

10 February 2010

Keith Skeoch
Chief Executive Officer

Lord Myners
Financial Services Secretary to The Treasury
HM Treasury
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16 FEB 2010

Dear Paul

Thank you for your letter of 28 January. Let me address your request and provide relevant context.

We agree that it is vitally important that good corporate governance is exercised by all those involved in the process including how it is applied to the banks. This will ensure that the interests of the companies we invest in, the interests of our clients and, through business growth and the tax revenue this provides, ultimately the interests of the public are met.

Over the last two years Standard Life Investments has been engaged, individually and collectively, in an on-going dialogue with the executive and non-executive directors of the UK's major banks, including the Royal Bank of Scotland and Lloyds. These dialogues have covered a wide range of stewardship and investment issues, not least remuneration and capital adequacy. In recent months, we have met, or have arranged to meet, the Remuneration Committee Chairs of Lloyds, RBS, HSBC and Barclays. I should emphasise that these on-going discussions cover not just bonuses but also the other types of remuneration, such as pensions, which as you will appreciate, is an important component that should not be overlooked.

In general, the discussions have enhanced our understanding of the issues that the boards of the banks concerned have had to address in framing and implementing their policies. We have taken measured encouragement from the approaches being taken. In particular, there is a clear trend to move away from cash incentives to share based ones. Also, a move towards increased deferral and, in some cases, longer time horizons than the historic norm of 3 years. To sum up, we believe their remuneration policies and practices are heading in the right direction.

In respect of bonuses, the discussions have enabled us to convey views of principle, with a view to exercising constructive influence over the deliberations of the banks on this matter. To date, the banks have not been in a position to share with us their concrete proposals on quantum. As their annual financial statements approach completion over the next few weeks, I expect that this will be remedied.

Standard Life Investments Limited, tel. +44 131 225 2345, a company registered in Scotland (SC 123321) Registered Office 1 George Street Edinburgh EH2 2LL.

The Standard Life Investments group includes Standard Life Investments (Mutual Funds) Limited, SLTM Limited, Standard Life Investments (Corporate Funds) Limited and SL Capital Partners LLP. Standard Life Investments Limited acts as Investment Manager for Standard Life Assurance Limited and Standard Life Pension Funds Limited.

Standard Life Investments may record and monitor telephone calls to help improve customer service.
All companies are authorised and regulated by the Financial Services Authority.

In fulfilling our responsibilities on behalf of our clients when implementing our Corporate Governance Guidelines, which are disclosed on and available from our website, we have developed high level guidance to address the special factors pertaining to banks. The approach derived from this high level guidance:

- takes account of the risk appetite of the respective banks;
- makes allowance for the different approaches to remuneration by regulators in the different markets in which the relevant bank operates; and
- tends to favour:
 - reward arrangements that are genuinely long-term;
 - moves towards rebalancing fixed and variable pay in a manner that causes neither excessive cost pressures nor upward ratcheting of reward potential;
 - paying more in equity or quasi-equity instruments, provided that such a move can be accommodated within existing dilution guidelines; and
 - linking arrangements over the long-term to dividend payments and dividend cover, when relevant.

The approach outlined above has helped position us in our on-going discussions with the banks and will provide a basis for evaluating their remuneration reports when they are published.

It is important to bear in mind that the banks concerned operate in a competitive environment of global dimensions. That environment is not a level playing field and probably never will be. In the UK, British banks have to compete for talent with foreign banks who are not subject to the same level of scrutiny on matters of pay. Banks and their investors need to be mindful of this and its possible consequences in order to ensure they are enabled to implement balanced yet competitive proposals that are in the best long-term interests of the bank concerned.

Also, I should emphasise that in respect of Lloyds and the Royal Bank, institutional shareholders, such as Standard Life Investments, are, in substance, minority shareholders. It is the Government, through UKFI, which controls these banks. It is the Government, through UKFI, which is best positioned to exercise control over their direction in all matters, not least remuneration policies and practices. UKFI and Standard Life Investments enjoy a good, compliant relationship on stewardship matters at banks of mutual interest. That said, there are legitimate differences of opinion. For example, as long-term investors, we have serious reservations about the use of share price targets for long-term incentives; we understand that UKFI does not share such reservations. In our experience, the banks concerned have sought to strike an acceptable balance when seeking to reconcile such differences but in doing so they may motivate behaviours, such as seeking to maximise the share price in an unsustainable manner that are not consistent with their long-term interests.

It is important for the UK that it retains its reputation as a world leader in financial services and banking. A strong banking sector will be in a position to reimburse the government/taxpayer for the assistance they have been given and provide strong tax revenues going forward. It is in all our interests to see a strong and competitive banking sector which is well regulated and making a significant contribution to the economic well being of the country.

Before concluding, I should like to place on record our concerns regarding the high level of fees charged by investment banks, especially in respect of capital raisings. Such fees serve to fan the fire when bankers' pay comes into focus. As you know, we are examining ways to try to address this concern but I do not underestimate the challenges to achieving meaningful progress. I urge you to give this matter further consideration since a joined up approach is more likely to be successful than unilateral ones.

I trust the above information addresses the substance of your request and serves to underscore the responsible approach we seek to take in fulfilling our responsibilities on behalf of our clients.

With kind regards

Yours sincerely

A handwritten signature in dark ink, appearing to read "Keith", followed by a horizontal line.

Keith Skeoch
Chief Executive Officer
Standard Life Investments

