can be found on the company's website at www.lloydsbankinggroup.com

Table 3.1: Key financial performance metrics

	2012	2011	2010	2009
Risk measures				
Core tier 1 ratio	12.0%	10.8%	10.2%	8.1%
Loan: deposit ratio	121%	135%	154%	169%
Short term wholesale funding (<one year)	£51bn	£113bn	£149bn	£163bn
Liquidity portfolio[1]	£205bn	£202bn	£160bn	£151bn
Value drivers				
Return on equity	-3.1%	-6.2%	-0.7%	8.8%
Cost: income ratio	55%	50%	47%	48%

(All figures from statutory accounts)

Note

1. *Eligible assets held for contingent liquidity purposes including cash, Government issued securities and other eligible securities with central banks.*

Commenting on the Group's performance over the course of 2012, António Horta-Osório, Chief Executive, said:

> "In 2012, we accelerated the delivery of our strategic initiatives and are now ahead of our plan to transform the Group, despite the challenging economic environment and continued regulatory uncertainty. As a result of our actions, the Group is now in a far stronger position, with capital ratios further improved, our funding position transformed, a significant and capital-accretive reduction in non-core assets achieved, costs reduced in absolute terms and asset quality further improved. While legacy issues, notably Payment Protection Insurance (PPI), resulted in the Group still reporting a loss at the statutory level, our achievements resulted in a significant improvement in both Group underlying and statutory performance, and continued strong returns, above our cost of equity, being delivered in our core business.
>
> In addition to investing for sustainable growth and returns in our core business, we are reducing risk through substantial reductions in our non-core asset portfolios and a sustainable approach to risk in our core business, which together have resulted in a significant reduction in the impairment charge. We are also continuing to reduce risk and strengthen the balance sheet by reducing wholesale funding, lowering operational leverage and building higher capital ratios. We expect these initiatives, together with our focus on lower-volatility retail and commercial banking, to lower our risk premium over time, and give us a significant competitive advantage.
>
> We are making significant investments in our simple, lower-risk, customer-focused UK retail and commercial banking model, thereby continuing to support our customers and helping Britain to prosper. We expect this to enable us to return to profitability and to grow our core business, to realise our full potential to deliver strong, stable and sustainable returns to shareholders, and to allow UK taxpayers' investment in the Group to be repaid."

Shareholding in Lloyds

The Government's capital injection in Lloyds has been made in three different tranches, as summarised in the table below. The gross cost of these injections is £20,313 million at an average cost per share of 73.6p. Taking into account the fees received from Lloyds, including £2.5 billion in relation to the implicit capital support provided by the APS in 2009, the net cost is £17,433 million, equivalent to 63.1p per ordinary share.

HM Treasury has informed us that the price at which the Government's stake in Lloyds is recorded in the public finances is the equivalent of 61p per share.

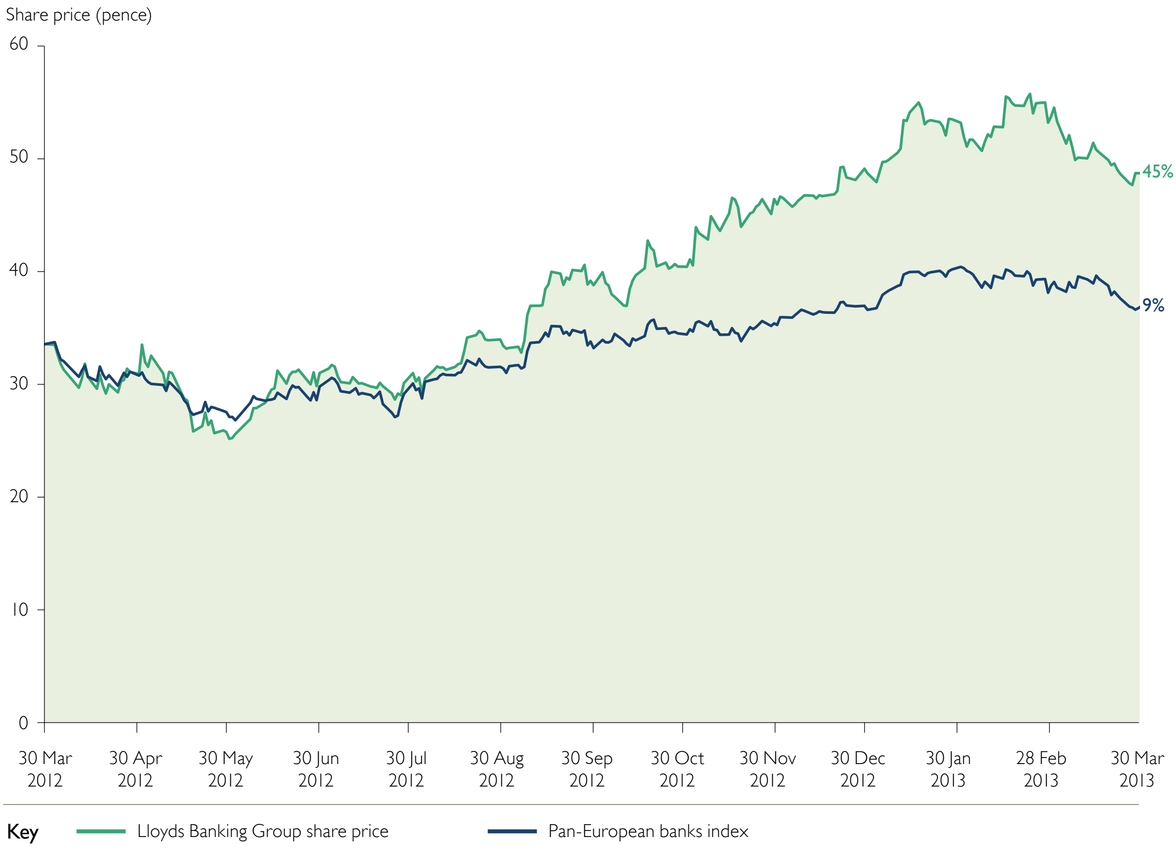
HM Treasury shareholdings in Lloyds		Shares	Total capital injection	Per share	Value at 31 March[1]
		m	£m	p	£m
Initial recapitalisation[2]	January 2009	7,277	12,957	182.50	3,543
Preference share conversion[3]	June 2009	4,521	1,506	38.43	2,201
Rights issue	December 2009	15,810	5,850	37.00	7,698
Total		**27,609**	**20,313**	**73.6 (avg)**	**13,442**
Fees received[4]			(381)		
Total, net of fees		**27,609**	**19,933**	**72.2 (avg)**	-
APS exit fee[5]			(2,500)		
Total, net of all fees		**27,609**	**17,433**	**63.1(avg)**	

(All figures from statutory accounts)

Notes

1. *Based on Lloyds share price of 48.69p as at 31 March 2013.*
2. *Includes Lloyds capitalisation issue on 11 May 2009 (177 million shares).*
3. *Ownership stake adjusted to include accrued dividends and redemption premiums of around £230 million.*
4. *Underwriting and commitment fees on transactions paid to HM Treasury, including in relation to the recapitalisation, preference share conversion and rights issue.*
5. *£2,500 million paid by Lloyds for the implicit capital support provided by the APS in 2009.*

Figure 3.1 Lloyds Banking Group share price performance



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UK Asset Resolution Ltd

Summary of Government shareholding

UKFI is responsible for managing the Government's 100 per cent shareholding in UK Asset Resolution Ltd, and its subsidiaries, Bradford & Bingley plc and Northern Rock (Asset Management) plc, on behalf of HM Treasury.

Company overview

On 1 October 2010, UKFI announced the establishment of UK Asset Resolution Ltd (UKAR) as the single holding company to manage, on an integrated basis, the closed mortgage books of both Northern Rock (Asset Management) plc (NRAM) and Bradford & Bingley plc (B&B).

Following the split of Northern Rock on 1 January 2010, NRAM holds and services the closed mortgage book of the original Northern Rock. As at 31 December 2012, the company's total assets were £48.6 billion, of which £36.3 billion were loans and advances to customers.

B&B was brought into public ownership by way of a Transfer Order on 29 September 2008. The Transfer Order also facilitated the sale of the UK and Isle of Man retail deposit business to Abbey National plc, part of the Santander Group, including all of B&B's retail deposit accounts and its branch network. As at 31 December 2012, the company's total assets were £38.5 billion, of which £32.5 billion were loans and advances to customers.

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

UKAR provides common governance, management and operations to both subsidiaries, although both remain as separate legal entities with their own balance sheets and Government support arrangements. The integration of the two companies, which was completed during the first half of 2012, creates a larger entity, which enjoys economies of scale. Increased efficiency and shared capability in arrears management and treasury functions will reduce operating costs and is expected to enhance future repayment of Government loans.

The year ending 31 December 2012 is the second full financial year for UKAR in which it produced consolidated results for the group.

At 31 December 2012, UKAR owed HM Treasury £43.5 billion, an amount which the company expects to repay in full.

Company performance

Table 4.1: UKAR Key Financial Performance Metrics[1]

£ million	2012	2011
Underlying net operating income	1,515	1,759
Operating expenses	(207)	(221)
Loan impairment loss	(241)	(390)
Underlying profit/(loss) before tax	1,097	1,089
Statutory profit/(loss) for the year	691	1,375
Loans from HM Treasury (year end)[2]	43,487	46,582
Shareholder funds (year end)	5,265	4,676

Notes

1. *UK Asset Resolution Ltd Annual Report & Accounts 2012.*
2. *Loans from HM Treasury at 31 December 2012 comprise £18,063 million HM Treasury loan to NRAM, £18,416 million B&B Statutory Debt to HM Treasury (of which £15,655 million is owed to the Financial Services Compensation Scheme) and £7,008 million HM Treasury Working Capital Facility to B&B.*

The underlying profit of the combined UKAR businesses increased from £1,089 million in 2011 to £1,097 million in 2012. Total payments to the taxpayer, including repayments, interest, fees and corporation tax, increased from £2.8 billion to £4.0 billion. In 2012, payments of interest to HM Treasury grew after UKFI and HM Treasury requested an increase in the interest rate charged on the Government loan provided to NRAM, adding to the increase in 2011 to the rate charged on the B&B working capital facility. These higher interest charges amount to around £260 million year-on-year and reflect the improved balance sheet strengths of B&B and NRAM.

The number of customers in arrears by three months or more reduced from 33,200 to 25,600 as a direct consequence of proactive arrears management, coupled with the continued benign interest environment in 2012. This contributed to the new provisions for loan impairment falling from £390 million to £241 million. UKAR reduced customer balances from £75.3 billion to £68.7 billion which enabled it to repay £3.10 billion of government loans. Ongoing costs are being well controlled, with operating expenses 6 per cent lower than 2011, at £207 million.

In December 2012, UKAR announced that remediation was required in respect of a segment of NRAM Consumer Credit Act regulated loans, incurring an exceptional cost of £271 million which has been included in the 2012 accounts.

The Board of UKAR has asked Deloitte LLP to conduct an independent enquiry into the specific circumstances of the issue and to make recommendations on potential enhancements to the associated processes and controls. This report has now been published and the Board have accepted Deloitte's recommendations.

In 2012, UKAR undertook tender offers in respect of securitised notes issued by B&B and NRAM securitisation structures, resulting in the purchase of notes with a face value of £537 million, generating a profit of £143 million. This takes the total gains generated for the taxpayer to over £2.2 billion from liability management programmes undertaken by UKAR over the past three years. In July 2012, NRAM announced the sale of £465 million of loans to customers, at par, secured on residential property, to Virgin Money.

THE UKFI BOARD AND SENIOR MANAGEMENT

Robin Budenberg – Chairman

Robin Budenberg joined UKFI on 1 January 2010 from UBS, where he was responsible for senior UK client relationships. He was Chief Executive of UKFI until January 2012, when he became Chairman. He was involved in the Government's Bank Recapitalisation Scheme in October 2008. He qualified as a Chartered Accountant with Price Waterhouse before joining SG Warburg in 1984. He subsequently worked at the successor firms – SBC Warburg, UBS Warburg and latterly UBS. During this time, he carried out various management roles and also advised a number of the UK's largest companies on major projects.

Jim O'Neil – Chief Executive

Jim O'Neil joined UKFI in October 2010 as Head of Market Investments and became Chief Executive on 2 April 2012. He is responsible for managing the Government's shareholdings in Lloyds and RBS as well as managing the Government's 100 per cent stake in UKAR and its subsidiaries. He joined UKFI from Bank of America Merrill Lynch, where he had spent 17 years. He has extensive experience of both the capital markets and the banking industry. He joined Merrill Lynch in 1993 in New York and relocated to London in 1999. Most recently he was Head of International Corporate Finance. He holds a BSc from the University of Virginia and an MBA from the University of Chicago Graduate School of Business.

Kirstin Baker – Non-Executive Director

Kirstin was appointed HM Treasury's Finance and Commercial Director in January 2013. In this role she oversees HM Treasury's finances and corporate services and is a member of the HM Treasury Board.

Kirstin previously worked as a senior policy official in HM Treasury, heading the team responsible for coordinating public spending and managing many of HM Treasury's interventions in individual banks in the wake of the 2008 crisis. Kirstin's earlier career was in European policy, and she worked as a competition official in the European Commission and in policy advisor roles in the Cabinet Office and the Foreign & Commonwealth Office. More recently, Kirstin was seconded to the Scottish Government, leading work on infrastructure investment.

Kirstin is a member of the Chartered Institute of Management Accountants. She was awarded a CBE in 2011 for her work during the financial crisis.

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 and in 1989 he joined Mercury Asset Management where, following the acquisition by Merrill Lynch, he rose to become Chief Investment Officer for Merrill Lynch's Investment Management activities outside the US.

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

Michael Kirkwood – Non-Executive Director

Michael Kirkwood is currently Chairman of hospital group Circle Holdings plc, a Non-Executive Director of AngloGold Ashanti Ltd and of Eros International plc, and Senior Advisor (formerly Chairman) of Ondra Partners LLP. Michael retired from a 31-year career with Citicorp at the end of 2008. Schooled in Scotland and a graduate of Stanford University, he initially worked for HSBC and the Bowater Ralli Group. His career has taken him to Asia, the US, continental Europe and Scandinavia, as well as the UK.

Michael served on the Board of Kidde plc for four years prior to its acquisition by United Technologies in 2005. Until June 2011 he was Deputy Chairman of PwC's Advisory Board. During his City career Michael served as Vice 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 and as 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.

Philip Remnant – Non-Executive Director

Philip Remnant is a Senior Adviser of Credit Suisse's investment banking division in Europe, Senior Independent Director of Prudential plc, Chairman of City of London Investment Trust plc and Deputy Chairman of the Takeover Panel. Between 2007 and 2012 he was Chairman of the Shareholder Executive.

Previously, Philip was a Vice Chairman of Credit Suisse First Boston in Europe, and was Director General of the Takeover Panel for two years between 2001 and 2003, and again in 2010. He formerly held senior investment banking positions with BZW and Kleinwort Benson. He is a qualified chartered accountant and has an MA in Law from New College, Oxford.

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

Lucinda Riches – Non-Executive Director

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

Lucinda was formerly an investment banker and has extensive experience in capital markets and privatisations. She began her career at Chase Manhattan Bank. Lucinda worked at UBS and its predecessor firms for 21 years until 2007. At UBS, she was Managing Director, Global Head of Equity Capital Markets and a member of the Board of the Investment bank.

Lucinda has an MA in Philosophy, Politics and Economics from Brasenose College, Oxford, and an MA in Political Science from the University of Pennsylvania.

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Directors' Report and Governance Statement

UKFI Board

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

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

Board membership	Current position	Committee membership
Robin Budenberg (01/01/2010)	Chairman	N (Chair), R
Jim O'Neil (31/01/2012)	Executive Director – Chief Executive	
Kirstin Baker (31/01/2013)	Treasury-Appointed Non-Executive	A (Chair)
Peter Gibbs (18/01/2009)	Independent Non-Executive	N, R, A
Michael Kirkwood (18/01/2009)	Independent Non-Executive	N, R (Chair), A
Philip Remnant (11/03/2009)	Treasury-Appointed Non-Executive	N
Lucinda Riches (15/01/2009)	Independent Non-Executive	N, R, A

Former Board members		Committee membership
Julian Kelly (27/01/2011 – 30/01/2013)	Treasury-Appointed Non-Executive	A (Chair)
Keith Morgan (31/01/2012 – 24/07/2012)	Executive Director – Head of Wholly Owned Investments	

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

During 2012/13 the membership of the Board changed, with Keith Morgan stepping down as an executive director. In addition, Kirstin Baker replaced Julian Kelly as an HM Treasury appointed non-executive director.

During the year the terms of appointment for Robin Budenberg, Peter Gibbs, Michael Kirkwood, Lucinda Riches and Philip Remnant expired, and these were all extended for a further 12 months. Jim O'Neil's appointment to the Board was also extended by a further 12 months.

The Board has put in place arrangements to manage any conflicts of interest. As part of this each director has disclosed, at the outset of their term as a director, any direct or indirect conflicts of interest they are aware of and may have in connection with being appointed a director of the company.

The Board meets a minimum of nine times a year and on an ad-hoc basis as required. The Board met 14 times during this reporting period.

The Chairman considers the effectiveness of the Board on a regular basis, and also reviews compliance with the Corporate Governance Code. UKFI has complied with all relevant provisions of the Code.

Board Committees

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

Audit and Risk Committee

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

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

The Audit and Risk Committee is authorised by the Board to investigate any activity within its terms of reference 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 the Financial Statements before submission to the Board; reviewing and considering reports from the auditors and the audit management letter and management response; and reviewing the operation and effectiveness of the company's internal control systems.

Remuneration Committee

The Remuneration Committee has met twice during this reporting period. The membership, details and terms of reference for the Remuneration Committee are set out in the Directors' Remuneration Report (Chapter 6).

Nominations Committee

The Nominations Committee did not meet during this reporting period. Certain succession issues were included as items for discussion at the main Board meetings.

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 them to be necessary.

The Nominations Committee works 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 as well as appropriate experience, qualifications, background and reputation, so that any such appointment will enhance the Board's ability to discharge its functions and responsibilities as set out in the Framework Document.

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

Meetings

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

	Board	Audit	Remuneration	Nomination
Total number of meetings held in 2012/13	14	3	2	0
Number of meetings attended in 2012/13				
Robin Budenberg	14		2	
Jim O'Neil	14			
Kirstin Baker[1]	3	1		
Peter Gibbs	13	3	2	
Michael Kirkwood[2]	14	3	2	
Philip Remnant[2]	12			
Lucinda Riches	13	3	2	
Former directors				
Julian Kelly[3]	9	1		
Keith Morgan[4]	5			

Notes

1. *Kirstin Baker was appointed to the Board on 31 January 2013.*
2. *With the consent of the Chairman, both Michael Kirkwood and Philip Remnant absented themselves from sections of four Board meetings during the year to avoid any actual or perceived conflict of interest relating to discussions on matters where they had previously declared an interest. These were formally minuted as separate Board meetings, but were in essence a continuation of the same Board meeting.*
3. *Julian Kelly stepped down as Director on 30 January 2013.*
4. *Keith Morgan stepped down as Director on 24 July 2012.*

Risk and Internal Control Framework

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

UKFI actively manages risks faced as an organisation and has therefore put in place business and operational risk management arrangements so that the Board, and through it, UKFI's stakeholders, can be reassured that UKFI is operating within the risk parameters set by the Framework Document and the Investment Mandate which is in place between UKFI and HM Treasury.

As part of this, UKFI maintains a risk register to record both the risks faced by UKFI as an organisation and those posed by having shareholdings in the banking sector. This document is maintained by the Chief Executive and reviewed and discussed by the UKFI Board on a regular basis.

The system of governance and internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

The following events were potential risk events during the year. UKFI identified these and took action to mitigate that risk.

1. Economic headwinds persisted throughout most of 2012, both in the UK and in the eurozone. There have been more encouraging data in relation to growth in the UK in the first quarter of 2013 and the eurozone crisis seems to have been calmed largely through actions taken by the European Central Bank. Nevertheless, the economic backdrop continues to provide a challenging operating environment for the banks, so UKFI has engaged with management regularly to assess how they are adapting the performance of their businesses to the underlying economic situation.
2. The regulatory environment continued to evolve throughout the year, both domestically in the UK and in Europe. In particular, the review into the capital positions of UK banks by the FPC and the transition from the Financial Services Authority (FSA) to the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) were at the forefront of the regulatory issues the banks faced. There was also the initial agreement at EU level regarding a cap on variable pay for senior staff and risk takers in banks either operating in the EU or domiciled in the EU. UKFI has reviewed these proposed new regulatory rules, approaches and structures and has discussed with those banks in which the Government is a shareholder how they might affect their operations.
3. Remuneration in the banking sector remains a high profile issue, particularly in light of the regulatory conducts issues experienced by several banks and the EU's proposals on a cap for variable pay. As in previous years, the UKFI banks continued to attract a high degree of attention and scrutiny. UKFI worked with the banks' Remuneration Committees on their approaches to remuneration, ensuring that they pursue policies that promote long-term sustainable performance.
4. Linked to this, a number of banks in the UK and elsewhere faced regulatory conduct fines and penalties throughout the year. This included RBS for attempted manipulation of LIBOR, a number of UK banks for Interest Rate Hedging Product (IRHP) mis-selling and the continued provisioning for Payment Protection Insurance (PPI) mis-selling. UKFI engaged closely with the management and Boards of Lloyds and RBS to ensure that appropriate sanctions were applied to any culpable individuals where necessary and to ensure the development and maintenance of robust risk management and controls systems to reduce the incidences of such failings in the future.

5. There were also conduct issues as UKAR, relating to a segment of NRAM Consumer Credit Act regulated loans. UKFI engaged closely with the Board and management of UKAR to ensure that any actions taken represented a fair deal for customers, consistent with UKAR's Treating Customers Fairly obligations, whilst minimising costs to the taxpayer.
6. During the year there were changes to the UKFI leadership, with the Head of Wholly Owned Investments stepping down in 2012 following the completion of his role in restructuring UKFI's wholly owned portfolio. UKFI ensured that processes were in place to manage effectively the succession risk associated with operating a small team.

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 its 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. There were no personal data related incidents during the year.

UKFI has policies and procedures which set out how staff are expected to operate in discharging their duties. These cover the operation of the UKFI Board, compliance, risk management, procurement, finance and human resources. In addition, all UKFI staff are required to undertake mandatory training that ensures awareness of the major risks associated with UKFI's day-to-day operating environment. There were three security incidents during the financial year, none of which resulted in any leak of information.

Sustainability

UKFI is committed to its contribution to sustainable development. UKFI is based on the Government estate, firstly in the Department for Culture, Media & Sport building until November 2012, and then in the HM Revenue & Customs (HMRC) building from December 2012. 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 central government negotiated contracts, which include 10 per cent renewable energy. We share HMRC's facilities management and mail service contractors, and both contractors hold their own ISO14001 accreditations.

Transparency

UKFI adheres to the Government's transparency agenda and publishes a range of data, either on our own website or on www.data.gov.uk, including:

- senior staff members' hospitality and expenses;
- salaries greater than that of the Prime Minister;
- transactions over £25,000;
- corporate credit card transactions over £500; and
- awarded contracts.

Payment of suppliers

In May 2010, the Government introduced a five day target for small and medium sized enterprise suppliers to receive payment. This accelerated their payment from the previous 10 day target set in November 2008. During 2012/13, UKFI made 90 per cent of all supplier payments within five days.

Review of effectiveness

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

The review of the compliance procedures for UKFI was completed in 2012/13. The processes have been agreed by the Audit Committee and the Board, and the procedures are now more formalised.

As Accounting Officer, under the terms of my appointment I have responsibility for maintaining and reviewing the effectiveness of the system of internal control. There were no significant control issues in the year under review.

Disclosure of information to auditors

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

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

UKFI has appointed the Comptroller and Auditor General as its external auditor. The National Audit Office carries out the audit for and on behalf of the Comptroller and Auditor General. The remuneration paid to the auditors is disclosed in the Financial Statements. No non-audit work was undertaken by the auditors.

Statement of Directors' and Accounting Officer's responsibilities in respect of the Directors' Report and the Financial Statements

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

In preparing these Financial Statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the the company's 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 UKFI. The responsibilities of the Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding UKFI's assets, are set out in Managing Public Money, published by HM Treasury.

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

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

Jim O'Neil
Chief Executive

8 July 2013

06

Directors' Remuneration Report

Remuneration Committee

The Remuneration Committee operates as a sub-committee of the UKFI Board. The membership of the Committee comprises the Chair of the Board and non-executive directors, and shall consist of no fewer than three members. The Board is responsible for any new appointments to the Remuneration Committee. The current members of the Remuneration Committee are Michael Kirkwood (Committee Chair), the Chair of the Board, Peter Gibbs and Lucinda Riches.

The Remuneration Committee meets a minimum of two times per year and on an ad-hoc basis as required. The Remuneration Committee met twice in this reporting period. Only members of the Remuneration Committee have the right to attend Remuneration Committee meetings. However, other individuals may be invited to attend for all or part of any meeting as and when appropriate.

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

- approve and agree with HM Treasury the remuneration levels for UKFI directors;
- approve UKFI's broad policy relating to remuneration for all UKFI employees;
- ensure that the individuals for whom the Remuneration Committee is responsible are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their contributions to the success of UKFI;
- periodically review the broad policy and make recommendations to the Board for changes, as appropriate;
- review, and by reference to the broad policy applying from time to time, approve the terms of any contract of employment and remuneration arrangements, including any annual or longer-term incentive packages and pension rights of:
  - the Chairman 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 Chief Executive, any executive director or direct report to the Chief Executive, (plus any other member of staff where the terms proposed are unusual or exceptional), with a view to ensuring that the individual is treated fairly, but that failure is not rewarded.

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

Remuneration policy

In approving the remuneration for Board members and other UKFI employees, the Remuneration Committee takes into account all factors it deems necessary, including the fact 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, the Business Plan, and the Investment Mandate.

UKFI has a policy of recognising those staff who have performed well in their roles through the payment of bonuses. Performance related pay is awarded based upon performance in the annual staff appraisal. Information on UKFI remuneration can be found in the UKFI Financial Statements 2012/13 in Chapter 8.

Any UKFI performance-related pay is calculated as a fraction rather than multiple of salary. A total of £77,923 was awarded for the performance year 1 December 2011 to 30 November 2012, of which £31,487 was paid out and £46,436 was retained because UKFI bonuses are deferred over three years and subject to clawback in line with the arrangements now in place at the investee banks. The total award represents 5.4 per cent of staff costs incurred over the same period.

In the previous performance year (1 November 2010 to 30 November 2011), a total of £85,294 was awarded, representing 4.7 per cent of staff costs for the same period, of which £36,171 was paid out and £49,123 retained. This year, £49,135 was paid out relating to deferred bonuses.

Staff profile

UKFI is a small organisation. At 31 March 2013, the number of full-time employees, including the Chief Executive, was nine. The average over the 2012/13 period was 10 excluding non-executive directors, and 16 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.

Due to the small number of staff in post throughout the year, this report does not include detailed statistics on the UKFI workforce. The release of such data would enable personal information on individual staff to be identified, which individual staff would have no reasonable expectation of being disclosed.

During the year, UKFI staff took an average of 3.3 days (2010/11: 4.8 days) of sickness absence.

Directors' information

Service contracts

UKFI policy on duration of contracts is that directors' contracts continue for a period of 12 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.

Changes during the year

Jim O'Neil became Chief Executive of UKFI on 2 April 2012.

Julian Kelly was a member of the Board as an employee of HM Treasury. Julian left his post of Finance Director at HM Treasury during the financial year, and Kirstin Baker was appointed in his place. Kirstin was therefore appointed to the UKFI Board in place of Julian Kelly.

Changes after the reporting period

On 25 April 2013 UKFI announced that Jim O'Neil will be stepping down from his role as Chief Executive. UKFI has started a process to recruit a new Chief Executive.

Directors' remuneration – salary

The table below shows the remuneration of each director for the period ending 31 March 2013, and has been audited by the company's auditors. The value of non-cash benefits is zero, and salary therefore includes only gross salary.

Each non-executive director is paid a fee of £28,500 for their attendance at the Board, plus £4,750 for each Board Committee Chairmanship held, plus £2,375 for each Board Committee membership for which they are not Chairman.

Director	Salary (£) Year ended 31 Mar 2013	Salary (£) Year ended 31 Mar 2012
David Cooksey (to 11 January 2012)	0	74,059 (Full year equivalent: £95,000)
Robin Budenberg	75,000	147,251
Peter Gibbs	35,625	35,625
Michael Kirkwood	38,000	38,000
Lucinda Riches	35,625	35,625
Philip Remnant	30,875	30,875
Julian Kelly[1] (to 30 January 2013)	0	0
Kirstin Baker[1] (from 31 January 2013)	0	0
Jim O'Neil (from 31 January 2012)	180,000	30,000 (Full year equivalent: 180,000)
Keith Morgan (from 31 January 2012 to 24 July 2012)	62,903 (Full year equivalent: 200,000)	33,333 (Full year equivalent: 200,000)

Note

1. *Julian Kelly and Kirstin Baker are/were members of the Board as employees of HM Treasury and do/did not receive remuneration for their services.*

In accordance with the Hutton Review of Fair Pay, we have disclosed the top to median staff pay multiples. The ratio between the highest paid director and the median pay of UKFI of £36,800 is 4.9 (2011/12: ratio of 4.3 between the highest paid director and the median pay of £46,300).

Directors' remuneration – performance-related pay

Neither the UKFI non-executive directors, nor the Chairman, are eligible for UKFI performance related pay.

The appraisal year for UKFI runs from December to November. Any awards made for the period December 2012 to November 2013 will be determined by the Remuneration Committee in line with the annual performance timetable in January 2014.

Keith Morgan received a bonus of £17,500 for the period he was a director in the 2011/12 appraisal year. Jim O'Neil waived his right to performance related pay for the 2011/12 appraisal year.

Expenses

Director	Expenses (£) Year ended 31 Mar 2013	Expenses (£) Year ended 31 Mar 2012
Sir David Cooksey	0	0
Robin Budenberg	0	482
Peter Gibbs	0	0
Michael Kirkwood	0	0
Lucinda Riches	0	0
Philip Remnant	0	0
Julian Kelly	0	0
Kirstin Baker	0	0
Jim O'Neil	1,164	77
Keith Morgan	134	10

Directors' pension arrangements

None of the non-executive directors or Robin Budenberg receives a pension from the company.

Jim O'Neil participates in the UKFI pension scheme, which is provided by Standard Life. UKFI matches individual contributions up to 15 per cent of salary. Keith Morgan also participated in the scheme until 31 March 2013.

The following employer contributions were made relating to the period that they were Board members:

Director	Employer pension contributions 2012/13 (£)	Employer pension contributions 2011/12 (£)
Jim O'Neil (from 31 January 2012)	27,000	4,500 (Full year equivalent: 27,000)
Keith Morgan (from 31 January 2012 to 24 July 2012)	0	5,000 (Full year equivalent: 30,000)

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

Michael Kirkwood
Chair of the Remuneration Committee

8 July 2013

07

Independent Auditor’s Report to the Shareholders of UK Financial Investments Limited

I have audited the Financial Statements of UKFI for the year ended 31 March 2013, 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 EU.

Respective responsibilities of the directors and the auditor

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

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Financial Statements. In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If I become aware of any apparent material misstatements or inconsistencies, I consider the implications for my report.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the Financial Statements have been applied to the purposes intended by Parliament and that the financial transactions recorded in the Financial Statements conform to the authorities which govern them.

Opinion on Financial Statements

In my opinion:

- the Financial Statements give a true and fair view of the state of the company's affairs as at 31 March 2013, and of its results for the year then ended;
- the Financial Statements have been properly prepared in accordance with the International Financial Reporting Standards as adopted by EU; and
- the Financial Statements have been prepared in accordance with the Companies Act 2006.

Opinion on regularity

In my opinion, in all material respects the expenditure and income recorded in the Financial Statements have been applied to the purposes intended by Parliament, and the financial transactions recorded in the Financial Statements conform to the authorities which govern them.

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which I report by exception

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

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

Bryan Ingleby
Senior Statutory Auditor

9 July 2013

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

ANNUAL REPORT AND ACCOUNTS 2012/13

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UKFI Financial Statements

Income statement for the year ended 31 March 2013

	Note	2012/13 £000	2011/12 £000
Revenue	4	2,199	5,693
		2,199	**5,693**
Expenses and fees incurred on the sale of Northern Rock plc		159	3,170
UKFI administrative expenses		2,040	2,523
		2,199	**5,693**
Profit/(loss) before corporation tax	2–7	**0**	**0**
Taxation	3(g)	0	0
Profit/(loss) for the period		**0**	**0**

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

All activities are classified as continuing.

The notes on pages 54 to 63 are an integral part of these Financial Statements.

Statement of financial position as at 31 March 2013

	Note	31 Mar 2013 £000	31 Mar 2012 £000
Non-current assets			
Property, plant and equipment	8	6	81
Intangible assets	9	0	8
Total non-current assets		**6**	**89**
Current assets			
Trade and other receivables	10	214	354
Cash and cash equivalents	11	131	292
Total current assets		**345**	**646**
Total assets		**351**	**735**
Equity			
Share capital	12	0	0
Retained earnings		0	0
Total equity		**0**	**0**
Liabilities			
Current liabilities			
Trade and other payables	13	299	669
Total current liabilities		**299**	**669**
Non-current liabilities			
Trade and other payables	14	52	66
Total non-current liabilities		**52**	**66**
Total liabilities		**351**	**735**
Total equity plus liabilities		**351**	**735**

These financial statements were approved by the Board of Directors on 27 June 2013 and were signed on its behalf by:

Robin Budenberg
Director

8 July 2013

Jim O'Neil
Director

8 July 2013

UKFI Company Number 6720891

The notes on pages 54 to 63 are an integral part of these Financial Statements.

Statement of cash flows for the year ended 31 March 2013

	Note	31 Mar 2013 £000	31 Mar 2012 £000
Cash flows from operating activities			
Profit/(loss) for the period		0	0
Adjustments for:			
Depreciation	8	52	67
Amortisation	9	7	9
Loss/(gain) on disposal of assets		24	0
		83	**76**
Decrease/(increase) in trade and other receivables	10	140	(66)
(Decrease)/increase in trade and other payables	13	(384)	175
Net cash from operating activities		**(161)**	**185**
Cash flows from investing activities			
Acquisition of property, plant and equipment		0	(6)
Acquisition of intangible assets		0	0
Net cash used in investing activities		**0**	**(6)**
Net increase/(decrease) in cash and cash equivalents		(161)	179
Cash and cash equivalents at 1 April		292	113
Cash and cash equivalents at 31 March		**131**	**292**

The notes on pages 54 to 63 are an integral part of these Financial Statements.

Notes to the Financial Statements

1. Reporting entity

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

2. Basis of preparation

(a) Statement of compliance

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

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

The Financial Statements were authorised for issue by the Board of directors on 27 June 2013.

(b) Basis of measurement

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

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

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

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

(c) Functional and presentation currency

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

(d) Use of estimates and judgements

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

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

Notes to the Financial Statements (continued)

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements.

(a) Foreign currency

Transactions which are denominated in foreign currencies are translated 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 asset date are translated into sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

(b) Property, plant and equipment and intangible assets

(i) Recognition and measurement

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

(ii) Subsequent costs

The cost of replacing a part of an item or property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that 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	3 to 10 years
Computer and telecom hardware, software and licences	3 to 10 years

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

(c) Leased assets

All of the company's leases are classified as operating leases, and the leased assets are not recognised in the Company's statement of financial position. Payments made under operating leases are recognised in 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.

(e) Revenue

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

(f) Corporation tax

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

(g) VAT

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

(h) Trade receivables

Trade and other payables are stated at cost.

(i) Cash and cash equivalents

Cash and cash equivalents are comprised solely of cash balances.

(j) 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) that 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.

Notes to the Financial Statements (continued)

(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. UKFI has no loans however, it has the following receivables included in the current assets: cash at bank and in hand and accrued income owed by group undertaking.

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 from 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 from fair value.

(k) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 March 2013, and have not been applied in preparing these Financial Statements. None of these is expected to have an effect on the Financial Statements of the company.

(l) Segmental reporting

UKFI has two reportable segments: the operation of UKFI, and the sale of Northern Rock plc. The budget updates are provided to the Chief Operating Decision Maker, which is UKFI's Board. Expenses associated with the Northern Rock plc sale are disclosed in the income statement.

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

4. Income

	2012/13 £000	2011/12 £000
Investment management fees	2,040	2,524
Reimbursement of fees relating to the sale of Northern Rock plc	159	3,169
Total	**2,199**	**5,693**

5. Remuneration of directors

	2012/13 £000	2011/12 £000
Directors' emoluments	496	425
Total	**496**	**425**

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

6. Personnel expenses

The average number of people working at the company during the period was 16 (2011/12: 20). This figure includes directors and long-term inward secondees.

The aggregate payroll costs of these people were as follows:

	2012/13 £000	2011/12 £000
Wages and salaries	1,033	1,465
Social security contributions	108	177
Defined contributions	67	103
Contributions to other pension plans	28	55
Agency staff	19	32
Total	**1,255**	**1,832**

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 Home Office secondees. UKFI has no ongoing liability in respect of the underlying pension schemes.

A bonus amount of £77,923 was awarded in respect of the period 1 December 2011 to 30 November 2012, representing 5 per cent of staff costs incurred over the same period. In respect of the previous performance year, £49,135 was paid out this year in deferred bonuses.

7. Profit before tax

Profit before tax is stated after charging:

	2012/13 £000	2011/12 £000
Auditors' remuneration: audit of these Financial Statements	11	16

Notes to the Financial Statements (continued)

8. Property, plant and equipment

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

2011/12	IT £000	Furniture & fittings £000	Total £000
Cost or valuation			
At 1 April 2011	103	119	222
Additions	0	6	6
Disposals	0	0	0
At 31 March 2012	**103**	**125**	**228**
Depreciation			
At 1 April 2011	(37)	(43)	(80)
Charged in year	(34)	(33)	(67)
At 31 March 2012	**(71)**	**(76)**	**(147)**
Carrying value at 31 March 2012	**32**	**49**	**81**
Carrying value at 31 March 2011	66	76	142

9. Intangible assets

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

2011/12	Software £000	Total £000
Cost or valuation		
At 1 April 2011	26	26
Additions	0	0
At 31 March 2012	**26**	**26**
Amortisation		
At 1 April 2011	(9)	(9)
Charged in year	(9)	(9)
At 31 March 2012	**(18)**	**(18)**
Carrying value at 31 March 2012	**8**	**8**
Carrying value at 31 March 2011	17	17

10. Trade receivables and other current assets

	31 Mar 2013 £000	31 Mar 2012 £000
Prepayments	22	11
Trade receivables due from related parties	192	343
Total	**214**	**354**

Notes to the Financial Statements (continued)

11. Cash and cash equivalents

	31 Mar 2013 £000	31 Mar 2012 £000
Government Banking Service, commercial banks	131	292
Cash in hand	0	0
Total	**131**	**292**

12. Called up share capital

	31 Mar 2013 £	31 Mar 2012 £
Authorised		
Equity: ordinary shares of £1 each	**100**	**100**
Allotted, called up and fully paid		
Equity: ordinary shares of £1 each	**1**	**1**

13. Trade payables and other current liabilities

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling due within one year		
Trade and other payables due to related parties	0	2
Other trade payables	9	66
Non-trade payables and accrued expenses	193	177
Taxation and social security	97	424
Total	**299**	**669**

14. Non-current liabilities

	31 Mar 2013 £000	31 Mar 2012 £000
Amounts falling due after more than one year		
Trade and other payables due to related parties	0	0
Non-trade payables and accrued expenses	46	58
Taxation and social security	6	8
Total	**52**	**66**

15. Operating leases

The total future minimum lease payments under operating leases are given in the table below for each of the following periods.

	31 Mar 2013 £000	31 Mar 2012 £000
Obligations under operating leases for the following periods comprise:		
Buildings		
Less than one year	141	180
Between two and five years	235	0
More than five years	0	0
Total	**376**	**180**

£145,000 was recognised as an operating lease expense during 2012/13.

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 (2011/12: nil).

17. Financial instruments

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

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

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

UKFI's financial liabilities are: trade and other payables due to related parties, other trade payables, non-trade payables and accrued expenses and taxation and social security. All are classified as 'other financial liabilities' and denominated in pounds sterling. The maturity analysis of the financial liabilities is less than one year (note 13) and more than one year (note 14).

In accordance with IFRS7, the carrying values of short-term financial assets and liabilities (at amortised cost) are not considered different from fair value.

Market risk

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

Credit risk

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

Notes to the Financial Statements (continued)

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.

18. Contingent liabilities

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

19. Related parties

As at 31 March 2013, the company is a wholly owned subsidiary undertaking of HM Treasury, which is registered in England and Wales and operates in the UK.

Jim O'Neil, UKFI's Chief Executive, is a non-executive director of Bradford & Bingley plc, Northern Rock (Asset Management) and UK Asset Resolution Ltd.

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

At the end of the year, the company had the following balances with related parties:

	31 Mar 2013 £000	31 Mar 2012 £000
Trade receivables due from related parties		
HM Treasury	192	343
Total	**192**	**343**

	31 Mar 2013 £000	31 Mar 2012 £000
Trade and other payables due to related parties		
HM Treasury less than one year	5	2
HM Treasury more than one year	0	0
Total	**5**	**2**

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

	31 Mar 2013 £000	31 Mar 2012 £000
HM Treasury – provision of investment management services	2,040	2,524
HM Treasury – expenses and fees for the sale of Northern Rock plc	159	3,169
Total	**2,199**	**5,693**

20. Events after the reporting period

On 25 April 2013, UKFI announced that Jim O'Neil will be stepping down from his role as UKFI Chief Executive. He will remain in post until summer 2013, and UKFI has started the recruitment process for his replacement.

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ISBN 978-0-10-298569-6