

| | |
|---|---|
| 65 Board of directors | 80 Internal control and risk management |
| 65 Biographies | 80 Directors' responsibility for internal control |
| 66 Group Executive and Advisory Boards | 80 Organisation structure |
| 67 Composition of the Board | 80 The risk management system |
| 67 Independence of the non-executive directors | 80 Systems of internal control |
| 67 Role of the Board | 81 Shareholders and share capital |
| 67 Directors' induction, training and information | 81 Share capital and voting rights |
| 68 Board effectiveness | 81 Payments to shareholders |
| 68 Conflicts of interest | 81 Communication with shareholders |
| 68 Indemnity | 81 Share class rights |
| 69 Board committees | 82 Restrictions on transfer of shares and limitations on holdings |
| 69 Attendance at meetings of the Board and its principal committees in 2008 | 82 Shareholder agreements and consent requirements |
| 69 Remuneration committee | 82 Authority to issue shares |
| 69 Nominations committee | 82 Authority to purchase own shares |
| 69 Audit committee | 82 Voting rights |
| 69 Ethics committee | 82 Major shareholdings |
| 69 Risk committee | 83 Other statutory information |
| 70 Directors' remuneration report | 83 Political donations |
| 70 Introduction | 83 Change of control |
| 70 The remuneration committee | 83 Essential commercial relationships |
| 70 Remuneration policy | 84 Annual report and the financial statements |
| 70 The main components of remuneration | 84 Statement of directors' responsibilities |
| 72 Service contracts | 84 Going concern |
| 72 External directorships of executive directors | 84 Disclosure of information to auditors |
| 73 Non-executive directors | 84 Responsibility statement |
| 73 Performance graph | |
| 74 Aggregate directors' remuneration | |
| 74 Directors' emoluments | |
| 74 Payments made to former directors of the Company | |
| 75 Pensions | |
| 76 Directors' share interests | |
| 78 Share options | |
| 78 Long-term incentive awards | |

Rolls-Royce attaches the highest priority to corporate governance, the system by which the Company is directed, managed and controlled in the interests of all its stakeholders. The strength of the Company's corporate values, its reputation and its ability to achieve its objectives are influenced by the effectiveness of the Company's approach towards corporate governance.

The Company is subject to the Combined Code on Corporate Governance published in June 2006 by the Financial Reporting Council (the Combined Code). A copy of the code can be obtained free of charge from FRC publications, telephone: +44 (0)20 8247 1264, email: customer.services@cch.co.uk and online at: www.frcpublications.com.

The Board confirms that throughout 2008, the Company complied with the Combined Code. This report explains how the Company discharges its corporate governance responsibilities.

Board of directors

At February 11, 2009

Simon Robertson

Non-executive Chairman

Chairman of the nominations committee

Appointed to the Board in 2004, he is the founder member of Simon Robertson Associates LLP and a non-executive director of HSBC Holdings plc, Berry Bros & Rudd Ltd, and The Economist Newspaper Limited. He is a director of The Royal Opera House Covent Garden Limited and a Trustee of The Eden Project and the Royal Opera House Endowment Fund. He is the former President of Goldman Sachs Europe Limited. Age 67.

Sir John Rose

Chief Executive

A member of the nominations committee

Appointed to the Board in 1992, having joined Rolls-Royce in 1984, and has been Chief Executive since 1996. He is a Trustee of The Eden Project. Age 56.

Helen Alexander CBE

Non-executive director

Chairman of the remuneration committee and a member of the ethics and nominations committees

Appointed to the Board in September 2007, she is a Senior Adviser of Bain Capital and a non-executive director of Centrica plc. She is Chair of the Advisory Board, Said Business School, Oxford University, a Trustee of the Tate Gallery and a governor of St Paul's Girls' School. Former CEO of the Economist Group from 1997 to 2008, she was awarded a CBE for services to publishing in 2004. She was Chairman of PPA, the magazine industry trade association, from 2006 to 2008. Age 52.

Peter J Byrom BSc, FCA

Non-executive director

A member of the remuneration, ethics and nominations committees

Appointed to the Board in 1997, he is Chairman of Domino Printing Sciences plc and a non-executive director of AMEC plc. He is a Fellow of the Royal Aeronautical Society. He was a director of N M Rothschild & Sons Limited from 1977 to 1996. Age 64.

Iain C Conn

Non-executive director, Senior Independent Director

A member of the audit and nominations committees

Appointed to the Board in 2005, he is an executive director of BP p.l.c. having held a range of executive positions within the BP Group worldwide. He is Chairman of the Advisory Board of The Imperial College Business School. Age 46.

Professor Peter Gregson

Non-executive director

A member of the remuneration and nominations committees

Appointed to the Board in March 2007, he is President and Vice-Chancellor of Queen's University Belfast and serves on the Northern Ireland Economic Development Forum, the Council of CBI Northern Ireland and the Steering Group of the US – Ireland Research and Development Partnership. He is a Fellow and Council Member of the Royal Academy of Engineering, a Member of the Royal Irish Academy, and Deputy Lieutenant of Belfast. He was formerly Professor of Aerospace Materials and Deputy Vice-Chancellor of the University of Southampton and has served on the Council for the Central Laboratory of the Research Councils. Age 51.

James M Guyette BSc

President and Chief Executive Officer of Rolls-Royce North America Inc.

Appointed to the Board in 1998 having joined Rolls-Royce in 1997, he is a director of the PrivateBank and Trust Company of Chicago, Illinois and of priceline.com Inc. Until 1995 he was Executive Vice President, Marketing and Planning of United Airlines. Age 63.

Dr John McAdam

Non-executive director

A member of the remuneration and nominations committees

Appointed to the Board in February 2008, he is Chairman of United Utilities PLC and Rentokil Initial plc, the Senior Independent Director of J Sainsbury plc and a non-executive director of Sara Lee Corporation. He was the Chief Executive of ICI plc until ICI's acquisition by Akzo Nobel. Age 60.

John Neill CBE

Non-executive director

A member of the audit and nominations committee

Appointed to the Board in November 2008, he is the Chief Executive of the Unipart Group of Companies. He is a member of the Council and Board of Business in the Community and is a non-executive director of Charter plc. He is Vice President of the Society of Motor Manufacturers and Traders, BEN, the automotive industry charity and The Institute of the Motor Industry. Age 61.

John Rishton

Non-executive director

Chairman of the audit committee and a member of the ethics and nominations committees

Appointed to the Board in March 2007, he is Chief Executive Officer of Royal Ahold. He began his career in 1979 at Ford Motor Company and held a variety of positions both in the UK and in Europe. In 1994 he joined British Airways Plc where he was Chief Financial Officer from 2001 to 2005. He is a former non-executive director of Allied Domecq. Age 50.

Andrew B Shilston MA, ACA, MCT

Finance Director

Appointed to the Board in 2003 having joined Rolls-Royce in 2002, he was a non-executive director of Cairn Energy PLC until May 2008 and he was Finance Director of Enterprise Oil plc from 1993 until 2002. Age 53.

Colin P Smith BSc Hons, FREng, FRAeS, FIMechE

Director – Engineering and Technology

Appointed to the Board in 2005 having joined Rolls-Royce in 1974, he has held a variety of key positions within Engineering, including Director – Research and Technology and Director of Engineering and Technology – Civil Aerospace. He is a Fellow of the Royal Academy of Engineering, the Royal Aeronautical Society and the Institution of Mechanical Engineers. Age 53.

Ian C Strachan

Non-executive director

Chairman of the ethics committee and a member of the audit and nominations committees

Appointed to the Board in 2003, he is a non-executive director of Johnson Matthey plc, Xstrata plc, Transocean Inc and Caithness Petroleum Limited. He is the former Chief Executive of BTR plc, former Deputy Chief Executive (1991 to 1995) and Chief Financial Officer (1987 to 1991) of Rio Tinto plc, former non-executive Chairman of Instinet Group Inc and former non-executive director of Commercial Union and Reuters Group plc. Age 65.

Mike J Terrett

Chief Operating Officer

Appointed to the Board in 2007, having joined Rolls-Royce in 1978, he has held a variety of senior positions in the development of new aero-engine programmes, including Managing Director of Airlines and President and Chief Executive Officer of International Aero Engines (IAE) based in the United States. Prior to his appointment as Chief Operating Officer he was President – Civil Aerospace. He is a member of the Institute of Mechanical Engineers and a Fellow of the Royal Aeronautical Society. Age 52.

Tim Rayner

General Counsel and Company Secretary

He joined Rolls-Royce in 2007 having previously been General Counsel and Company Secretary at United Utilities PLC. Age 48.

The Group Executive

The Group Executive is responsible for the management of the Group within the strategy determined by the Board. It is chaired by Sir John Rose, Chief Executive, and its other members are:

| | | | |
|-----------------------------|---|------------------------|--|
| Axel Arendt | President – Defence Aerospace | Dr Mike Lloyd | Director – Manufacturing |
| Charles Blundell | Director – Public Affairs | Alain Michaelis | President, Gas Turbine Supply Chain & Deputy Chief Operating Officer |
| Tom Brown | Director – Human Resources | Dr Mike Orris | Chief Procurement Officer |
| Miles Cowdry | Director – Global Corporate Development | John Paterson | President – Marine |
| Tom Curley | President – Energy | Tim Rayner | General Counsel and Company Secretary |
| James Guyette | President and Chief Executive Officer of Rolls-Royce North America Inc. | Andrew Shilston | Finance Director |
| Dr Michael Haidinger | President – Rolls-Royce Deutschland Ltd & Co KG | Colin Smith | Director – Engineering and Technology |
| Lawrie Haynes | President – Nuclear | Mike Terrett | Chief Operating Officer |
| Mark King | President – Civil Aerospace | Tony Wood | President – Services |

International Advisory Board

The International Advisory Board (IAB), formed in 2006, advises the Group on emerging political, business and economic trends. Membership of the IAB is as follows:

| | | | |
|---------------------------------|---|--------------------------|---|
| Lord Powell of Bayswater | Chairman of IAB, former Foreign Affairs and Defence Adviser to Prime Ministers Margaret Thatcher and John Major | Mustafa Koç | Chairman of Koç Holding AS |
| Bernard Duc | Senior Partner, HMI Ltd (Hong Kong), Chairman of the Rolls-Royce South East Asia Advisory Board, former Deputy Chairman of the Rolls-Royce European Advisory Board | Taizo Nishimuro | Chairman of Tokyo Stock Exchange Group Inc. and former Chairman of Toshiba Corporation |
| Sir Rod Eddington | Non-executive Chairman, Australia & New Zealand JPMorgan Chase Bank NA and former Chief Executive, British Airways Plc | Lubna Olayan | CEO of the Olayan Financing Company |
| Dr Fan Gang | Professor at China's Academy of Social Sciences and Head of National Economic Research Institute | Eduardo Serra | Former Spanish Defence Minister |
| Carla Hills | Chair and CEO, Hills & Company, International Consultants, former US Trade Representative, former Secretary of Housing and Urban Development, former Assistant Attorney General | Ratan Tata | Chairman of Tata Sons Ltd |
| General Sir Mike Jackson | Former Chief of the General Staff, UK Ministry of Defence | Matthias Wissmann | Former Minister for Transport and Research in Germany, President of the Association of the German Automotive Industry (VDA), Vice-Chairman of the Federation of German Industries (BDI) and Senior International Counsellor at WilmerHale |
| | | Lee Hsien Yang | Chairman, Fraser & Neave Limited |
| | | Ernesto Zedillo | Former President of Mexico, Director, Yale Center for the Study of Globalization |

South East Asia Advisory Board

The South East Asia Advisory Board (SEAAB), formed in 1987, advises the Group on political, economic and business trends in Singapore, Thailand, Malaysia and the Philippines. Membership of the SEAAB is as follows:

| | | | |
|---|--|--------------------------------|---|
| Bernard Duc | Chairman of the SEAAB, Senior Partner, HMI Ltd (Hong Kong) former Deputy Chairman of the Rolls-Royce European Advisory Board | Edward W Rubin | Chairman of a Hong Kong-based private investment company, Non-Executive Director of Singapore-listed Noble Group Ltd |
| Chatrachai Bunya-Ananta | Member of the National Legislative Council of Thailand Former Senator of Thailand Former President of Thai Airways International plc | Soedibyo | Brigadier-General (retired) Senior Fellow, Institute for Strategic Studies of Indonesia. Former Vice-Assistant to the Commander-in-Chief Indonesian Air Force for Policy & Planning |
| Dato' Jaffar Indot | Independent Non-Executive Director, Shell Refining Company (FO) Berhad Chairman, Malaysian Dutch Business Council President, Federation of Family Planning Associations Malaysia | Prof (Mrs) Tan Sook Yee | Member of the Panel of the Strata Titles Board ex-Professor of Law, National University of Singapore |
| H E Ambassador Jose V Romero, Jr | Chairman/President, Philippine Council for Foreign Relations, Former Philippines Ambassador to Italy | Dr Bernardo M Villegas | University Professor, University of Asia and the Pacific, Manila, Philippines, Visiting Professor in Economics, IESE Business School, Barcelona, Spain |

Composition of the Board

Simon Robertson chairs the Board of directors and Sir John Rose is the Chief Executive. The division of responsibilities between them is set down in writing and agreed by the Board. Iain Conn is the Company's Senior Independent Director.

There are currently 14 directors on the Board comprising the non-executive Chairman, the Chief Executive, four other executive directors and eight non-executive directors.

The quality and broad experience of the directors, the balance of the Board's composition and the dynamics of the Board as a group, ensure the Board's effectiveness and also prevent any individual or small group dominating the Board's decision making.

Each executive director receives a service contract on appointment (see page 72 for further information) and each non-executive director receives a letter setting out the conditions of his or her appointment.

Non-executive directors are appointed for an initial term of three years, which may be extended subsequently with the agreement of the Board, although reappointment is not automatic. Executive directors are employees who have executive responsibilities in addition to their duties as directors. Non-executive directors are not employees and do not participate in the daily business management of the Group.

During the year, there were a number of Board changes: Dr John McAdam was appointed as a non-executive director on February 19, 2008; Carl Symon retired as a non-executive director at the Annual General Meeting (AGM) on May 7, 2008 and was succeeded by Helen Alexander CBE as chairman of the remuneration committee; and John Neill CBE joined the Board as a non-executive director on November 13, 2008.

Under the Company's Articles of Association, one third of the directors are subject to re-election every year, with each director also being subject to re-election at intervals of not more than three years. Any director appointed during the year is separately required to retire and seek election by the shareholders at the next AGM. The Board also requires any non-executive director who has served on the Board for more than nine years to be subject to annual re-election at the AGM.

John Neill CBE, having been appointed to the Board during the year, will seek election by shareholders at the AGM. The directors retiring under the annual re-election provisions contained in the Articles of Association are Iain Conn, James Guyette, John Rishton and Simon Robertson. They all offer themselves for re-election.

Peter Byrom, having served more than nine years on the Board, is subject to annual re-election by shareholders. No other non-executive director has served for more than nine years on the Board. In recommending Peter Byrom for re-election, the Board took account of the desirability of retaining a non-executive director with long experience on the Rolls-Royce Board. The Board believes strongly that in a long-term, complex and technologically advanced business it is essential that non-executive directors have the opportunity to acquire, over a number of years, the experience and knowledge of the business and the sectors within which the Group operates.

The Articles of Association also provide that no person may be appointed to the office of chairman (in an executive capacity) or to the office of chief executive, managing director or joint managing director of the Company, unless the individual is a British citizen. No person may be appointed to the office of director of the Company if, immediately following such appointment, the number of directors of the Company who are not British citizens would exceed one half of the total number of directors of the Company for the time being.

Subject to the provisions of relevant statutes, the Company's Memorandum and Articles of Association and any directions given by special resolution, the directors may exercise all the powers of the Company.

Independence of the non-executive directors

The Board applies a rigorous process in order to satisfy itself that its non-executive directors remain independent. The Combined Code does not regard the Chairman as being independent in view of his unique role in corporate governance. However, on his appointment as Chairman on January 1, 2005, Simon Robertson met the criteria for independence contained in the Combined Code. His other significant commitments are described on page 65. The Board reviews the independence of the non-executive directors every year, based on the criteria in the Combined Code. This review was undertaken in 2008, and the Board concluded that all the non-executive directors (other than the Chairman) were independent in character and judgement. The Board determined that Peter Byrom remains independent in character and judgement notwithstanding that he has served on the Board for more than nine years, that there are no relationships or circumstances which are likely to affect his independent judgement and that he is in no way dependent on the remuneration he receives from the Company.

Role of the Board

The Board is responsible to all the Company's stakeholders for its conduct and for the performance of the Company.

The day-to-day running of the Company is delegated by the Board to the executive team under the leadership of Sir John Rose, the Chief Executive.

The Board retains responsibility for the approval of certain matters which affect the shape and risk profile of the Company, as well as such items as the annual budget and performance targets, the published accounts, payments to shareholders, major capital investments and any substantial change to balance sheet management policy. This division of responsibilities between the Board and the executive team is set out in detail in a schedule approved annually by the Board, which defines those decisions which can only be taken by the Board itself.

The Board has approved the following statement summarising its core responsibilities:

Primary goal

The primary goal of the Board is to ensure that the Company's strategy creates value for the long-term investor within an acceptable risk profile.

The Board's tasks

In line with its primary goal, the Board's principal tasks are to:

- ensure the development of the Company's strategy and keep it under rigorous review;
- monitor the implementation of the strategy, ensuring that the necessary financial and human resources are in place to deliver it and that effective controls exist to manage risk;
- safeguard the values of the Company, including its brand and corporate reputation and the safety of its products;
- oversee the quality and performance of management and ensure through effective succession planning and remuneration policies that it is maintained at world-class standards; and
- maintain an effective corporate governance framework that aspires to deliver long-term value to shareholders.

Directors' induction, training and information

Newly appointed directors participate in a structured induction programme and receive a comprehensive data pack providing detailed information on the Group.

An existing executive director acts as a mentor to each newly appointed non-executive director, giving guidance and advice as required. As part of their briefing, non-executive directors visit key sites and meet a cross-section of managers and employees to gain a better understanding of the Group and its operations. Ongoing training is available for all the directors, including presentations by the executive team on particular aspects of the business.

There is a procedure for directors to take independent professional advice at the Company's expense. This is in addition to the access every director has to the General Counsel and Company Secretary.

Board effectiveness

The Chairman and the non-executive directors meet at least once a year without the executive directors present, in order to review the operation of the Board.

The Chairman has an annual meeting with each non-executive director to review his or her contribution to the Board. The Senior Independent Director chairs an annual meeting with the non-executive directors to review the performance of the Chairman, the outcome of which is reported back to him.

Each year, the Chairman reviews the performance of the Chief Executive as part of the annual salary review process overseen by the remuneration committee. The Chief Executive reviews the performance of the other executive directors in the same way.

In 2008, the annual process to enable the Board to evaluate the effectiveness of its performance involved the completion of a written questionnaire by the directors and a series of meetings between the Chairman and each individual director. The Board reviewed the results of this exercise in February 2009.

The review covered all aspects of corporate governance, including board and committee structure, board dynamics, the conduct and frequency of board meetings, the consideration of strategic issues by the Board and the information provided to directors. The Board considered that it was operating effectively. The review identified the need for improvements in some areas, including revising the format of the Board strategy sessions and improving the consistency of Board papers. The Board agreed to encourage greater interaction between the Board and management, for example, by arranging Board visits to Company facilities. The Board has also asked to receive more regular reports on succession planning for executives. These improvements will be implemented in 2009. The audit, remuneration and nominations committees have separately undertaken reviews of their terms of reference and effectiveness during 2008.

Conflicts of interest

Directors have a duty to avoid a situation in which they have, or can have, a direct or indirect interest which conflicts, or possibly may conflict, with the interests of the Company unless that situational conflict has been authorised by the Board. The Board has reviewed and authorised all directors' situational conflicts and has agreed that while directors are required to keep confidential all Company information, they shall not be required to share with the Company confidential information received by them from a third party which is the subject of the situational conflict. The Board has also agreed that the authorisation of situational conflicts will be reviewed annually.

Indemnity

The Company has entered into separate deeds of indemnity in favour of its directors. The deeds provide substantially the same protection as that already provided to directors under the indemnity in Article 170 of the Company's Articles of Association. The Company has also arranged appropriate insurance cover for any legal action taken against its directors and officers.

The Board is assisted by its committees. Details of their membership and principal terms of reference are set out below. Their full terms of reference are available on the Group's website at www.rolls-royce.com.

Attendance at meetings of the Board and its principal committees in 2008

| | Board | | Remuneration | | Nominations | | Audit | | Ethics | |
|---------------------|-------|-----------|--------------|------------|-------------|------------|-------|------------|--------|------------|
| | Held | *Attended | Held | * Attended | Held | * Attended | Held | * Attended | Held | * Attended |
| Helen Alexander CBE | 8 | 7 | 5 | 5 | 2 | 2 | | | 2 | 2 |
| Peter Byrom | 8 | 7 | 5 | 5 | 2 | 2 | | | 2 | 2 |
| Iain Conn | 8 | 7 | | | 2 | 1 | 5 | 4 | | |
| Prof Peter Gregson | 8 | 6 | 5 | 4 | 2 | 1 | | | | |
| James Guyette | 8 | 8 | | | | | | | | |
| Dr John McAdam | 7 | 6 | 4 | 4 | 2 | 2 | | | | |
| John Neill CBE | 2 | 1 | | | 1 | 0 | 0 | 0 | | |
| John Rishton | 8 | 8 | | | 2 | 2 | 5 | 5 | 2 | 2 |
| Simon Robertson | 8 | 8 | | | 2 | 2 | | | | |
| Sir John Rose | 8 | 7 | | | 2 | 2 | | | | |
| Andrew Shilston | 8 | 8 | | | | | | | | |
| Colin Smith | 8 | 7 | | | | | | | | |
| Ian Strachan | 8 | 8 | | | 2 | 2 | 5 | 5 | 2 | 2 |
| Carl Symon | 3 | 3 | 2 | 2 | 0 | 0 | | | | |
| Mike Terrett | 8 | 8 | | | | | | | | |

* The number of meetings held during the period a director was in office or a member of a committee.

Remuneration committee

The committee has responsibility for making recommendations to the Board on the Group's policy regarding executive remuneration. The committee determines, on the Board's behalf, the specific remuneration packages of the Chairman, the executive directors and a number of senior executives. The committee met five times during the year. The committee's membership and principal terms of reference are set out in the Directors' remuneration report on page 70.

Nominations committee

In 2008, the nominations committee was chaired by Simon Robertson. Its other members were Helen Alexander CBE, Peter Byrom, Iain Conn, Professor Peter Gregson, Dr John McAdam (from February 19, 2008), John Neill CBE (from November 13, 2008), John Rishton, Sir John Rose, Ian Strachan and Carl Symon (until May 7, 2008). The committee met twice during the year.

The committee makes recommendations to the Board on the appointment of executive and non-executive directors and on the membership of Board committees. It is assisted in the former task by external recruitment consultants. It reviews succession planning generally and also reviews specific appointments to the Board and to other senior positions within the Group. The committee also oversees the annual review of Board effectiveness.

In carrying out these tasks, the committee gives careful consideration to the balance of skills required on the Board, including the need to reflect diversity, international experience and strong managerial and business skills. Before recommending the appointment of a non-executive director to the Board, the committee satisfies itself that the candidate will have sufficient time available to discharge his or her responsibilities effectively.

Audit committee

The audit committee consists exclusively of independent, non-executive directors. During 2008, the committee was chaired by John Rishton who has recent and relevant financial experience. In 2008, its other members were Iain Conn, Ian Strachan and John Neill CBE (from November 13, 2008). The committee met five times during the year. The Director of Risk, Head of Business Assurance and a representative of the external auditors normally attend the meetings. Additionally, the Head of Business Assurance has direct access to the committee. The Chairman of the Board, the Chief Executive, the Finance Director and any other Board member or senior executive may attend the meetings as necessary, at the invitation of the audit committee chairman.

The committee has responsibility for recommending to the Board the published accounts and for reviewing the Group's financial reporting and accounting policies, including major announcements made to a regulatory information service. It is also responsible for the relationship with the external auditors and for assessing the role and effectiveness of the internal audit function, which in Rolls-Royce is termed Business Assurance. In addition, the committee reviews the Group's procedures for detecting, monitoring and managing the risk of fraud.

The committee has responsibility for recommending to the Board the appointment of the external auditors and for reviewing the nature, scope and results of the annual external audit. It also approves the audit fee and, on an annual basis, assesses the effectiveness and independence of the external auditors. A resolution to reappoint the auditors, KPMG Audit Plc, and to authorise the directors to determine the auditors' remuneration, will be proposed at the 2009 AGM.

It keeps under review the Group's internal controls and systems for assessing and mitigating financial and non-financial risk. It also reviews and approves the Business Assurance work programmes and ensures that this function is adequately resourced and co-ordinated with the work of the external auditors. Twice a year the committee receives a written report on the reviews conducted throughout the Group by Business Assurance, and a report from senior executives on the key business risks and risk systems in selected sectors.

In order to safeguard auditor independence and objectivity, the following policy is applied in relation to services provided by the auditors:

Audit related services – these services are undertaken by the auditors as it is work that they must, or are best suited to, perform. It includes formalities relating to borrowings, shareholder and other circulars, risk management services, various regulatory reports and work in respect of acquisitions and disposals;

Tax, accounting and mergers and acquisitions – the auditors are used for this work where they are best suited to undertake it. All other significant consulting work in these areas is put out to tender; and

All other advisory services/consulting – the auditors are generally prohibited from providing these services.

Throughout the year the committee monitors the cost of non-audit work undertaken by the auditors and is, therefore, in a position to take action if at any time it believes that there is a risk of the auditors' independence being undermined through the award of this work.

Ethics committee

In September 2008, the Board approved the formation of an ethics committee. The ethics committee consists exclusively of independent non-executive directors. Ian Strachan chairs the committee and its other members during 2008 were Helen Alexander CBE, Peter Byrom and John Rishton. The committee met twice during 2008. The Director of Risk, who has executive responsibility for ethics, attends the meetings. The Chairman of the Board, the Chief Executive and other executives of the Company may be invited to attend meetings of the committee.

The committee is responsible for reviewing compliance with the Group's Global Code of Business Ethics (the Global Code) and will make recommendations to the Board as appropriate for changes to the Global Code. The Global Code sets out the principles to be followed by employees when conducting business.

The committee will review recommendations on ethical matters made by external regulatory authorities or other bodies, such as the Woolf Committee, and will make recommendations to the Board about whether, and if so, to what extent, these should be applied to the Company. It also has responsibility for receiving reports on issues raised through the Group's confidential reporting lines and for reviewing the results of subsequent investigations.

The committee will ensure that ethical policies and practice are subject to an appropriate level of independent internal audit and, where necessary, will appoint auditors to conduct an external review.

Risk committee

The Board has a risk committee, chaired by the Chief Executive, with specific accountability for the system of risk management and for reporting key risks and their associated mitigating actions to the Board. In 2008, its other members were James Guyette, Andrew Shilston, Colin Smith and Mike Terrett.

Introduction

This report to shareholders covers:

- the policy under which the executive directors, the Chairman and the non-executive directors are remunerated; and
- details of the remuneration, fees and share interests of the directors.

It provides the information required by the Directors' Remuneration Report Regulations 2002 (the Regulations) and describes how the Company applies the principles of the Combined Code in relation to executive directors' remuneration. The Company confirms that it complies with the requirements of the Combined Code.

The report was approved by the remuneration committee (the committee) on February 10, 2009 and was signed on the Board's behalf by Helen Alexander CBE as the chairman of the committee. A resolution will be put to shareholders at the Annual General Meeting on April 30, 2009 inviting them to approve this report.

The remuneration committee

The committee has responsibility for making recommendations to the Board on the Group's policy regarding executive remuneration. The committee determines, on the Board's behalf, the specific remuneration packages of the Chairman, the executive directors and a number of senior executives. A copy of the committee's terms of reference is available on the Group's website at www.rolls-royce.com.

The committee consists exclusively of independent, non-executive directors. During 2008, it was chaired by Carl Symon (until May 7, 2008) and by Helen Alexander CBE (from May 7, 2008). Its other members were Peter Byrom, Professor Peter Gregson and Dr John McAdam (from March 31, 2008).

In 2008, Simon Robertson, Chairman, Sir John Rose, Chief Executive, the Director – Human Resources and the General Counsel and Company Secretary, attended meetings by invitation of the committee but were not present during any discussion of their own emoluments.

The committee met on five occasions in 2008 and details of members' attendance are set out in the table on page 69.

Advice to the remuneration committee

The committee may call for information and advice from advisers inside and outside the Group. In 2008, Simon Robertson and Sir John Rose made recommendations to the committee relating to the performance of their direct reports. Internal support to the committee was provided primarily by the Director – Human Resources, advised by Deloitte LLP. Additional advice was provided by senior employees from the human resources and finance functions.

The committee received advice on remuneration matters from Deloitte LLP, and the Company's lawyers, Freshfields Bruckhaus Deringer LLP. During 2008, Deloitte LLP also advised the Group on tax, assurance, pensions and corporate finance and Deloitte MCS Limited provided consulting services.

Remuneration policy

The policy framework

The Group operates in a highly competitive, international market. Its business is complex, technologically advanced and has long time horizons. The Group is committed to achieving sustained improvements in performance and this depends crucially on the individual contributions made by the executive team and by employees at all levels. The Board therefore believes that an effective remuneration strategy plays an essential part in the future success of the Group.

Accordingly the Board has adopted, on the recommendation of the committee, a remuneration policy reflecting the following broad principles which it will continue to apply in 2009:

- the remuneration of executive directors and other senior executives should reflect their responsibilities and contain incentives to deliver the Group's performance objectives; it must also be capable of attracting and retaining the individuals necessary for business success;
- a significant proportion of total remuneration should be based on Group and individual performance, both in the short and long term; and
- the system of remuneration should establish a close identity of interest between senior executives and shareholders through measures such as encouraging the senior executives to acquire shares in the Company.

When determining remuneration, the committee takes into account pay and employment conditions elsewhere in the Group.

The committee regularly reviews both the competitiveness of the Group's remuneration structure and its effectiveness in incentivising executives to enhance value for shareholders over the longer term. It considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Group's business environment and in remuneration practice.

For 2009, to ensure that executives are appropriately incentivised towards the achievement of stretching performance, a number of changes are being made to the Group's annual and long-term incentives (as described in the relevant sections on pages 71 and 72). Following these changes, executive directors' total incentive package opportunity will be positioned between the lower quartile and the median of FTSE 100 practice.

The main components of remuneration

The main components of remuneration comprise base salary, annual incentive arrangements, long-term share-based incentives and pension and life assurance benefits. Executive directors and senior executives are also entitled to a company car or car allowance, private medical insurance and financial counselling. James Guyette is entitled to a housing allowance and the costs of additional housing are met by the Company for Mike Terrett.

The committee considers that there should be a continuing emphasis on those elements of remuneration, such as annual and long-term incentives, which directly influence the performance of senior executives.

Base salaries

In determining the relative importance of these elements of remuneration, the committee believes that base salaries should be set at levels required to recruit and retain high quality senior executives and with reference to the levels in the relevant marketplace for companies of similar size, internationality and complexity. The committee has commissioned salary benchmarks from Deloitte LLP. The benchmarks have been prepared using their company size and complexity methodology which is based on these factors.

All salary increases must be justified on the basis of performance and are not automatic. Following the March 1 review, there will be no increases in the base salaries of executive directors for 2009. Other benefits are generally at the median of market practice.

Annual incentives

Executive directors and selected senior executives participate in the Annual Performance Related Award plan (APRA). For UK participants, APRA awards do not form part of pensionable earnings.

Target and maximum APRA bonus opportunity

Under APRA as operated in 2008, executive directors were eligible for awards in accordance with the table below:

| | Target bonus (as a % of salary) ¹ | Maximum bonus (as a % of salary) ¹ |
|-----------------|---|--|
| James Guyette | 48 | 80 |
| Sir John Rose | 60 | 100 |
| Andrew Shilston | 48 | 80 |
| Colin Smith | 48 | 80 |
| Mike Terrett | 48 | 80 |

¹ It was possible for a bonus award to be increased by a further 20 per cent to reflect exceptional personal performance, and for 2008, an additional 25 per cent if the Group achieved a target reduction in operating costs.

APRA performance measures

The APRA performance measures set by the committee are based on the Group's annual operating plans. For 2008, the measures for executive directors included underlying profit, average cash balance, cash flow, operating costs and individual contribution assessed with reference to the achievement of personal objectives and overall personal performance. The committee is mindful of corporate, environmental, social and governance risks when setting personal objectives. Forty per cent of any APRA bonus depends on personal performance.

A high proportion of the annual remuneration for executive directors is based on performance. For the Chief Executive, his 150 per cent maximum bonus opportunity means that 60 per cent of his combined basic pay and bonus opportunity is directly related to annual financial and personal performance. In 2008, the level of achievement against the financial measures was sufficient to generate up to 56.25 per cent of the maximum bonus for individual participants subject to the achievement of their personal objectives.

Deferred APRA

One third of the value of APRA is currently delivered in the form of a deferred award of shares in the Company. A participant who is granted a deferred share award under APRA must normally continue to remain an employee of the Group for two years from the date of the award in order to retain the shares, although shares will be released early in certain circumstances including retirement or redundancy.

The value of any deferred share awards is derived from the annual bonus criteria and is therefore dependent on personal and business financial performance; the release of deferred share awards is not dependent on the achievement of any further performance conditions. This arrangement provides a strong link between performance and remuneration, promotes a culture of share ownership amongst the Group's senior management and encourages decisions in the long-term interest of shareholders. The deferred share element operated for 2008 will result in share awards as described in the directors' emoluments table on page 74. Details of deferred shares held under the plan are shown in the table on page 78.

Changes to APRA for 2009

For 2009, APRA will change as follows:

- The opportunity to increase the bonus payable by 25 per cent for exceptional operating cost performance will be removed.
- Annual bonus opportunity levels will increase from 100 per cent to 135 per cent of salary for the Chief Executive and from 80 per cent to 125 per cent of salary for other executive directors.
- The percentage of APRA delivered in the form of a deferred award in the Company's shares will increase from 33 per cent to 40 per cent. This further aligns the interests of executives with those of shareholders.
- In order to simplify APRA, the average cash balance measure will be removed. The cash flow measure in APRA and the Cash Flow Per Share measure in the Rolls-Royce Group plc Performance Share Plan will both remain.

Other annual incentives

The same targets as set for APRA are used for the All-Employee Bonus Scheme, which typically enables all employees worldwide to receive a bonus of up to two weeks' pay, based on corporate and business performance. Those executives participating in APRA are excluded from the All-Employee Bonus Scheme.

Rolls-Royce Group plc Performance Share Plan

The Rolls-Royce Group plc Performance Share Plan (PSP) is designed to reward and incentivise selected senior executives who can influence the long-term performance of the Group.

Under the rules of the PSP, selected executives are granted conditional share awards entitling them to a number of shares determined by reference to corporate performance over a three-year performance period. The measures of corporate performance are Cash Flow Per Share (CPS), Earnings Per Ordinary Share (EPS) and Total Shareholder Return (TSR). These measures are considered particularly important in generating shareholder value and are explained in more detail below. There is no retesting of the performance criteria and no automatic vesting in the event of a takeover. In the three-year period to December 31, 2008, the Company's financial and TSR performance generated 80 per cent of the maximum number of shares under the rules of the plan.

Performance measures

No shares will be released from the PSP unless the growth in the Company's EPS exceeds the UK retail price index by three per cent per year over the performance period.

The number of shares released (if any) will be determined in accordance with CPS targets, which will not be adjusted for inflation. CPS is calculated as cash flow after interest, taxation and capital expenditure, but before cost of business acquisitions or proceeds of disposals and payments to shareholders, divided by the weighted average number of shares in issue. Intermediate levels of performance attract pro rata releases. The Company's TSR over the performance period will be compared with the TSR of the companies constituting the FTSE 100 index on the date of grant. This comparison will be carried out by an independent agency. If the Company's TSR exceeds the median of that group of companies, the number of shares due to be released to an executive following achievement of the EPS and CPS targets will be increased by 25 per cent.

Shareholders have authorised the committee to set CPS performance targets for future grants provided that, in the committee's reasonable judgement, the targets are no less challenging in the light of the Group's business circumstances and its internal forecasts than the targets for the initial grant in 2004 as approved by shareholders.

The following CPS targets apply to the grants to be made in 2009:

| Aggregate CPS over three-year performance period | Percentage of maximum award released |
|---|---|
| 40p | 30 |
| 62p | 100 |

The committee believes that these CPS targets are challenging and that the performance necessary to achieve awards towards the upper end of the range is stretching. They should not, therefore, be interpreted as providing guidance on the Group's performance over the relevant period.

PSP award levels

The size of awards under the PSP are set taking into account competitive levels within the marketplace for UK companies of a similar size and complexity to the Group. In 2008, Sir John Rose received a conditional award of shares with a market value at the time of grant of 110 per cent of his annual salary. For other executive directors and business heads the grant was 80 per cent, and 65 per cent for other members of the Group Executive. As described above, the number of shares released is increased by 25 per cent if the Company's TSR exceeds the median of the FTSE 100 Index.

For 2009, the number of conditional shares awarded under the PSP will increase from 110 per cent to 120 per cent of salary for the Chief Executive and from 80 per cent to 100 per cent of salary for other executive directors. A further stretch will be incorporated such that if TSR performance exceeds the upper quartile of the FTSE 100 index, awards are increased by 50 per cent, with straight line vesting between median and upper quartile performance.

These increases are within the existing limits for the PSP (200 per cent of salary), approved by shareholders in 2004.

Share retention policy

The committee believes it is important that the interests of the executive directors should be closely aligned with those of shareholders. The deferred APRA award and the PSP provide considerable alignment. However, participants in the PSP are also required to retain at least one half of the number of after-tax shares released from the PSP, until their shareholding reaches the level of 1.5 multiplied by the value of the shares conditionally granted to them in their most recent PSP grant. When this level is reached, it must be retained until retirement or departure from the Company.

Executive share option plan

No options have been granted under the executive share option plan since the introduction of the PSP and the Company does not currently intend to make any further grants. The plan terminates in 2009.

All-employee share plans

The committee believes that share-based plans make a significant contribution to the close involvement and interest of all employees in the Group's performance. Executive directors are eligible to participate in the Group's all-employee share plans on the same terms as other employees. There are three main elements to these arrangements:

- i) the ShareSave Plan – a savings-related share option plan available to all employees. In the UK, this plan operates within UK tax legislation (including a requirement to finance the exercise of the option using the proceeds of a monthly savings contract) but the key principles are applied globally. The exercise of the option is not subject to the achievement of a performance target;
- ii) the 'Free Share' element of the Share Incentive Plan (SIP), under which UK employees receive shares of up to the equivalent of one and a half weeks' pay as part of the Company component of any bonus paid for 2008. The SIP attracts tax benefits for UK employees; and
- iii) the 'Partnership Share' element of the SIP under which UK employees may make regular purchases of shares from pre-tax income.

Service contracts

The committee's policy is that executive directors appointed to the Board are offered notice periods of 12 months. The committee recognises that in the case of appointments to the Board from outside the Group, it may be necessary to offer a longer initial notice period, which would subsequently reduce to 12 months after that initial period.

The committee has a defined policy on compensation and mitigation to be applied in the event of a UK director's contract being prematurely terminated. In these circumstances, steps are taken to ensure that poor performance is not rewarded. When calculating termination payments, the committee takes into account a range of factors including the director's obligation to mitigate his or her own loss.

The following table summarises the terms of the executive directors' service contracts:

| | Date of contract | Unexpired term | Notice period Company | Notice period individual |
|-----------------|-------------------|----------------|--------------------------|-----------------------------|
| James Guyette | 29 September 1997 | Indefinite | 30 days ¹ | 30 days |
| Sir John Rose | 4 December 1992 | 12 months | 12 months ² | 6 months |
| Andrew Shilston | 5 November 2002 | 12 months | 12 months | 6 months |
| Colin Smith | 1 July 2005 | 12 months | 12 months | 6 months |
| Mike Terrett | 1 September 2007 | 12 months | 12 months | 6 months |

¹ James Guyette has a contract with Rolls-Royce North America Inc, drawn up under the laws of the State of Virginia, US. It provides that, on termination without cause, he is entitled to 12 months' severance pay without mitigation and, in addition, appropriate relocation costs.

² In the event of the service contract being terminated by the Company, other than in accordance with the contract's terms, Sir John Rose is entitled to receive a liquidated sum of 12 months' salary and benefits. Performance related payments are not covered under this arrangement, although an annual bonus may be paid if he is in post at the end of the performance year.

External directorships of executive directors

James Guyette was a director of The PrivateBank and Trust Company of Chicago, Illinois and of priceline.com Inc. and Andrew Shilston was a non-executive director of Cairn Energy PLC until his resignation on May 23, 2008.

In each case, the director retained the relevant fees from serving on the boards of these companies, as shown in the table below:

External directorship fees

| | Payment received £000 |
|------------------------------|--------------------------|
| James Guyette ^{1,2} | 68 |
| Andrew Shilston | 25 |

¹ James Guyette was paid in US dollars translated at \$1.854 = £1.

² In addition to an annual fee, James Guyette received 1,418 Restricted Share Units in PrivateBank. During 2008, 1,000 of his stock options in PrivateBank vested at an exercise price of US\$46.51 per share and 1,000 stock options vested at an exercise price of US\$33.73 per share. Also during 2008, 500 shares of restricted stock vested at US\$107.90 per share, 500 shares of restricted stock vested at US\$115.33 per share and 500 shares of restricted vested at US\$134.53 in priceline.com. He was also granted 863 shares of restricted stock at US\$115.33 per share.

Non-executive directors

The Chairman and the non-executive directors have letters of appointment rather than service contracts. No compensation is payable to the Chairman or to any non-executive director if the appointment is terminated early.

Non-executive directors' fees

The Board takes account of independent market surveys in determining the fees payable to the Chairman and the non-executive directors. The fees paid to the Chairman and non-executive directors are shown in the emoluments table.

The current annual fees payable to the non-executive directors are as follows:

| | Fees payable |
|------------------------------------|--------------|
| Chairman | £370,000 |
| Other non-executive directors | £55,000 |
| Chairman of audit committee | £15,000 |
| Chairman of remuneration committee | £12,000 |
| Chairman of ethics committee | £12,000 |
| Senior Independent Director | £10,000 |

The Chairman and the non-executive directors are not eligible to participate in any of the Group's share schemes, incentive arrangements or pension schemes. A facility is in place which enables non-executive directors to use some or all of their fees, after the appropriate statutory deductions, to make market purchases of shares in the Company on a monthly basis.

Performance graph

The Company's TSR performance over the previous five years compared to a broad equity market index is shown in the graph below. The FTSE 100 has been chosen as the comparator index because it contains a broad range of other leading UK listed companies.



Aggregate directors' remuneration

The total amounts for directors' remuneration were as follows:

| | 2008 £000 | 2007 £000 |
|---|--------------|--------------|
| Emoluments | 5,022 | 4,988 |
| Gains on exercise of share options | 9 | 10,364 |
| Value of shares vested under long-term incentive awards | 3,458 | 4,850 |
| Money purchase pension contributions | 558 | 433 |
| | 9,047 | 20,635 |

Directors' emoluments

The directors' emoluments are analysed as follows:

| | 2008 | | | | | | | 2007 |
|---|--|----------------------------------|--------------------|--------------------------------------|--------------------|---------------------------------------|---------------------------------------|--|
| | Annual Performance Related Award plan (APRA) | | | | | | | Aggregate emoluments excluding pensions contributions ⁴ |
| | Basic salaries £000 | Board and committee fees £000 | Cash bonus £000 | Deferred shares ¹ £000 | Total APRA £000 | Pension payments ² £000 | Taxable benefits ³ £000 | Aggregate emoluments excluding pensions contributions ⁴ £000 |
| James Guyette ⁵ | 413 | — | 116 | 58 | 174 | — | 36 | 623 |
| Sir John Rose | 842 | — | 255 | 128 | 383 | — | 28 | 1,253 |
| Andrew Shilston | 543 | — | 140 | 70 | 210 | — | 15 | 768 |
| Colin Smith | 384 | — | 100 | 50 | 150 | 96 | 11 | 641 |
| Mike Terrett | 493 | — | 130 | 65 | 195 | 123 | 113 | 924 |
| Helen Alexander CBE | — | 63 | — | — | — | — | — | 63 |
| Peter Byrom | — | 55 | — | — | — | — | — | 55 |
| Iain Conn | — | 65 | — | — | — | — | — | 65 |
| Professor Peter Gregson | — | 55 | — | — | — | — | — | 55 |
| Dr John McAdam ⁶ | — | 48 | — | — | — | — | — | 48 |
| John Neill CBE ⁷ | — | 7 | — | — | — | — | — | 7 |
| John Rishton | — | 70 | — | — | — | — | — | 70 |
| Simon Robertson | — | 367 | — | — | — | — | — | 367 |
| Ian Strachan | — | 59 | — | — | — | — | — | 59 |
| Carl Symon ⁸ | — | 24 | — | — | — | — | — | 24 |
| Former directors who did not serve during the 2008 financial year | — | — | — | — | — | — | — | — |
| | 2,675 | 813 | 741 | 371 | 1,112 | 219 | 203 | 5,022 |

¹ Shares forming part of the bonus under APRA have been valued at the date of award. An investment is expected to be made by March 31, 2009 when the trustee will acquire the required number of shares at the prevailing market price.

² Colin Smith and Mike Terrett received cash allowances in lieu of future pension accrual.

³ Taxable benefits include the following: company car or car allowance, private medical insurance and financial counselling, and in the case of James Guyette, a housing allowance and appropriate club membership fees. In the case of Mike Terrett, the figure in the above table includes housing costs paid on his behalf and the tax charge on that benefit paid by the Company.

⁴ Details of the directors' pensions are set out on page 75.

⁵ James Guyette was paid in US dollars translated at \$1.854 = £1.

⁶ Dr John McAdam was appointed as a non-executive director with effect from February 19, 2008.

⁷ John Neill CBE was appointed as a non-executive director with effect from November 13, 2008.

⁸ Carl Symon retired as a non-executive director with effect from May 7, 2008.

Payments made to former directors of the Company

John Cheffins retired from the Board on September 30, 2007. Following his retirement, he has continued to be retained by the Company for one day per week to give support and advice on the strategy and implementation of Rolls-Royce Fuel Cell Systems Limited, supply chain management, and the assembly and test facilities. He was paid £103,200 and received benefits totalling £33,097.

Dr Mike Howse retired from the Board on June 30, 2005. Following his retirement, he has continued to be retained by the Company for his expertise in engineering. He was paid £39,060.

Sir Robin Nicholson retired as a non-executive director on May 4, 2005. He was retained by Rolls-Royce Fuel Cell Systems Limited for his management and technical expertise, and to provide advice on business related matters. Sir Robin was paid total fees of £30,000.

Phil Ruffles retired from the Board on October 18, 2001. He was retained by Rolls-Royce Fuel Cell Systems Limited until December 31, 2008 to give general advice on the best contacts and direction for the business. Phil Ruffles received total fees of £5,080.

Pensions

The Group's UK pensions schemes are funded, registered schemes and were approved under the regime applying until April 6, 2006. They are defined benefit pension schemes providing, at retirement, a pension of up to two thirds of final remuneration, subject to HM Revenue & Customs limits. Andrew Shilston is a current member of the Group's UK pension scheme. Colin Smith and Mike Terrett have opted out of future pension accrual with effect from April 1, 2006. Sir John Rose opted out of future pension accrual with effect from February 1, 2008, see note 6 below.

Details of the pension benefits, which accrued over the year in the Group's registered UK defined benefit pension schemes¹, are given below:

| | Increase in accrued pension during the year ended Dec 31, 2008 £000pa | Total accrued pension entitlement at the year ended Dec 31, 2008 £000pa | Transfer value of accrued pension as at Dec 31, 2008 £000 | Transfer value as at Dec 31, 2007 of accrued pension at that date £000 | Increase in transfer value over 2008 net of the member's own contributions £000 | | |
|------------------------------|--|--|--|---|--|------|-------|
| Sir John Rose ⁶ | 10 | (8) | 449 | 10,632 | 11,225 | -598 | (191) |
| Andrew Shilston ⁷ | 2 | (2) | 12 | 307 | 259 | 203 | (49) |
| Colin Smith ⁸ | 43 | (36) | 241 | 3,847 | 4,160 | -313 | (259) |
| Mike Terrett ⁸ | 22 | (13) | 250 | 5,230 | 4,885 | 345 | (269) |

James Guyette participates in pension plans sponsored by Rolls-Royce North America Inc.

Details of the retirement benefits, which accrued over the year in the defined benefit plans sponsored by Rolls-Royce North America Inc., are given below:

| | Increase in accrued retirement lump sum during the year ended Dec 31, 2008 £000pa | 2 | Total accrued retirement lump sum entitlement at the year ended Dec 31, 2008 £000pa | 9 | Transfer value of accrued retirement lump sum as at Dec 31, 2008 £000 | 10 | Transfer value as at Dec 31, 2007 of accrued retirement lump sum at that date £000 | 10 | Increase in transfer value over 2008 net of the member's own contributions £000 | 5 |
|----------------------|--|------|--|---|--|----|---|----|--|-------|
| James Guyette 11, 12 | 91 | (66) | 711 | | 711 | | 620 | | 487 | (462) |

¹ Members of the schemes have the option to pay Additional Voluntary Contributions. Neither the contributions nor the resulting benefits are included in the above table.

² The figure in brackets is the increase in pension/retirement lump sum during the year ended December 31, 2008 but, in this case, excluding the effect of inflation.

³ The pension entitlement shown is that which would be paid annually on retirement, based on service to the end of the year, or to April 1, 2006 for members with enhanced protection from 'A' day.

⁴ The transfer values stated represent liabilities of the Rolls-Royce sponsored pension schemes and are not sums paid to the individuals. The transfer values of the accrued pensions as at December 31, 2007 have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 (GN11). GN11 covers individual transfer calculations and the above figures have been calculated using assumptions certified by the Actuaries as being consistent with GN11. The transfer values of the accrued pensions as at December 31, 2008 have been calculated on a basis adopted by the trustees on October 6, 2008 following receipt of actuarial advice for transfer values.

⁵ The figure in brackets is the transfer value of the increase in pension/retirement lump sum during the year ended December 31, 2008 excluding the effect of inflation and net of the member's own contributions.

⁶ Sir John Rose started to receive his pension from February 1, 2008. Sir John Rose is not accruing any further benefit or allowance in lieu of pension benefit from his ongoing employment with the Group. The total accrued pension entitlement at December 31, 2008 is after allowance for reduction for early payment of pension and taking a part of his pension as lump sum. The transfer value is the value of benefits in payment as at December 31, 2008 increased by cash taken on retirement.

⁷ The Group operates the Rolls-Royce Supplementary Retirement Scheme. The purpose of the Scheme is to fund pension provision above the pensionable earnings cap which was imposed on approved pension schemes by the 1989 Finance Act. Membership of the Scheme is restricted to executive directors and to a limited number of senior executives. Andrew Shilston is a member of this Scheme. He joined the Group after the introduction of the earnings cap and his terms and conditions on joining included a commitment to provide pension and life cover based on total salary. Employer contributions to the Scheme during 2008 have been added to the increase in transfer value over 2008 for the registered defined benefit plans, and are therefore included in the figures shown in the right hand column of the first table.

⁸ Colin Smith and Mike Terrett receive a cash allowance in lieu of future pension accrual. Had they elected to continue to accrue pension the estimated cost of that accrual would be higher than the cash allowance to be paid in lieu.

⁹ The lump sum entitlement shown is that which would be paid on immediate retirement based on service to the end of the year.

¹⁰ The transfer values have been calculated on the basis of actuarial advice.

¹¹ Benefits are translated at US\$ = £1.438.

¹² James Guyette is a member of two defined benefit plans in the US, one qualified and one non-qualified. He accrues a retirement lump sum benefit in both of these plans. The aggregate value of the retirement lump sums accrued in these two plans, and the transfer values of these benefits, are shown in the second table. In addition, James Guyette is a member of two 401(K) Savings Plans in the US, one qualified and one non-qualified, to which both he and his employer, Rolls-Royce North America Inc., contribute. James Guyette is also a member of an unfunded non-qualified deferred compensation plan in the US, to which his employer makes notional contributions. Employer contributions to these three plans during 2008 have been added to the increase in transfer value over 2008 for the defined benefit plans, and are therefore included in the figures shown in the right hand column of the second table.

Directors' share interests

The directors who held office at December 31, 2008 and their connected persons had the following interests in the ordinary shares and B Shares¹ of the Company in respect of which transactions are notifiable to the Company under DTR 3.1.2R of the Disclosure Rules and Transparency Rules as shown in the following table:

| | Ordinary shares | | | B Shares | | |
|-----------------------------|-------------------|-----------------|---------------------|-------------------|-----------------|---------------------|
| | January 1, 2008 * | Changes in 2008 | December 31, 2008 § | January 1, 2008 * | Changes in 2008 | December 31, 2008 § |
| James Guyette | 255,152 | 95,729 | 350,881 | — | — | — |
| Sir John Rose ² | 864,276 | 222,042 | 1,086,318 | — | — | — |
| Andrew Shilston | 260,626 | 103,111 | 363,737 | — | — | — |
| Colin Smith | 71,901 | 31,864 | 103,765 | — | — | — |
| Mike Terrett | 293,786 | 79,031 | 372,817 | — | — | — |
| Helen Alexander CBE | 1,000 | 21 | 1,021 | — | — | — |
| Peter Byrom | 159,383 | 44,576 | 203,959 | — | — | — |
| Iain Conn | 8,386 | 3,355 | 11,741 | 28,504 | (28,504) | — |
| Professor Peter Gregson | — | 1,219 | 1,219 | — | — | — |
| Dr John McAdam ³ | — | — | — | — | — | — |
| John Neill CBE ⁴ | — | — | — | — | — | — |
| John Rishton | 519 | 2,878 | 3,397 | — | — | — |
| Simon Robertson | 27,233 | 10,992 | 38,225 | — | — | — |
| Ian Strachan | 11,500 | — | 11,500 | — | — | — |
| Carl Symon ⁵ | 7,049 | 52 | 7,101 | — | — | — |

* or date of appointment if later.

§ or date of retirement if earlier.

¹ Non-cumulative redeemable convertible preference shares of 0.1p each.

² Sir John Rose had a non-beneficial interest in 45,191 (2007: 43,932) ordinary shares.

³ Dr John McAdam was appointed as a non-executive director with effect from February 19, 2008.

⁴ John Neill CBE was appointed as a non-executive director with effect from November 13, 2008.

⁵ Carl Symon retired as a non-executive director with effect from May 7, 2008.

Directors' interests in the Company's share plans are shown separately on pages: 77 (Share Incentive Plan); 78 (share options); 78 (Annual Performance Related Award plan); and page 79 (Performance Share Plan). No director had any other interests, beneficial or otherwise, in the share capital of the Company or any of its subsidiaries as at December 31, 2008.

Changes in the interests of the directors between December 31, 2008 and February 11, 2009 are listed below:

- On January 2, 2009, Simon Robertson was allotted 2,186,470 non-cumulative redeemable preference shares of 0.1p each (C Shares).
- On January 6, 2009, the following directors purchased ordinary shares under the C Share Reinvestment Plan: James Guyette 5,502; Andrew Shilston 5,703; Colin Smith 1,526; Mike Terrett 5,845; Peter Byrom 3,194; Iain Conn 173; Professor Peter Gregson 15 and John Rishton 43.
- The following directors purchased ordinary shares under arrangements made for non-executive directors to purchase shares on a monthly basis using a percentage of their after tax fees:
On January 7, 2009, Iain Conn 276; Professor Peter Gregson 108; John Neill CBE 276; and John Rishton 276 and on February 9, 2009, Iain Conn 297; Professor Peter Gregson 116; John Neill CBE 297; and John Rishton 297.
- On February 2, 2009, Colin Smith exercised a ShareSave option under the Rolls-Royce International ShareSave Plan and was allotted 2,396 ordinary shares.
- On February 2, 2009, James Guyette exercised a ShareSave option under the Rolls-Royce International ShareSave Plan and was allotted 65 ordinary shares.

Directors' share interests continued*'Partnership Shares' held in trust under the Share Incentive Plan¹*

| | Ordinary shares | | |
|--------------------------------|-----------------|-----------------|-------------------|
| | January 1, 2008 | Changes in 2008 | December 31, 2008 |
| Sir John Rose ^{2,3} | 3,214 | (875) | 2,339 |
| Andrew Shilston ^{2,3} | 2,944 | (603) | 2,341 |
| Colin Smith ^{2,3} | 3,214 | (875) | 2,339 |
| Mike Terrett ^{2,3} | 3,213 | (871) | 2,342 |

'Free Shares' held in trust under the Share Incentive Plan¹

| | Ordinary shares | | |
|------------------------------|-----------------|-----------------|-------------------|
| | January 1, 2008 | Changes in 2008 | December 31, 2008 |
| Sir John Rose ⁴ | 6,593 | (3,906) | 2,687 |
| Andrew Shilston ⁴ | 4,989 | (319) | 4,670 |
| Colin Smith ⁴ | 2,352 | 751 | 3,103 |
| Mike Terrett ⁴ | 1,395 | 41 | 1,436 |

'Unrestricted Shares' held in trust under the Share Incentive Plan¹

| | Ordinary shares | | |
|--------------------------------|-----------------|-----------------|-------------------|
| | January 1, 2008 | Changes in 2008 | December 31, 2008 |
| Sir John Rose ^{3,5} | 208 | 5,470 | 5,678 |
| Andrew Shilston ^{3,5} | — | 2,235 | 2,235 |
| Colin Smith ^{3,5} | 208 | 1,375 | 1,583 |
| Mike Terrett ^{3,5} | 106 | 1,367 | 1,473 |

¹ Under the Share Incentive Plan (SIP), 'Free Shares' and 'Partnership Shares' held in trust for more than five years are classified as 'Unrestricted' and are no longer subject to income tax or national insurance contributions on withdrawal. 'Unrestricted Shares' can be held in Trust under the SIP for as long as the participant remains an employee of the Company.

² On January 2, 2009, C Shares were awarded under the 'Partnership Shares' element of the SIP to Sir John Rose 138,080; Andrew Shilston 138,195; Colin Smith 138,080 and Mike Terrett 138,080.

³ Sir John Rose, Andrew Shilston, Colin Smith and Mike Terrett purchased 36 ordinary shares each on January 7, 2009 and 38 ordinary shares each on February 9, 2009 under the HM Revenue & Customs approved Share Incentive Plan. On January 7, 2009 and February 9, 2009 the ordinary shares held as Partnership Shares by Sir John Rose 81 and 78; Andrew Shilston 82 and 78; Colin Smith 81 and 78 and Mike Terrett 83 and 79 were classified as Unrestricted Shares.

⁴ On January 2, 2009, C Shares were awarded under the 'Free Shares' element of the SIP to Sir John Rose 153,697; Andrew Shilston 267,124; Colin Smith 177,492 and Mike Terrett 82,140.

⁵ On January 2, 2009, C Shares were awarded under the 'Unrestricted Shares' element of the SIP to Sir John Rose 315,744; Andrew Shilston 118,804; Colin Smith 81,510 and Mike Terrett 75,389.

Share options

The directors held the following options under the Rolls-Royce 1999 Executive Share Option Plan, all of which have vested and are capable of exercise unless otherwise indicated, and the Rolls-Royce International ShareSave Plan.

All employees were eligible for options under the International ShareSave Plan and the 2003 (five year) plan matured on December 1, 2008.

| | January 1, 2008 | Granted in 2008 | Lapsed in 2008 | Exercised in 2008 | December 31, 2008 | Exercise price | Market price at date exercised | Aggregate gains 2008 £000 | Aggregate gains 2007 £000 | Exercisable dates |
|----------------------------|--------------------|--------------------|-------------------|----------------------|----------------------|-------------------|--------------------------------------|---------------------------------|---------------------------------|----------------------|
| James Guyette ¹ | 1,397 | | | | 1,397 | 298p ² | | | | 2009 |
| | 683 | | | | 683 | 416p ² | | | | 2011 |
| | 2,080 | | | | 2,080 | 337p ³ | | | 2,082 | |
| Colin Smith ⁴ | 15,444 | | | | 15,444 | 194p ⁵ | | | | 2009-2010 |
| | 6,362 | | | 6,362 | | 142p ² | 286p | 9 | | 2009 |
| | 2,396 | | | | 2,396 | 108p ² | | | | 2009 |
| | 1,233 | | | | 1,233 | 298p ² | | | | 2011 |
| | 25,435 | | | 6,362 | 19,073 | 190p ³ | | 9 | 235 | |
| Mike Terrett | 180,556 | | | | 180,556 | 216p ⁶ | | | | 2009-2011 |
| | 6,900 | | | | 6,900 | 142p ² | | | | 2009 |
| | 187,456 | | | | 187,456 | 213p ³ | | | | |

¹ On February 2, 2009, James Guyette exercised a ShareSave option under the Rolls-Royce International ShareSave Plan and was allotted 65 ordinary shares.

² ShareSave plans.

³ Weighted average exercise price of December 31, 2008 balance.

⁴ On February 2, 2009, Colin Smith exercised a ShareSave option under the Rolls-Royce International ShareSave Plan and was allotted 2,396 ordinary shares.

⁵ Granted under the Rolls-Royce 1999 Executive Share Option Plan. The only performance criteria is that the growth in EPS must exceed UK RPI over a rolling three-year period.

⁶ Granted in 2001 under the Rolls-Royce 1999 Executive Share Option Plan with additional performance and personal shareholding requirements. Vesting of these Supplementary options is subject to attainment of significant personal shareholding targets and the requirement that the growth in EPS exceeds an average of six per cent year on year as well as exceeding the UK RPI by three per cent per year over a rolling three-year period. The increases are measured from the year 2000 or the base year of the rolling three-year period, whichever is the more stringent. All options were granted at the market value on the date of issue and no discount was applied. No options were varied during the year and no consideration was paid for the grant of options. The market price of the Company's ordinary shares ranged between 249p and 547p during 2008. The closing price on December 31, 2008 was 335.50p.

Long-term incentive awards

The directors as at December 31, 2008 had the following deferred share awards arising out of the operation of the Annual Performance Related Award¹ plan:

| | January 1, 2008 | Vested during 2008 | Granted during 2008 | December 31, 2008 |
|-----------------|--------------------|-----------------------|------------------------|----------------------|
| James Guyette | 41,123 | 22,271 | 12,805 | 31,657 |
| Sir John Rose | 84,868 | 42,777 | 34,771 | 76,862 |
| Andrew Shilston | 46,871 | 23,634 | 20,313 | 43,550 |
| Colin Smith | 27,428 | 11,041 | 12,045 | 28,432 |
| Mike Terrett | 30,360 | 14,777 | 14,888 | 30,471 |

¹ Under the Annual Performance Related Award plan (APRA), shares vest after two years. Shares went into trust in 2006, 2007 and 2008 at prices of 447.60p, 501.62p and 440.03p respectively. At December 31, 2008, the amounts stated in the emoluments table representing the 2008 APRA deferred shares had not yet been applied by the Trustee to purchase shares. An investment is expected to be made by March 31, 2009 when the trustee will acquire the required number of shares at the prevailing market price. The market value per share, which vested under APRA during 2008, was 432.14p.

Long-term incentive awards continued

Conditional awards, granted under the Rolls-Royce Group plc Performance Share Plan (PSP) to executive directors are set out below. The number of shares released will be dependent upon the achievement of the EPS and CPS targets over the three-year performance period and will be increased by 25 per cent if the TSR exceeds the median for the FTSE 100 companies over the three-year performance period.

| | | | | | | | | PSP |
|-----------------|--------------------|------------------------|--|--------------------------------|----------------------|-----------------------------|------------------|-------------------------------------|
| | January 1, 2008 | Granted during 2008 | TSR uplift at vesting ¹ | Total vested during 2008 | December 31, 2008 | Performance period | Date of grant | Market price at date of grant |
| James Guyette | 93,871 | — | 23,468 | 117,339 | — | Jan 1, 2005 to Dec 31, 2007 | March 8, 2005 | 261.58p |
| | 72,670 | — | — | — | 72,670 | Jan 1, 2006 to Dec 31, 2008 | March 1, 2006 | 443.75p |
| | 60,669 | — | — | — | 60,669 | Jan 1, 2007 to Dec 31, 2009 | March 1, 2007 | 501.00p |
| | — | 70,672 | — | — | 70,672 | Jan 1, 2008 to Dec 31, 2010 | March 3, 2008 | 439.20p |
| | 227,210 | 70,672 | 23,468 | 117,339 | 204,011 | | | |
| Sir John Rose | 263,782 | — | 65,946 | 329,728 | — | Jan 1, 2005 to Dec 31, 2007 | March 8, 2005 | 261.58p |
| | 177,240 | — | — | — | 177,240 | Jan 1, 2006 to Dec 31, 2008 | March 1, 2006 | 443.75p |
| | 175,649 | — | — | — | 175,649 | Jan 1, 2007 to Dec 31, 2009 | March 1, 2007 | 501.00p |
| | — | 212,888 | — | — | 212,888 | Jan 1, 2008 to Dec 31, 2010 | March 3, 2008 | 439.20p |
| | 616,671 | 212,888 | 65,946 | 329,728 | 565,777 | | | |
| Andrew Shilston | 109,596 | — | 27,399 | 136,995 | — | Jan 1, 2005 to Dec 31, 2007 | March 8, 2005 | 261.58p |
| | 82,930 | — | — | — | 82,930 | Jan 1, 2006 to Dec 31, 2008 | March 1, 2006 | 443.75p |
| | 81,438 | — | — | — | 81,438 | Jan 1, 2007 to Dec 31, 2009 | March 1, 2007 | 501.00p |
| | — | 100,183 | — | — | 100,183 | Jan 1, 2008 to Dec 31, 2010 | March 3, 2008 | 439.20p |
| | 273,964 | 100,183 | 27,399 | 136,995 | 264,551 | | | |
| Colin Smith | 22,403 | — | 5,601 | 28,004 | — | Jan 1, 2005 to Dec 31, 2007 | March 8, 2005 | 261.58p |
| | 54,085 | — | — | — | 54,085 | Jan 1, 2006 to Dec 31, 2008 | March 1, 2006 | 443.75p |
| | 59,881 | — | — | — | 59,881 | Jan 1, 2007 to Dec 31, 2009 | March 1, 2007 | 501.00p |
| | — | 70,356 | — | — | 70,356 | Jan 1, 2008 to Dec 31, 2010 | March 3, 2008 | 439.20p |
| | 136,369 | 70,356 | 5,601 | 28,004 | 184,322 | | | |
| Mike Terrett | 83,179 | — | 20,795 | 103,974 | — | Jan 1, 2005 to Dec 31, 2007 | March 8, 2005 | 261.58p |
| | 60,638 | — | — | — | 60,638 | Jan 1, 2006 to Dec 31, 2008 | March 1, 2006 | 443.75p |
| | 61,693 | — | — | — | 61,693 | Jan 1, 2007 to Dec 31, 2009 | March 1, 2007 | 501.00p |
| | — | 91,075 | — | — | 91,075 | Jan 1, 2008 to Dec 31, 2010 | March 3, 2008 | 439.20p |
| | 205,510 | 91,075 | 20,795 | 103,974 | 213,406 | | | |

¹ Under the rules of the PSP, the number of shares vesting in 2008 was increased by 25 per cent as the TSR exceeded the median of the FTSE 100 companies during the three-year performance period to December 31, 2007. The market value per share, which vested under the PSP during 2008, was 413.73p.

Approval of the Directors' remuneration report

The Directors' remuneration report above was approved by the Board of directors on February 11, 2009 and signed on its behalf by

Helen Alexander CBE

Chairman of the remuneration committee

Directors’ responsibility for internal control

The directors are responsible for the Group’s system of internal control and for maintaining and reviewing its effectiveness from both a financial and an operational perspective. The system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss. The Group’s approach to internal control is based on the underlying principle of line management’s accountability for control and risk management.

In reviewing the effectiveness of the system of internal control, the Board has taken account of the results of the work carried out to audit and review the activities of the Group.

There is an ongoing process to identify, assess and manage risk, including those risks affecting the Group’s reputation. This process is subject to continuous improvement and has been in place throughout the financial year to which these statements apply and up to the date of their approval. In 2008, the effectiveness and consistency of risk management at all levels of the organisation has been measured, improved and reported via the sector and function assurance framework.

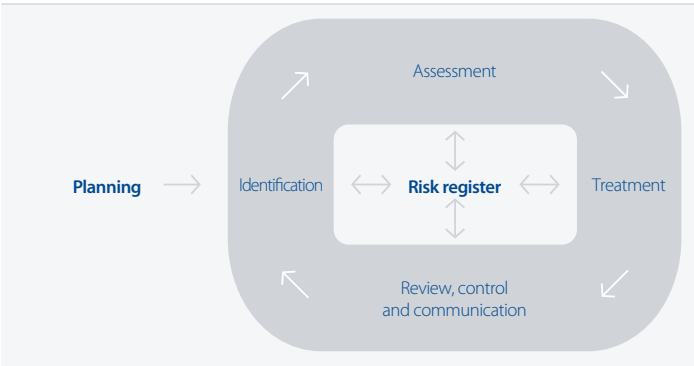
The Board has reviewed the risk management process and confirms that ongoing processes and systems ensure that the Group continues to be compliant with the Turnbull guidance as contained in ‘Internal Control: Guidance for Directors on the Combined Code’.

Organisation structure

The Group has a clearly defined organisation structure within which operational management has detailed responsibilities and levels of authorisation, supported by written job descriptions and operating manuals.

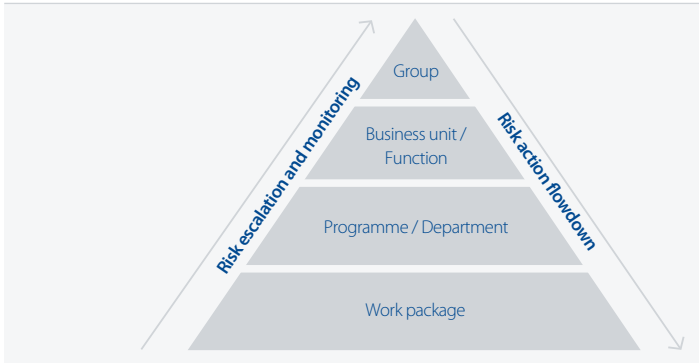
The risk management system

The risk management system is an integral part of management’s approach to delivering business objectives and is a systematic process designed to identify, assess, treat, manage and communicate risks.



The risk management process

Risks are recorded in regularly updated risk registers operating at all levels of the organisation and are continuously reviewed and monitored. The risk management process places significant emphasis on learning from and sharing prior experience. The system provides methods for escalation and delegation to the appropriate levels within the organisation and ensures that actions are owned, defined, resourced and effective.



The risk escalation process

Risks may arise from a variety of internal and external sources. They may be associated with regulations, customer requirements and competitor actions, or could result from the capability of the processes used to execute the business, or from external and largely unpredictable events, such as terrorist activity or war. The principal risks and uncertainties for the Group are shown on pages 21 to 24.

Risks, irrespective of source, are managed through processes operated by business unit and functional teams. The corporate risk register is updated and reviewed by the risk committee twice a year so that the Board may then consider and review these risks in terms of their potential impact.

Management has continued to perform comprehensive risk reviews for all key projects, programmes and business change plans.

All the processes operated by the Group are subject to continuous improvement, including the risk management process itself. Development and deployment of the process is the responsibility of a dedicated Enterprise Risk Management team. The team has created a comprehensive framework for the assessment of risk management maturity at all levels throughout the organisation that enables focused improvement actions and drives consistent application of the risk management process throughout the Group.

The risk process is underpinned by an integrated range of tools and training and education programmes. Deployment of an enterprise-wide risk management software application enables the analysis, management and communication of risks across the business. A network of risk champions, mentors and facilitators helps to develop, embed and share best practice throughout the organisation.

Systems of internal control

The general managers of individual businesses are aware of their responsibility to operate systems of internal control which provide reasonable assurance of effective and efficient operations, reliable financial information and compliance with laws and regulations. Financial managers are required to acknowledge in writing that their routine financial reporting is based on reliable data and that their results are properly stated in accordance with Group requirements.

The Group has a comprehensive budgeting system with an annual budget approved by the Board. Revised forecasts for the year are reported at least quarterly. Actual results are reported monthly against budget and variances reviewed.

The activities of the Group are subject to review by the Department of Risk, including business assurance and product introduction and life cycle management, and the assurance functions of Health, Safety and Environment, Quality and Engineering. These functions operate to work programmes agreed by the appropriate Board member.

The business assurance function, which works closely with the external auditors, undertakes a programme of financial and operational audits and reviews agreed by the audit committee and covering all Group activities. The programme includes independent reviews of the systems of internal control and risk management. The findings and the status of corrective actions taken to address these are reported in writing to both the audit and risk committees twice a year.

Share capital and voting rights

At December 31, 2008, the Company's authorised share capital was £3,500,050,000.60 and comprised: 2,499,999,998 ordinary shares of 20p; 2,000,000,000,000 C Shares of 0.1p; 1,000,000,000,000 B Shares of 0.1p; one Special Share of £1; and 50,000 preference shares of £1.

On December 31, 2008, there were 1,843,740,136 ordinary shares and one Special Share in issue. The ordinary shares are listed on the London Stock Exchange. The first issue of C Shares took place on January 2, 2009. The C Shares are not listed.

Payments to shareholders

At the AGM on April 30, 2009, the directors will recommend an issue of 85.8 C Shares with a total nominal value of 8.58p for each ordinary share. Together with the interim issue on January 2, 2009 of 57.2 C Shares for each ordinary share with a total nominal value of 5.72p, this is the equivalent of a total annual payment to ordinary shareholders of 14.30p for each ordinary share.

Communication with shareholders

The Company attaches importance to the effectiveness of its communications with shareholders. It publishes an Annual review and summary financial statement as well as a full Annual report. There are also separate reports covering the environment and community relations.

The Company maintains a regular dialogue with institutional shareholders and the financial community. This includes presentations of the preliminary and interim results, regular meetings with major shareholders, participation in stockbrokers' seminars and site visits.

Each year the Group holds an investors' seminar, in order to improve the financial community's understanding of the Group and to introduce investors to a broader range of management. All shareholders can gain access to these and other presentations, as well as to the Annual report and other information about the Group, on the Group's website at www.rolls-royce.com.

Holders of ordinary shares may attend the Company's AGM at which the Company highlights key business developments during the year and at which shareholders have an opportunity to ask questions. The chairmen of the audit, remuneration, ethics, and nominations committees are available to answer any questions from shareholders on the work of their committees.

The Company confirms that it sends the AGM notice and relevant documentation to all shareholders at least 20 working days before the date of the AGM. For those shareholders who have elected to receive communications electronically, notice is given by email of the availability of documents on the Group's website. Responsibility for maintaining regular communications with shareholders rests with the executive management team led by the Chief Executive. However, the Board is informed on a regular basis of key shareholder issues, including share price performance, the composition of the shareholder register and City expectations. Independent research is commissioned annually into institutional shareholder perceptions of the Group. The Chairman, the Senior Independent Director and the non-executive directors make themselves available to meet with shareholders as required.

Share class rights

The rights and obligations attaching to ordinary shares are set out in the Company's Articles of Association.

- 1 *Ordinary shares* – Holders of ordinary shares are entitled to receive the Company's Annual report. They are also entitled to attend and speak at general meetings of the Company, to appoint one or more proxies or, if they are corporations, corporate representatives, and to exercise voting rights. Holders of ordinary shares may receive a bonus issue of C Shares or a dividend and on liquidation may share in the assets of the Company.

Holders of not less than ten per cent of the issued ordinary share capital of the Company may requisition a general meeting of the Company. Holders of not less than five per cent of the issued share capital of the Company or 100 holders holding shares with an average of not less than £100 per member paid up on such shares (which reflects the nominal value not the market value of the relevant shares) may requisition the Company to give shareholders notice of any resolution which may properly be moved at an AGM or may require the Company to circulate a statement of not more than 1,000 words with respect to a matter referred to in a proposed resolution or other business to be dealt with at a general meeting.

- 2 *C Shares* – Since January 2009 the Company has issued non-cumulative redeemable preference shares (C Shares) as an alternative to paying a cash dividend. Shareholders can choose to:
 - redeem all C Shares for cash;
 - redeem all C Shares for cash and reinvest the proceeds in additional ordinary shares using the C Share Reinvestment Plan (CRIP) operated by Computershare Investor Services PLC (the Registrar); or
 - keep the C Shares.

Any C Shares retained attract a dividend of 75 per cent of LIBOR on the 0.1p nominal value of each share, paid on a twice-yearly basis, and have limited voting rights. In certain circumstances the Company has the option to compulsorily redeem the C Shares, at any time, if the aggregate number of C Shares in issue is less than ten per cent of the aggregate number of all C Shares issued, or on the acquisition or capital restructuring of the Company.

On a return of capital on a winding-up, the holders of C Shares shall be entitled, in priority to any payment to the holders of ordinary shares, to the repayment of the nominal capital paid-up or credited as paid-up on the C Shares held by them, together with a sum equal to the outstanding preferential dividend which will have been accrued but not been paid until the date of return of capital.

The holders of C Shares are entitled to attend, speak and vote at a general meeting only if a resolution to wind up the Company is to be considered, in which case they may vote only on such resolution.

- 3 *B Shares* – Up to July 2008, the Company had issued B Shares as an alternative to paying a cash dividend. Following a strategic financial review, the directors concluded that the dilution caused by the conversion of B Shares to ordinary shares was inconsistent with the Group's strategy. The only material difference between B Shares and C Shares is that C Shares do not carry the option to convert directly into ordinary shares. C Shares can only be redeemed for cash. All remaining B Shares were redeemed on September 22, 2008 and the Company has no intention of issuing further B Shares.

- 4 *Special Share* – Certain rights attach to the special rights non-voting share (Special Share) issued to HM Government (Special Shareholder). Subject to the provisions of the Companies Act 1985, the Special Share may be redeemed by the Treasury Solicitor at par at any time. The Special Share confers no rights to dividends but in the event of a winding-up it shall be repaid at its nominal value in priority to any other shares.

Certain Articles (in particular those relating to the foreign shareholding limit, disposals and the nationality of directors) that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder.

The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

- 5 *Preference shares* – The 50,000 preference shares were issued pursuant to the Company's incorporation and were subsequently redeemed. They cannot be reissued.

Restrictions on transfer of shares and limitations on holdings

There are no restrictions on transfer or limitations on the holding of the ordinary shares or C Shares other than under the Articles of Association (as described below), under restrictions imposed by law or regulation (for example, insider trading laws) or pursuant to the Company’s share dealing code.

The Articles of Association provide that the Company should be and remain under United Kingdom control. As such, an individual foreign shareholding limit is set at 15 per cent of the aggregate votes attaching to the share capital of all classes (taken as a whole) and capable of being cast on a poll and to all other shares that the directors determine are to be included in the calculation of such holding.

Shareholder agreements and consent requirements

There are no known arrangements under which financial rights carried by any of the shares in the Company are held by a person other than the holder of the shares and no known agreements between the holders of shares with restrictions on the transfer of shares or exercise of voting rights.

No disposal may be made to a non-Group member which, alone or when aggregated with, the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear business or the assets of the Group as a whole, without consent of the Special Shareholder.

Authority to issue shares

At the AGM in 2008, authority was given to the directors to allot new ordinary shares up to a nominal value of £128,748,950, equivalent to one third of the issued share capital of the Company at February 6, 2008. Such authority is valid until the AGM in 2009 or 18 months from May 7, 2008, whichever is the earlier. A further special resolution was passed to effect a disapplication of pre-emption rights for a maximum of five per cent of the issued share capital of the Company at February 6, 2008. The directors propose to renew these authorities at the AGM in 2009.

At the AGM in 2008, authority was given to the directors to allot new B Shares up to a nominal value of £350 million as an alternative to a cash dividend. Such authority is valid until the AGM in 2009 or 18 months from May 7, 2008, whichever is the earlier. The directors do not propose to renew this authority at the AGM in 2009.

At the AGM in 2008, authority was given to the directors to allot new C Shares up to a nominal value of £350 million as an alternative to a cash dividend. Such authority is valid until the AGM in 2009 or 18 months from May 7, 2008, whichever is the earlier. The directors propose to renew this authority at the AGM in 2009.

Authority to purchase own shares

At the AGM in 2008, the Company was authorised by shareholders to purchase up to 182,161,998 of its own ordinary shares representing ten per cent of its issued ordinary share capital as at February 6, 2008. The Company did not make use of this authority during 2008.

The authority for the Company to purchase its own shares expires at the conclusion of the AGM in 2009 and a resolution to renew it will be proposed at that meeting.

Voting rights

Deadlines for exercising voting rights

Electronic and paper proxy appointment and voting instructions must be received by the Company’s Registrars not less than 48 hours before a general meeting.

Voting rights for employee share plan shares

Shares are held in various employee benefit trusts for the purpose of satisfying awards made under the various employee share plans. For shares held in a nominee capacity or if plan/trust rules provide the participant with the right to vote in respect of specifically allocated shares, the trustee votes in line with the participants’ instructions. For shares that are not held absolutely on behalf of specific individuals, the general policy of the trustees, in accordance with investor protection guidelines, is to abstain from voting in respect of those shares.

Major shareholdings

At February 11, 2009, the following companies had notified an interest in the issued ordinary share capital of the Company in accordance with the Financial Services Authority’s Disclosure and Transparency Rules:

| Company | Date notified | % of issued ordinary share capital |
|-----------------------------|------------------|------------------------------------|
| Invesco Limited | February 4, 2008 | 6.91 |
| Legal and General Group Plc | December 4, 2008 | 4.99 |

Political donations

In line with its established policy, the Group made no political donations pursuant to the authority granted at the 2008 AGM.

Although the Company does not make, and does not intend to make, donations to political parties, within the normal meaning of that expression, the definition of political donations is very broad and includes expenses legitimately incurred as part of the process of talking to members of parliament and opinion-formers to ensure that the issues and concerns of the Group are considered and addressed. These activities are not intended to support any political party and the Group's policy is not to make any donations for political purposes in the normally accepted sense.

A resolution will therefore be proposed at the 2009 AGM seeking shareholder approval for the directors to be given authority to make donations and incur expenditure which might otherwise be caught by the terms of the Companies Act 2006. The authority sought will be limited to a maximum amount of £25,000 per Group company but so as not to exceed £50,000 for the entire Group in aggregate.

During the year, one of our US subsidiaries made a contribution towards the running expenses of a political action committee (PAC) organised by its employees in an amount of US\$23,700 (2007: US\$22,440). PACs are a common feature of the US political system and are governed by the Federal Election Campaign Act. The Rolls-Royce PAC is independent of the Company and independent of any political party. Its funds are contributed voluntarily by employees and the Company cannot affect how they are applied. Such contributions do not require authorisation by shareholders under the Companies Act 2006 and therefore do not count towards the £25,000 and £50,000 limits for political donations and expenditure for which shareholder approval will be sought at the AGM.

Change of control

Contracts and joint venture agreements

There are a number of contracts and joint venture agreements which would allow the counterparties to terminate or alter those arrangements in the event of a change of control of the Company. These arrangements are commercially confidential and their disclosure could be seriously prejudicial to the Company.

Borrowings and other financial instruments

The Group has a number of borrowing facilities provided by various lenders. These facilities generally include provisions which may require any outstanding borrowings to be repaid or the alteration or termination of the facility upon the occurrence of a change of control of the Company. At December 31, 2008 these facilities were substantially undrawn.

The Group has entered into a series of financial instruments to hedge its currency, interest rate and commodity exposures. These contracts provide for termination or alteration in the event that a change of control of the Company materially weakens the creditworthiness of the Group.

Employee share plans

In the event of a change of control of the Company, the effect on the employee share plans would be as follows:

- *Executive Share Option Plan* – All options granted have vested and are exercisable. Consequently, no early vesting is currently possible. It is not proposed to make any further grants under this plan, which terminates in 2009.
- *Performance Share Plan* – Awards would vest pro-rata to service in the performance period, subject to remuneration committee judgement of company performance.
- *Annual Performance Related Award deferred shares* – The shares would be released from trust immediately.

- *ShareSave* – Options would become exercisable immediately. The new company might offer an equivalent option in exchange for cancellation of the existing option.
- *Share Incentive Plan* – Consideration received as shares would be held within the Plan, if possible, otherwise the consideration would be treated as a disposal from the Plan.

Essential commercial relationships

Supply chain

Certain suppliers to the Group contribute key components or services the loss of which could cause disruption to the Group's deliveries. However, none are so vital that their loss would affect the viability of the business as a whole. When dealing with suppliers, the Group is guided by the Supply Chain Relationships in Aerospace (SCRIA) initiative. It seeks the best possible terms from suppliers and, when entering into binding purchasing contracts, gives consideration to quality, delivery, price and the terms of payment. In the event of disputes, efforts are made to resolve them quickly. As the Company is a holding company and does not itself trade, it owed no amounts to trade creditors at December 31, 2008 and therefore the number of creditor days required to be shown in this report to comply with the provisions of the Companies Act 1985, is nil.

Export licences

The Group holds export licences with UK, US and a number of other national licensing authorities where the Group operates. Maintaining and securing such licences is critical to success as a global business. The Group therefore attaches the highest priority to complying fully with export controls in all the jurisdictions in which it operates. Detailed processes have been put in place to ensure that the Group follows all applicable legal and regulatory requirements. The Board has established an Exports Committee, chaired by the Chief Operating Officer, which has responsibility for policy and compliance with regard to the Group's export activity.

In the UK, the Group fully complies with the provisions of the UK Export Control Act (2002) and all relevant EU Export Control Regulations applicable in the UK. Globally, the Group complies with all relevant laws and regulations regarding the export of military, dual use goods and technology. Most notably, in the US the Group vigorously enforces a policy of compliance with the relevant legislation and its underlying regulatory intent.

Customers

The increasingly global nature of the business, balanced across the civil aerospace, defence aerospace, marine and energy businesses, ensures that the Group is not overly dependent on any individual customer.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual report and the Group and parent company financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law the directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the EU (IFRS) and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRS to present fairly the financial position and performance of the Group; the Companies Act 1985 (the 'Act') provides in relation to such financial statements that references in the relevant part of the Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the Group and parent company 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;
- for the Group financial statements, state whether they have been prepared in accordance with IFRS;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent 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 parent company and enable them to ensure that its financial statements comply with the Act. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' report, Directors' remuneration report and Corporate governance statement that comply with that law and those regulations. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Going concern

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements. The financial risk management objectives and policies of the Company and the exposure of the Company to price risk, credit risk, liquidity risk and cash flow risk is discussed on pages 60 to 63 of the business review.

Disclosure of information to auditors

Each of the persons who is a director at the date of approval of this report confirms that:

- i) so far as the director is aware, there is no relevant information of which the Company's auditors are unaware;
- ii) the director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 234ZA of the Act.

Responsibility statement

Each of the persons who is a director at the date of approval of this report confirms that to the best of his or her knowledge:

- i) each of the Group and parent company financial statements, prepared in accordance with IFRS and UK Accounting Standards respectively, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole; and
- ii) the Directors' report on pages 1 to 84 includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Tim Rayner

General Counsel and Company Secretary
February 11, 2009