RBS
The Royal Bank of Scotland Group

2008 Annual Results

ANALYSTS PRESENTATION

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Presenters

- **Sir Philip Hampton (Chairman)**
- **Stephen Hester (Group Chief Executive)**
- **Guy Whittaker (Group Finance Director)**

Sir Philip Hampton: Well good morning ladies and gentlemen, we are all settled down. Welcome to RBS' 2008 annual results. Whilst I have only been the chairman for a few weeks now, I am acutely conscious that 2008 was an extraordinarily difficult year for the business. For our customers, for employees and of course for shareholders—public and private—who put very large amounts of money, of new capital into the business in the course of the year. And of course we are particularly grateful today to the continuing support we have from the government and the UK taxpayers. That support which now secures our financial stability and underpins our future.

We are going to be a little longer today because we have got three things to discuss. Guy will go through the financial results in the customary way, although I think it is fair to say there are some fairly uncustomary figures and issues in there that we don't want to see repeated. And then critically today of course Stephen is going to go through the conclusions of the strategic review that he and his team have been working on in recent months. And then Stephen will give our first public thoughts on the asset protection scheme announced this morning. We are going to start with Stephen and since we have got a lot to do we will get on with it straight away. If I can make one request is that your mobiles are completely turned off please. Thank you very much.

Stephen Hester: Thank you, Philip. Good morning everyone. We, unconventionally—as Philip mentioned—thought I would go first so that whilst you are awake you hear from me and then the fireworks in the numbers will give you a jolt towards the end. You should have in the packs extensive appendices and it has been our attempt to make a significant stride forward from RBS' previous position in terms of financial transparency. We want to be at the forefront of financial transparency and so we are open to any suggestions in the future as to what more we can do that would be helpful.

So rather than, if you like, talk about the business backward looking it seems sensible to forward look as much as we could this morning. And the key task ahead of us is to execute the strategy that we are laying out, to restructure RBS to return it to being one of the world's premiere financial institutions. We will be anchored in the UK but serving customers globally. Clearly we need to rebuild shareholder value, clearly we need to allow the government to get out of our hair and get their money back and that can only be accomplished if we reinforce leadership in our markets but are disciplined in the way we do that and that is what we are getting on with.

I wanted to just give this next slide a perspective because I think moving back if you like to the October wake up call and recapitalisation that we required and many others required, there are an essential set of building blocks without which we can't go on the path of recovery and I think that we are putting those building blocks in place and many of them are indeed, after today in place against which to execute. Clearly recapitalisation and government support on funding has been a very, very important component of that as the management of the board changes as well. Understanding our problems and presenting them in of course the most comprehensive version of that again is in the financial statements presented today.

We then announced today the new strategy, the road map around which to unite our people, our resources and to tell you where we are planning to go. But of course since the early years of the execution of that strategy are going to be fraught with uncertainty, the stability that the asset protection scheme affords or improves is an equally essential bit of allowing us to be able to execute that strategic plan. And then of course there is the unmanageable bit which is exactly how many headwinds are we going to face and with what volatility from the market. But essentially after today our job becomes execution. Not small job but that is what it becomes. The strategy which I will be going through today in headlines is putting over 20% of our funded assets into a core division to work off over the next three to five years, cutting the cost base, obviously the asset protection scheme we will talk about and then all of the rest of our business will have extensive restructuring ranging from GBM where there is the most work to do. We plan to cut to 45% out of the capital base of GBM in restructuring it to what we believe will be a very strong and successful investment bank on its revised mandate and then clearly substantive change to all the rest of our businesses and alongside that management and processes.

And we have been pretty busy to date. I won't go through this slide, it has not been a relaxing few months and it won't be yet, but I think we are, one by one, ticking off a lot of things. Now just to say on the results—and Guy will obviously go through the numbers—but you know it is unambiguous, they are bad results. Both in terms of the headlines and in terms of the loss even pre goodwill. I do think though that it is important first of all obviously to put it in the context that that there is true of a number of other banks. I think we still only rank tenth in the league table of shame in terms of losses. But within these results actually the vast majority of our business was profitable even in GBM where the losses were concentrated there were £10 billion of revenues, nearly an all time record before the concentrated in specific areas that gave arise to very large losses where recorded. And that is important not just if you like to give credit to the past which is important, but also give a sense of assurance that we are not building on sand here. We are building on rock and what we need to do is sweep away the sand that currently lies over some of that rock.

So what we are trying to hard not to do, because it is unproductive, is to get into the blame game for the past. There are plenty of people who are spending their time doing that without you needing to hear it from me. But I think it is very important to just think a little bit about the issues that got us where we are because unless we correct for them, we have risk going forward, but also if you identify them it understands what you don't need to correct for and puts a strategy in context and as I say I don't want to belabour it but these six areas in my view as the areas which we need to address in order to correct what went wrong. In addition to that we clearly need to change the company to suit the way that markets are likely to change and those are the two components of the strategic plan. Leverage is clear; the ABN AMRO acquisition in a sense has ingredients from all the other boxes here.

I say strategy, I think that strategy is vital for companies, not just because it gives you a purposeful roadmap, but I think it makes you think more about your market, about your position in the markets, the capacity for growth and therefore if you are trying to do things with your business, the markets you operate in won't support, you will make mistakes. And whether it be the growth rates that markets will support or whether it be the strength of your competitive position and therefore the likely quality of the business you do and so on, founding things in clear strategy as opposed if you like day to day profit growth and opportunism will be a very, very important bit I think of the quality of business. Risk controls I suspect go without saying. Profit focus, well look - you know our job is to make profits and our job is to grow profits and there should be no ambiguity about that unless we do that well we will be seen to have failed. But there is I think a risk often frankly encouraged by audiences that public companies have of making that a solitary goal and that you have to think very carefully about how your profits are being made, with what resources, with what risks and make sure that there is a full suite of targets and management aspirations from which profits arise. And then clearly if you like management processes, the culture of the firm, the bench strength of the management and the empowerment of the businesses around those strategic targets, all of these are issues that we will address and strengthen and are doing.

So in conceptualising the strategic plan, we were really working both top down and bottom up and the strategic plan that we have is if you like the resolution of those. I set out for you when I last addressed you on joining three months ago, five tests that I had put forward if you like as a bottom up tests for every business we have to meet through the strategic planning process. Top tier competitive positions from which I think quality profits derive, 15%+ ROE which is where I believe we will get back to. How many years? I don't know the answer to that but we will get back to after the downturn. Proportionate use of balance sheet risk and funding - incredibly important; organic growth potential and that doesn't just mean taking a swipe at acquisitions, but it does mean that if your business is to grow organically you have to work them harder, you have to invest in them; the management capacity is stretched in doing that and so on and then of course, connectivity within the group. We can't have pieces we have to have businesses that work together and so these are the five tests against which every one of our businesses is being measured and the plans are being developed and the things that we are discarding have been discarded. But they have to fit the top down and I think the key disciplines—and we could make this more complex—we need to return to standalone strength and for now I see that as double-A category ratings, standalone. Today we benefit from those courtesy of government support; we need to benefit from those standalone. Guy at the end of his presentation will give some indication of what we think that might be in terms of the balance sheet and capital although of course that is the voyage of discovery for many. And profitability I have set out the targets, top down as well as bottom up and obviously business mix where we are not in any way saying we won't take risk. If you don't take risk you don't make money in financial services, but obviously that has to be more balanced than it was before.

So the first, if you like, step of the plan is to identify those things that we believe are not capable of meeting my five strategic tests and initially labelling them a non-core division and by doing that and managing that division separately albeit on a makeshift basis within the group, we free the rest of the group both visually and in some of the management effort to do its own restructuring to meet the own business targets. I think that you can see that throughout the plan what we have had to do is basically come up with what I would describe as a self-help plan. There is not at the moment an active M&A market that ascribes good values to financial services assets. It would be nice if there was a wonderful rabbit to pull out of a hat that way but there isn't. That may change and as a matter of management philosophy there is no business that we will be irrational with in terms of value. If someone wants to pay more for a business than it is worth, we must always—regardless of that business—be open to that. However, we are not relying on that, we have to chart—we believe—a self help plan and any inorganic opportunities to short cut that will be what they will be.

Let me give you some more dimensions around the non-core division. We did announce by the way, this morning separately that we have hired or rehired Nathan Bostock who was at Abbey recently as finance director, but he ran the portfolio business unit for me at Abbey in the early 2000s and so has done this before albeit on a different scale and he will be heading up the division in which—the non core division for us. It is important to note that the non core division contains a bunch of different things. It does contain a bunch of stressed assets, in fact many of our stressed assets but it also contains assets that are not stressed but simply are non strategic relative to the five tests that I set out. It is a mixture of portfolios, individual assets and businesses. And it comes in large parts from our wholesale businesses but not exclusively and I will show that on the next slide.

Now unfortunately because of the illiquidity and distressed nature of markets for assets, we can't with confidence chart the speed of sell down of these businesses and these assets or indeed the cost and one of the major benefits of the asset protection scheme is to allow us to do it with a higher likely end-NPV than if we are under pressure to do it very, very fast because there is a capital risk involved. But we clearly can't give that forecast, what we will do obviously is report regularly against it. So the objectives in selling it down are to sell it down purposefully but with the best eye on NPV of outcome that we can have.

You will see the broad financial parameters on the right hand side of the slide. And just to give you some sense of where these assets come from, geographically and through our divisions divided into the derivative assets which are in the lighter shading and the balance sheet funded assets, we give this breakdown. There are other breakdowns that we will give, but I would ask you for some patience. We have been going at breakneck speeds to come up with this plan. There are many details that still in the next two or three months will need to be worked out. There are also a whole bunch of human sensitivities and so we may not be as forthcoming on detailed disclosure about this as you would like until the summer.

What I can now do in a sense having just given you the dimensions of the non core business there, is move on if you like to our ongoing businesses. And I am going to spend time slightly strangely on this, because I will spend not very much time on the businesses that, if you like, need the least surgery or have the least questions around them and more time on the ones which I know are newsworthy. But that is not in any way to suggest that that is the apportionment of importance. So, clearly as I have mentioned already the biggest changes that we need to execute are in our investment banking business where we plan to take 45% out. But it is important to note that we believe that there is a good future of this business. We have top tier positions in a number of key customer franchises, liquid markets and we believe that we can make a good living out of those. That they will be complementary; that they can risk characteristics that will pave their way and that we can have a very successful business as part of a group on a significantly smaller scale overall, but on a big scale in the areas in on which we choose to compete. And we have set out on this slide some of the parameters around that and giving you a few more details on this next slide, dividing between core businesses—every business we have needs to do some things to strengthen and improve. Non core businesses where we will substantially exit and then what we call restructured core businesses in the middle where they will remain very important businesses for us but need particularly heavy changes or surgery in order to regain the risk and return characteristics and the centring around customer franchises that we require.

And geographically as you will know, one of the consequences of the ABN AMRO acquisition was that we became extremely diverse in geography but the vast majority of those geographies we were actually fairly small and marginal players in. And in a different world where we need to husband our resources, where we need to pay attention to the places we can definitely be winners that investment profile is not sustainable. And so as a consequence there will be a significant reduction in the number of countries in which we have a presence and in a number of countries our presence will be significantly reduced in order to make sure we can be strong, meaningful market leaders in our core countries. That doesn’t mean to say we won’t be global. We will be global but you do not need to be in every country to be global and it is better to be meaningful in lesser countries than to be spread thin and that is the heart of what this slide is trying to say.

Let me move off GBM to our US retail and commercial business which I think has attracted lots of attention and thought. It is our belief that this business can be restructured in a way that makes it an attractive part of our group. It is also our belief that in any event today there is not a value accretive alternative to that strategy although that won't always be the case. Citizens does have strong market leading positions in the attractive markets of the North Eastern, Mid-Atlantic United States. It is relative to other US retail and commercial banks, low risk. Now at the moment that doesn't mean absolutely low risk that is a relative statement and it does have and will have in restructured form very attractive funding characteristics being largely deposit funded in a way that improves the overall group balance as well. Nevertheless we have major things that we have to do to make Citizens what it can be. In particular we are going to draw back from a whole range of incursions that have been made outside the core footprint geographically of Citizens, both in terms of branches but, in particular in terms of individual lines and credit cards and also loans and dealer finance and things like that. And secondly we have a major restructuring to do in cost base and investment to do, Citizens ironically has been starved of technological investment in a number of ways which partly makes it inefficient, but partly means that the retail network for example is not operating as well as it should in terms of cross sales and revenues.

The retail area we need to particularly revitalise, both as a revenue generator and as a funding generator. Our risk portfolios have been growing faster than deposits and we need to peel back on those and peel back and add footprint lending. We believe that if we do all of that—we have tough targets for Citizens, not just the return targets and the market leadership targets we have for all our businesses, but we need to regain a one to one ratio which would be typical of US banks which is what we don't have in Citizens in terms of funding to deposits. We need to retain the below average risk profile for its markets and prove that we can grow it organically which has not been the case in the past. Although other banks in the same markets do grow organically and therefore we believe we can. And the connectivity with the rest of the group both in terms of use of products, in terms of personnel interchange, in terms of shared platforms is dramatically increasing as we speak. So we think that if we do all of these things for Citizens, Citizens will be valuable, attractive, meet our tests both as a holder and as an asset to the Group.

Now summarising the other businesses; every one of our other businesses which clearly mostly lie now in the UK, have got major things that we want to do to them in order to enhance their prospects of meeting my five business tests all to do with costs, to do with risk concentrations, to do with funding and balance sheet balance. There are some areas where there are more fundamental issues we need to confront. For example retail banking, I think for the industry in the UK has got big issues. Those issues arise clearly from low interest rates although hopefully that is cyclical as they arise from the various regulatory attacks on products like PPI and overdraft charging and I do think that the retail banking model in the UK will need to undergo substantial change in the ways in which money can be made, the cost bases that can be supported. In our case looking also at the geographic footprint, there is a lot of work to do here I think for all banks and for us going forward. Our market shares clearly are going to be hard to enhance, but they are very, very good although it may be that the Lloyds and HBOS combination make some market share easier to pick up if there is disruption in that area. Clearly our new lending commitments in support of the government are importantly executed through retail and corporate and commercial.

And covering the other three business areas of the group on this slide, I mean Ulster Bank of course in effect is part of the UK, both as it relates to Northern Ireland but obviously with the important Irish presence, it shares the UK infrastructure and many of the products. But clearly the island of Ireland has a very major set of economic challenges which are further exacerbated by the commercial property and residential property concentrations that we and all others in Ireland have and a major restructuring of that business is required although it ultimately will meet with five tests. And in effect is an extension of what we do in the UK albeit under a different brand. We are engaged in quite a radical set of actions there, including the closure of the First Active brand which is part of the goodwill write off that we announced. Insurance, I think we went through the very public debate. It is a great business; there was an issue about whether it was worth more to others than to us, for now that is demonstrably not the case. We can make it still better and have lots of work around to do that.

And then GTS which we sort of report separately but really isn't a separate business because it feeds off the back of the client relationships that we have in all our other businesses ain the capital that is deployed there, nevertheless a very high quality, high ROE, cash generative, funding generative business which we need to continue to roll out, albeit the global ambitions of which will clearly be slowed a little bit by the global moves that we are making in other businesses.

And if you like spread across the top of all the business specific actions we have, will be a whole range of changes to management process and culture which are all about addressing the issues that have arisen in the past, making sure that we are one of the best managed banks out there. None of this is rocket science; none of this is inventing something that hasn't been done before, which is why I am confident we can do it. It just takes time.

Expenses; clearly there is lots of work to do on expenses and all banks in the world have a fast changing market place against which to aim efficiency and so we don't know whether this will be the last word or not. But in addition to eliminating the expenses associated with the non-core division, we have set ourselves a target to cut out more than £2.5 billion from our costs over the next three years. The important provisos are that is constant exchange rates. Half a billion of that is the remaining fag-end not yet delivered of the ABN AMRO synergies. So you could say it is really an incremental £2 billion and there will be restructuring charges taken over the next three years to pay for that. We are obviously still working through the details, so we give a range of possible restructuring charge for that and I don't yet have a spread over in which year they will occur. And it is also important to note as I say that this does not include cost saves from business exits. It does also not include the effect of inflation, if there is any, in the next three years. That is the joy ahead of us of course, any movements on incentive pay, or new projects if there any, but nevertheless a substantive body of work across every one of our businesses and a necessary one.

Let me turn now to the asset protection scheme and a number of my colleagues have not had a lot of sleep for a number of weeks and have done and unbelievable, a stellar job in grappling with this sort of slippery, octopus of a process in coming up with what has been announced overnight. The facts are that we have if you like a headline, or outlined terms for the asset protection scheme but there is not a definitive agreement. There are lots of details still to work through. This needs to be put to our shareholders, among other things and obviously we can't make a full recommendation to our shareholders until the details are worked out. So what we are saying is we minded to go into it. We believe it is in the shareholders interest that these details are very important and it is not a decision to take lightly because this is not free—there are many difficult aspects to this for shareholders and hopefully I will take you through some of them as we go along. But clearly what we have been setting out to do, our objectives in engaging with the government in this has been to do something that enhances our financial strength. Obviously you know shareholders will have nothing if our customers and counterparties are not confident in dealing with us, even if conditions get much worse than they are today.

Reducing risk to shareholders, which has been a predominant theme of all financial services equities in recent months and weeks. Clearly the price tag for that is increased commitment in the UK. That in many respects is a welcome price tag. We have leading market shares, we can do great business in the UK, we remain free to price and risk assess as we would wish but if we have the wherewithal to capitalise when others are pulling back in our core market that ought to be attractive to shareholders over time in its own right. And clearly to the extent that stability in insurance allows us to run off the non core division more profitability for shareholders and I believe this does; that is good as well.

So against those objectives going into it, this is the opportunity that we have should we participate in the scheme we intend. We have an outline agreement for a pool of £300 billion of assets, made up approximately of £225 billion of funded assets on the balance sheet, £44 billion of committed undrawn lines to counterparties where we are worried about future stress. £33 billion of mark to market, plus a bit of future exposure on derivatives and underneath that approximately £160 billion of risk weighted assets, although we need to be careful with all of these, because all of these portfolios will have a fair amount of additional refinement between now and the scheme becoming effective. So anything we say now may be off a few percentage points either way, but I think in big picture terms we will be right. And to give you a sense, this is a bigger, a significantly bigger scheme than we planned for or were even seeking. But you can conceptually think of it as two things: we are trying to insure against our most stressed assets in order to protect the stability of the bank in a bad case. We are trying to make room for additional UK lending which is the price tag and in order to do that we need a bigger scheme which ensures a bunch of ongoing, good assets if you like. I mean they will all be subject to stress in a downturn, but it is that extra size that allows us to pony up on the lending whilst keeping the financial stability that was the goal of it. And so that is why approximately 55% of these assets are ones that you will find in our non-core and the balance are ones that you will find in our core businesses, mostly in the UK in terms of the ongoing lending.

Now just going through the pricing; risk weighted asset relief. The FSA has put out a ruling that gives us risk weighted asset relief in respect of these assets, caveated by two things. We keep a 10% strip of risks, so we obviously have the risk weighted assets associated with that and then there are risk weighted associated with the first loss. And so that is why of the full—even though there is £160 billion that is covered there is only £144 billion that actually comes off once you take account of the loss retention scheme. Losses up to 6% of that pool will be borne by us as a first loss and then split 90/10 and we are paying actually two kinds of fees. The explicit fee is 2% of the gross pool which is paid up front, although in our accounts will be amortised over seven years. In addition to that, we are being asked to give up tax relief in the UK in relation to our current deferred tax asset which is about £5 billion and any losses that we might make over the next two or three years before returning to profitability in the UK. And so who knows the real value of that tax give up and it is still to be worked through, it is one of the details that remains the source of let's say controversy between the parties. But the NPV of that depends very much a) on what losses we make and how much it increases and then how quickly we would be able to use it over the next ten, 20 years whatever it would be. But that de facto has the impact of probably doubling the fee from the stated 2%, but come up with your own numbers as to what you think it does relative to the fee.

Now the other important bits of this scheme is in a sense the capital side and that is to say that we are issuing to the government B shares which fall into, in a sense, three pots. One B shares to pay for the fee, which is £6.5 billion. Secondly a £13 billion issuance of B shares and I will explain what that is for in a second and we have an option to draw down a further £6 billion should in our judgement we need it for capital purposes as we go through whatever the downturn is bringing to us. Now let me talk about if you like the impact of all of this and why we are doing it and how it all works on the pro forma. The risk weighted assets change—pro forma is obviously straightforward. It is 144 billion a change or roughly 25%. There are a few moving pieces in the Core Tier one and that is also one of the reasons why we need some additional capital upfront. The Core Tier one clearly goes up by the amount of B shares that we issue, because the

B shares are designed to count as Core Tier one as the FSA has confirmed. But the regulatory treatment of the insurance is that 50% of the first loss piece needs to be deducted from Core Tier one capital, subject to a cap of 4% of the risk weighted assets that are being protected. And so putting that crudely in numbers there is roughly a £6 billion deduction from Core Tier one as a function of the way the FSA will account for the risk weighted asset relief that they give on the other side and that creates a capital hole.

Clearly as we go through in subsequent years as this thing unwinds, there will be various movements. The amortisation of the fee will hit core tier one because that doesn't hit on day one, that hits over the next seven years. As we make losses under the first loss piece then those losses hit Core Tier one but half of them are offset by the deduction that you take upfront in Core Tier one from the FSA's 50% allocation. So there is quite a few sort of moving parts in how that will play out in the next few years. But what it means is that although our Core Tier one ratio jumps a rather attractively high level pro forma; that is misleading high because we know over the next seven years, 6.5 billion comes off that as the fee amortises through because that is in a sense a commitment upfront. We know that if we go into this we have to wipe 5 billion off Core Tier one because of the deferred tax asset that would have to go if we went into it. And then clearly to the extent we take losses against the first loss piece there is a further deduction to Core Tier one and finally to the extent we lend more in the UK that is an increase in risk weighted asset. So all of those moving parts are you need to start with an unusually high Core Tier one ratio if you want to be very resilient even if things get really bad in the next two or three years in terms of capital hits. And it is for that reason that an upfront issuance of capital over and above the one that offsets the fee is needed to offset the write off deferred tax asset and of the FSA immediate deduction against Core Tier one and then whatever you think is going to happen as we go forward.

The characteristics of the B shares and again what we have is a term sheet as opposed to details, like terms and conditions which are still to be worked out. But they can be seen in quite different ways according to what perspective you want to take. They are designed in a liquidation to rank alongside ordinary shares, but in a liquidation no one is very happy so that is probably the least important way of thinking about them and that is what gets them Core Tier one treatment. They are in ordinary course;

they will pay a 7% dividend, after tax dividend of course. Actually it is a formula that is the higher off of 7% or 250% of dividends announced on the ordinary shares and the detail of that is set out in the press release to the company. So it is 7% or higher and in a sense that is in perpetuity unless certain things happen. So if you just thought about that in wanting to decide what are these things worth, you have to decide what discount rate you want to apply relative to the 7% and then discount the 7% in perpetuity to get to whatever value you think is the economic give of that. Clearly if you are the government funding at 3% you might see it in one way, if you were looking at the markets for preference shares you might think it was unbelievably cheap and a good deal for shareholders. There is a wide range of how you might think about that. The preference share dividends—the dividends on the B shares are effectively what are called junior preference shares. In other words they rank ahead of ordinaries in dividend priority, but behind preference shares. We can waive them, they are non cumulative although obviously the government which holds them, also holds the majority of our ordinary shares.

Now the other feature of these B shares is that they are convertible at the government's option into ordinary shares at a price of 50p per share. There are a few conditions around that. That is to say that the Government has agreed that it won't take its voting above 75% and so therefore in reality, if they converted they would have to convert and sell thereby increasing the float and clearly if they converted prior to the share price being above 50p they take a loss in doing it. And so in thinking through the economics of that again there are two quite different perspectives you can take. If we do a fully diluted calculation assuming that they convert on day one, with our share price yesterday at 20p—we will see where it ends today—then obviously a conversion price at 50p is an incredibly good deal for shareholders relative to what would be available in the market and it would mean that these capital instruments would be in a sense worth a big discount to face in terms of the value to ordinary shareholders of this capital. On the other hand if you wanted to think about it about it different way the Government can collect 7% every year until such time as the share price is at 50p and then convert and treat that as a maturity of its bond as it were and have it in a sense of a 7% bond, albeit with the risk characteristics associated with a very, very junior preferred. And so in just trying to think through what this means for shareholders there is actually quite a wide range of ways of thinking about the economic interest and subordination of shareholders to either the 7%

cash flow streams or to the conversion and it gives rise to the ability to have quite different perspectives on how dilutive this is of shareholders.

I believe that in all scenarios this is cheap insurance and the right thing for us to do but that is quite a different thing than saying it is a shareholder bonanza, it is not. The situation that we face if the economic downturn is tough and lots of the first loss is required that does in effect dilute ordinary shareholders interest in book value below these shares because of the 7% preference dividend. So I just urge you to think it through. I think no one will come to the conclusion other than it is a good deal, but you can come to quite a lot of different conclusions in terms of the end value of what the ordinary shareholders have today.

Along with this is UK lending commitments, we have committed to increase lending relative to our ’09 plan. Our ’09 plan was flat on ’08, so call it relative to the end of ’08 by £25 billion in each of the next two years. It won’t be quite calendar year, because we are starting a quarter late obviously. That commitment is split between mortgages and corporate business although there is some flexibility in that if needed and it is with the override of being able to price commercially, being able to risk asset commercially.

Moving away from APS I would be remiss to conclude my part of the presentation without reminding you that there are lots of things that can go wrong and there is a lot of hard work and time to elapse before we know of the success and therefore ultimate value of the restructuring plan and of RBS but I think you know all of that. But I then would end in just simply reminding you on a positive note, I do think that when you look at what are the building blocks that it is necessary for us to put in place to have a credible shot at rebuilding of the world’s premiere financial institutions with all the value that that can potentially do, and we are making really good progress on putting those building blocks in place and having something against which to execute with a good chance of success.

So I am sorry if that has gone on for a little but anyway now over to the main event, the numbers.

Guy Whittaker: Thank you very much and good morning. We have provided an enormous amount of information to you this morning and what I am would like to do is go through some of the main elements of the company announcement in really three main themes. Firstly the financial review, secondly some areas of our risk profile and finally some observations on the balance sheet.

The results we announced this morning are very much inline with the guidance, the trading update that we provided on January the 19th. The group generated pre impairment profit of £7.1 billion with an impairment charge of £7 billion, credit market write downs as indicated, £7.8 billion and after a little tax and minority interest and a few other things, reported and attributable loss from our business operations of £7.9 billion. We undertook an assessment to the carrying value of goodwill and intangible assets on the balance sheet and net of the £700 million deferred tax asset release wrote down £16.2 billion. About half of that related to the ABN AMRO transaction, about a quarter to acquisitions that have taken place in the United States. A combination of those two resulted in the attributable loss of £24.1 billion.

Our group income fell on the year by 19%. We had the benefit of a strong performance from GTS, the benefit of a weaker sterling. On the positive side this is offset by an increase in funding related cost as well as a lower performance in the core GBM business, the main driver of which is a £5.8 billion write down in our trading assets which I will talk in more detail about later.

Costs overall fell 4% to £15.9 billion, principally a reduction in variable compensation down 66% year over year, offset by a number of small items and an adverse FX move the other side of the positive impact on the income statement all adding up to a £15.9 billion cost in the cost/income ratio which rose 49% to 59% largely on the back of the weaker income number.

Our impairments rose by £4.8 billion to £6.9 billion on our loan books, the drivers of those are principally corporate and commercial activities in the UK and Ireland. Personal and corporate activities in the United States and Citizens and a £3 billion increase in the charge in global banking and markets, £2.7bn which occurred in the forth quarter, £900 million of which that we have previously indicated was related to LyondellBasel. In addition as part of the reclassification of assets under IAS39 which took place at the end of the third quarter, we released impairments against those available for sale assets is £500 million.

It is worth noting really that all of our major divisions, with the exception of GBM were profitable during the course of 2008. In fact it was a record year for RBS Insurance on the back of significantly reduced claims and a stable income line and Global Transaction Services where profits grew 12% to £1.3 billion. We generated £3.3 billion of profits from our UK operations. Sadly all of this was offset by 3.6 billion of losses in the Global Banking Markets as well as £1.9 billion relating to central funding costs and central department items. As a result of that our underlying business was in line with the January 19th statement of £80 million underlying profit.

This slide just highlights the main building blocks of income and you can see pretty flat year over year across our regional markets business, pretty flat on Insurance, GTS I have mentioned before. The major difference really GBM income coming down from £10.9 to £4.4 billion with the larger part of that relating to the write downs year over year down 19% from £33 billion to £26.7 billion. Within that obviously non interest income fell considerably down 48% to £10.9 billion, whilst net interest income grew 29% to £15.9 billion. Group NIM rose by 10 basis points to 210 largely on the back of a very strong GBM money market performance benefiting from the falling rate environment. Tighter margins across the Regional Markets business with higher funding costs and lower deposit margins also helped weighing the improved front book pricing and contributed to an overall 15 basis point decline in that activity.

A few notes at the bottom really talk to the trends there and I think it is worth noting that the impact of low rates, the impact of tighter deposit pricing and the cost of holding incremental liquidity consistent with the emerging regulatory regimes are expected to cost somewhere between 25 and 40 basis points in 2009.

I said I would come back to the GBM income story; last year £10.9 billion headline income. On an underlying basis around the businesses, £10.2 billion for 2008, with a very strong performance in rates, currencies and commodities with a very welcome £800 million contribution from our joint venture with Sempra which began on April 1st offset by weak and subdued credit market and exiting market related activities. Falling asset values, wider spreads and counterparty failure costs of £5.8 billion of trading write downs to give a published underlying business revenues of £4.4 billion in addition to the previously disclosed credit market related write downs largely in structured credit, monolines and some leveraged finance a £7 billion revenue fell to a negative £2.5 billion.

What I would like to now just look at the main components of some of the risk elements in the portfolio, the £5.8 billion that I mentioned earlier was principally down to four main areas. Firstly it was structured credit where we took write downs on the business of £2.4 billion. This business was part of our discontinued operations and now in run-off. We incurred £2.3 billion worth of counterparty failures, principally three names; Lehman Brothers, the catalyst perhaps to the events which unfolded in the fourth quarter, Icelandic Bank and Madoff. We raised an addition £600 million of provisions against our exposure to credit derivative product companies and we lost around £500 million in principal finance activities mostly in the merchant banking and private equity arena. It is worth noting that £4.9 billion of these pounds occurred in the second half of 2008. It was £4.1 billion in the fourth quarter post-Lehman.

On the previously disclosed credit market write downs we lost £7.3 billion. We will see an additional £500 million of impairments on top of that and within this we now have the ABS CDO high grade marks between 35 and 20, the mezzanine marked down at 6 and you can note that the most of the mortgage exposure has pretty much gone. At this stage the larger part of our residual exposure now is to the monoline counterparties where on a net basis after hedges and reserves we still have £4.8 billion of open exposure. We have a £6 billion credit valuation adjustment and more than 50% reserved at this point.

Looking at the loan books our impairments were up by £4.8 billion particularly in the second half of the year within the retail and commercial businesses largely centred around small business and mid corporate and commercial in the UK and Ireland. Mostly small business, mostly real estate related, but now starting to spread more widely across the portfolio. In the UK personal unsecured sector, impairments were flat although the second half was weaker than the first. GBM saw losses of the £3.2 billion I mentioned earlier, £2.6 billion of which was in Q4.

Overall for the portfolio loans grew by 8% on a constant currency basis, the non performing book more than doubled to just under £19 billion with non performing loans now at 2.6% of the portfolio versus 1.49% a year ago. Charge-off rates up from 37 basis points to 91 basis points, the half over half split for 2008 was 46 in H1 and 135 basis points in the second half.

Maybe slightly surprisingly in this environment our provision coverage fell. There are two principal reasons behind that. Firstly is the higher proportion of secured corporate credits that are now in our non performing book versus the higher preponderance of unsecured personal lending a year ago as well as write offs of provisions of £3 billion in 2008 versus £2 billion in 2007.

Some new disclosure on overall portfolio credit quality; this is our total nominal credit exposure to customers and banks both credit and trading risk, a total of £855 million. Over half of which resides within GBM, the remainder spread between our UK retail, corporate, Ulster Bank and United States activities. Three quarters of that is above the sort of AQ5 midpoint rating on our grading scales. That would equate to last year's report that counts as an AQ3 or above. It is worth noting over 80% of the portfolio at this stage is under our sort of regular review and normal monitoring. We have heightened monitoring against about 15% of the portfolio, half of which is in the FI space and half of which is corporate and in a non performing book, as I mentioned earlier, just over 2.5%.

Geographically well spread; obviously the largest market in the UK that is principally spread amongst the economies of the world. By sector it is generally well diversified with a notable concentration of 12% in property although it is slightly lower than the percentage this time a year ago and our heightened monitoring—if you look at this—is centred really in three main areas. At this point it is mostly financial institutions and intermediaries, not surprisingly in the environment we are going through in the commercial property sector and in the United States geographically. As I mentioned earlier the signs of this monitoring are now spreading out more widely to other sectors.

Now there is a few slides on areas of concentration; commercial property £97 billion of total exposure, 58% of which is in the UK. Roughly three quarters investment, one quarter development, 1.6% speculative development at this point. The average LTVs have moved from around 69% at the half year and on an index basis around 84% at the end of 2008. Our exposure really with largely tenanted is to the occupier, ability and signs are there, the occupier markets are weakening with obviously lower interest rates starting to minimise or mitigate some of the cash flow impact of that.

Stephen has mentioned in his remarks around the concentrations. We have 300 names with over £500 million worth of total committed exposure. This covers credit and counterparty risk. Substantial parts of this, certainly with the FI names, would be collateralised in some way or form and 60% of this exposure is with financial institutions, 40% is with corporates. Amongst the financial institutions 93% investment grade in the top 20 exposures, 96% in investment grade, two of them under heightened monitoring are in the investment grade category. In the corporate books there is a slightly broader split; 75% investment grade, 25% non investment grade amongst the top 20; 83% and 17% the two watch-list names are both investment grade.

A sharp up-tick in impairments took place both in numbers of cases going into our global restructuring group and also by value of cases going into the global restructuring group. I think earlier in the year the growth was very much related to the sort of early cycle sectors, largely real estate, property related activities that I have mentioned now more broadly into other sectors as well. Considerable actions going on in risk mitigation, scaling up the recoveries unit around the world, scaling up problem recognition and collection, tightening trading exposures, strengthening collateral management, targeted opportunities to reduce the largest exposures and concentrations as they present themselves and bringing down some our country risk and exposures and obviously the APS scheme announced this morning will provide the insurance against a significant element of these difficult areas of risk.

Within the derivative portfolio we saw significant growth from £280 billion to just under £1 trillion of assets. It is worth noting that 80% was a function of movement in the underlying parameters against them in which those derivatives were quantified. 12% was due to the weakness in Sterling and 8% was down to growth in the volume and the underlying activities notwithstanding a very large nominal increase. The bulk of our activities are in the liquid flow markets: rates, currencies, credit markets and the bulk of our activity, whilst we do take risk, is leveraging the back of the client's flows. 90% or so is covered by netting or collateral agreements that leaves around £96 billion worth of uncollateralised exposure against which we hold a £10 billion reserve.

Just a few remarks on the balance sheet; headline number £2.2 trillion up from £1.6 trillion this time a year ago. Derivatives really the entire driver of that going from roughly say £300 million to £1 trillion. The funded balance sheet was flat on a reported basis for 2007. With the weakness of Sterling at a constant FX number that would be down 17%. Looking at a leveraged ratio if you net—not strictly US GAAP but if you netted all our derivatives against each other you would be looking at 4.7 Tier one to total asset ratio. The driver reduction in the funded balance sheet on a constant FX basis, GBM related, and you can see the progress that was made. We did have a site in the third quarter which we talked about at the time of the October capital raising. The headline numbers coming down from 874 to 692 on a reported basis; 874 to 594, a 31% decline on constant currency with securities and repos driving that reduction to the loan book; in this environment not surprisingly remaining rather sticky.

RWAs grew from £486 to £578 billion, two third of that was foreign exchange related and 30% of our risk weighted are in Dollars, 17% in Euros. The balance is the procyclical impact of Basel II, largely within the GBM portfolio. There are other sort of small elements of data calibration, re-designation, various things that didn't make a great deal of difference but the main drivers FX and procyclicality. On a capital basis, our Core Tier one moved from 4% to 7% on a pro forma basis within the 6.9% to 7.4% range that we indicated on January the 19th. The drivers of that obviously the major capital raisings and the pref share conversion which was offset by the attributable loss by the procyclical impact and by the dividend that was paid in the first half of 2008. You can see FX impact on the risk rated assets were largely offset by hedges that we hold against that exposure. The final sort of two columns there, just show the Tier one deductions, the FSA guidelines would deduct, expected losses from Core Tier one it is about a 35 basis point pre tax deduction, 25 basis points post tax. And per those guidelines will bring our Core Tier one down to 6.8% in line I think with emerging best practice we will report on this basis going forward from this point.

And finally just to sort of bring it all back into where it might look like, three to five years time, an illustrative balance sheet that would take sort of where we are and some of the strategic actions which Stephen outlined would see us getting to a nominal balance sheet more like a £900 billion or so with risk weighted assets something in the order of £470, Core Tier one of 6.5% implies a £250 billion deduction in nominal assets, £110 billion reduction in the risk weighted assets; essentially the non-core bank scale. Look to see a more balanced funding position, you can see the sort of implied growth rate that means for deposits over loans over that time period. There will be significant parts of the loan book we will be looking to exit over that three to five year period and we think these would be at least of order of magnitude doable and achievable and then moving to an environment where stable returns in the 15%+ category. Our immediate challenges are really weathering the next period, 2009 to 2011 and the measures announced this morning are certainly helpful in mitigating the extent of whatever economic slowdown we are about to experience. And with that I will hand it back for questions. Thank you.

Sir Philip Hampton: Thank you very much, Guy. I hope you found those to be extremely full presentations and of course there is plenty more material in the appendix as well, but if we can go onto questions. If you could put up your hands and when selected, give your name, rank and serial number.

Leigh Goodwin: Thank you good morning. It is Leigh Goodwin from Fox-Pitt Kelton. A couple of questions please if I may on the Government asset protection scheme and the capital effects, just so that I understand them and apologies if I missed it in your description, Stephen, and then a couple of the outlook on income. I just wanted to understand again this point about how losses get absorbed. Not in the event of liquidation now but just in the event of just losses occurring and whether—if you could confirm the FSA is quite happy for the A share ordinary equity, Tier one ratio so to speak, to fall below 4% given that we now have the B share component as well?

Stephen Hester: As far as I am aware, the FSA has agreed to treat in a sense Core Tier one as core tier one and therefore the 4% applies to Core Tier one. But they have put out a separate announcement which you must read and I am afraid I have been too busy to read it. The loss absorption, again I think—I'm sorry to say this comes back into this matter of interpretation—that obviously losses are absorbed against our book value which contains both A shares—ordinary shares, let's call them A shares for the sake of this—and B shares. To the extent that the B shares carry a preferential set of dividend rights, you might have the perspective that the reality is that the A shares bear the first loss exception in liquidation to the extent that you feel that the right way to think about the B shares is that they are convertible into A shares at 50p and therefore have inherent in them a huge amount of loss adsorption capacity before you get to 50p you might have a different perspective. So you pay your money and your takes your choice.

Leigh Goodwin: Okay, well obviously we will have to think about that a little bit more as we go forward.

Stephen Hester: Can I just say I wasn't smart enough to come up with the instrument; it was the boffins in the treasury.

Leigh Goodwin: Very good. I just wanted to ask about the assets that are going into the asset protection scheme. Clearly we haven't got a definitive list of those. Could you perhaps venture to tell us whether the commercial real estate assets are going in, in total or whether that is still something that is being developed?

Stephen Hester: It is still being fiddled with and it subject both to our ability to fiddle with it before completion and to Government due diligence or Government advisor's due diligence making sure. So far the only asset that they have said is not eligible has been our merchant banking assets, but all our other assets so far have been conceptually available. And so obviously what we have been trying to do is work through in the first instance stressed assets including derivatives, the CDPC type things as well. And then in the second instance as I have mentioned there were a—the significant growth in the target size of this pool which occurred in recent days was really a lot of the UK loan books, not because they were stressed, although the stress bit was certainly in, but to make room for additional UK lending. But we—no I am very conscious—we will give full disclosure but there is sort of no point right now whilst it is a moving piece. So—and because we have to have an EGM and we have to give out information, you will have to wait a little bit I am afraid to get more. Clearly it is in our interest to cover the stressed assets first and to work through that and the Government wants us to do that, is allowing us to do that. And one other very important feature that I should have pointed out is the intent is that the insurance is back dated to 1st January.

Leigh Goodwin: Thank you. Just to ask a question just in terms of looking forward, two things—and thanks for the disclosure, it is very, very helpful on the risk concentrations but clearly there is a cost involved in managing down those concentrations, usually in capital loss perhaps taken. I don't know how much this is a feature of the fourth quarter of last year, but perhaps you can guide as to what we might be thinking in terms of the cost of de-risking, or taking out the risk concentrations going forward? And just related to that there was quite a sizeable jump in the impairments within GBM in the fourth quarter, taking our Lyondell there is still £2 billion and I don't know whether you could indicate to us what sort of mix that was and how we might think about 2009. Whether that starts a trend or whether that was just a blip?

Stephen Hester: I suppose the simple answer to you is that the costs of buying protection against big single name exposures is very, very expensive to the extent that it is available at all. There are some instances where we judge that expense nevertheless worth it because we have a more pessimistic view than the market, but there are other instances where we would much rather not and in a sense the advent of the APS is one of our routes out of that process and that covers my earlier comment as it relates to the non-core division, because in a sense the excess large exposures are non-core. We may still want to bank these companies but that in amount and the ability to work these down with the benefit of APS protection over time as opposed to panic in risk around short term is there, albeit we are subject to a very large first loss piece which one clearly can't lose sight of.

Guy Whittaker: Yes the fourth quarter, Lyondell was the only large—single large name; in the balance there were 30 or 40 names in the range of £50 to £100 million. It would be some property with related names but none with special concentration within that sector.

Leigh Goodwin: Is there any reason to think that that was a blip or should we think of that as the run rate now going forward for 2009?

Stephen Hester: It hasn't been the run rate in January but I am not sure that is a statistically meaningful period.

Leigh Goodwin: No but at least that is helpful in itself to tell us.

Guy Whittaker: It is only the first month of the year.

Sandy Chen: Morning. It is Sandy Chen from Panmure Gordon. Just to carry on the theme, I guess you are going to be getting a lot of questions on the asset protection scheme, but you just made that comment on the CDPC portfolio and other sort of very toxic parts of the balance sheet. It would seem very much in your interest to try to get as much of that onto the Government asset protection scheme, the CDPCs, the monoline exposures, CLOs within that. And it seems that you are getting it at a very good price effectively 6-8% loss ratios on assets that could easily take a 70-80% loss. I guess the question is really how explicit is this sort of Government acknowledgement of the potential losses that it might face in the near term i.e. 2009 on these types of assets? And are you wary about the potential losses that those asset might—losses that might be crystallised on those assets in the course of this year?

Stephen Hester: If I could just qualify some of your opening statements, of course it is the case that there are some assets in this mix which cause particular worries about the potential for loss, but because the pool gets as big at £300 billion, in judging whether it is cheap insurance or not you have to take the average loss potential, not the loss potential on just some of the assets and in a sense a bigger pool dilutes therefore the insurance benefit is a percentage not as an absolute amount. And so you know in an extreme you could lose 100% of a whole bunch of assets and if you don't lose much on a whole bunch of others, you know your average loss could well come within the 6%. The Government has had advisors crawling all over the portfolios in a complete open book approach and I think they go into it with their eyes open, but you know all of us have our open but we still can't foresee the future. And so who knows, I don't think any of us have any ability to ascribe a sensible probability to where the eventual loss will occur or with what pace.

Sandy Chen: Yes don't get me wrong, I think it is obviously very favourable pricing on RBS' terms. And just a second question, you mentioned a sort of ROE expectation, but given that you are probably going to be de-leveraging, shrinking particularly in GBM. Could you give guidance in terms of return on the risk weighted asset, return on asset expectations there on behalf of the Group?

Stephen Hester: I am afraid I am reluctant to because a) I don't feel confident enough that we have bottomed down and b) there is a lot of changes to happen in the world. So I can't get there yet.

Tom Rayner: It is Tom Rayner from Citigroup here. Could I just ask you a question which focuses on slide 25? It looks like you have built yourself a buffer here which compared to the 4% FSA post stress test minimum is sort of around the £36 billion and if I take out the £6.5 billion fee, the £5 billion deferred tax and maybe another £3 billion to fund your lending commitments, it still looks like a buffer against that minimum of £20, £21 billion. I am just trying to get a sense, is that a realistic proxy for how bad things might get in terms of retained losses over the next few years? Or am I sort of—some of my inputs into that are slightly awry?

Stephen Hester: I think the caveat is who knows how bad losses will get? I've no idea, you can guess as well as I can. What we were trying to do was to stay well above the regulatory minimum even in really bad cases. Whether we succeed or not the future will tell, but the other thing that we were quite mindful about is that while the APS improves our regulatory ratios, there is some risk that the B shares are not given the same credit as A shares, by the rating agencies. We don't yet know how the rating agency will react to them and our absolute leverage ratio doesn't improve, it actually gets worse because we do extra UK lending until such time as we can work off the assets that are in the non core division and therefore I think that increasingly banks will need to look both at the regulatory ratios and at the simple funding requirements, if you like the actual assets that are balanced on top of this amount of equity. And so we are also conscious that we weren't just solving for Core Tier one but just absolute amounts of equity that support the funding that we have got to do in uncertain times and so I think that is the nearest I can get to give some ways of thinking about it.

Tom Rayner: Thanks and just quickly on the same point, I am just a little bit confused by the amortisation of the £6.5 billion fee because the way I understood it when I read it first thing was that you would be issuing a certain number of shares, 13 billion shares to the government, but there wouldn't be any actual cash being transferred to you. But obviously I need maybe a bit more clarification on exactly how that works-?

Stephen Hester: No £13 billion is cash to us. So £6.5 billion is non cash, in other words fee and exchange, the £13 billion is cash. But there is a difference; we in a sense up front issue the £6.5 billion in compensation for the fee. From day one we have to service that, the 7% coupon, but through our accounts the fee will be written off over seven years and so our accounts will each year in respect of this fee component see a seventh of £6.5 billion written off, plus the servicing cost in perpetuity if you like or until conversion of the instrument that we have paid with.

Simon Samuels: Morning it is Simon Samuels also from Citigroup. A few questions, the first is sort of a follow on from what Tom was asking; if I look at your very last slide, slide 56 and appreciate you just described this as illustrative, but 6.5% Core Tier one and whatever it was £470 billion of RWAs is Core Tier one capital of about £30 billion versus the £54 billion that you are saying you have got at the moment. So can you just kind of tell us how that illustrative balance sheet—how you get there basically.

Stephen Hester: I think you are—this is the danger of putting it up which I recognise, you are in danger of investing significance in it. We have no ability to be precise about what it takes to be standalone, double-A rated in five years time because the rating agencies don't know themselves yet and the regulatory environment will change. So we have a moving target, but it nonetheless is something we have to think about. So what we are trying to do is think about directionally what are the things that we have to change in our financial make up to have a chance of having the standalone financial strength that we want to have and that slide is designed to say we need to have some things that relate to capital ratios; we need to have some things that relate to absolute leverage; we need to have something things that relate to the nature of our funded balance sheet customer deposits versus wholesale funding. And then we need to have some healthy businesses throwing off some cash flow. So it was designed really almost as a checklist of the things we have to do some surgery on, with perhaps an order of magnitude as to where they might have to end up for double-A rating. But no more than perhaps, but there is no attempt to then link that in to a particular set of financial ratios that we have at any one moment in time and what equity we may or may not lose and so on and so forth, absolutely none.

Simon Samuels: Yes, I kind of expected, but where this links in I think is with your non performing loan trends in a way because you know NPLs look like they have gone from about £8 billion in June to about £17 billion by December, so kind of up £1.5 billion a month run rate and I know it was asked earlier. And if you like at the other side that Philip gave out, the impairments showing the proportion of—or the number of corporate cases transferred to your recoveries unit that shows nothing like that trend. I mean it is up 20, 30% as the year progressed, versus doubling in the NPL trend. So can you give us some—and I hear what you say about January has not been as bad as December et cetera—but can you give any sort of guidance? Other banks have as you know in both the UK and Ireland in terms of their outlook for bad debts, can you give us any sense of your credit charge forecast?

Stephen Hester: I think the exact guidance is foolhardy because there is too much uncertainty, but what I might do is ask Peter Nathaniel who is our chief risk office to see if he wants to give you some words without giving a forecast.

Peter Nathaniel: Thank you. All I would say is the trends on the heightened management portfolio I think is the way it was put up there, which you might consider some of the early warning part of the portfolio are continuing to trend the way you might expect. So whilst January mightn't have see the actual credit cost come through the trend on the early warning indicators and that pipeline is still trending the way you are I think trying to allude to. So that comes through fourth quarter, January at the same trend and I would expect it to continue and proceed all the way through the recovery, through the rest of the year.

Jon Kirk: It is Jon Kirk of Redburn Partners. I am just trying to understand and I appreciate there are certain restrictions on what you can say, but exactly how much risk remains with the Royal Bank of Scotland? Because if I look at the assets that you have lost and say the risk weighted assets that you have lost, the risk weighting of the residual assets isn't wildly different actually from what it was before. I can't see the numbers in my head, but it wasn't materially different. Now does that mean that actually proportionately you haven't reduced that much risk compared—i.e. that the riskiness in the assets that have left the business, or been insured rather, is not wildly different to what is left. Or is the risk weighting a very bad guide to the relative riskiness of those assets?

Stephen Hester: It is a bad guide for two reasons. The first reason is that we haven't precisely calculated because it all happened too fast and one of the things that we will do as we work through precisely what assets go in is improve on precisely what risk weighting those have. Because none of our internal systems were designed for the sort of pick and mix activity that has just been taking place. So there is an element where the data will change, but also Basel II does not well cope with our subjective forward looking thoughts on where the most stress might arise and you know a good example of that would be commercial real estate where under Basel II because it is secured and because the scenarios you ran normally didn't include a 50% decline in the underlying asset values, you came up with very low loss given default and therefore a low risk weighting. But I think subjectively in the face of what we see in the market, we might ascribe a subjective weighting in our minds, significantly higher than that. That is a Basel II model based on historic modelling throughout. So I think that—those are the two answers that I would give you. But equally I think everyone would love there to be this really nice parcel you could say, these are my bad loans, they are gone and everything is good. And of course as we all know the world isn't like that, you have an infinite gradation of grey from good to bad and something you think is good may actually not be good tomorrow depending on exactly how this economic downturn twists and turns. But I do think that we will have significant impairments in our non insured portfolios but obviously if we do our job properly they will be rather less as a percent of assets than the ones that are insured, but the insured ones we bear first offer.

Jon Kirk: Just continuing then, when you were negotiating with the Treasury, was there a general acceptance on both sides of the negotiating table that actually it was better if you submitted your highest risk assets? Or were they trying to prevent you from submitting anything too toxic?

Stephen Hester: I think a negotiation is a kind word, it doesn't feel it was one to me, but no look the Treasury—I mean I want to be really fair, I think that what the Government has done is a really major politically courageous scheme which is obviously available to many banks, we just had to be first, which I think has important benefits for the financial system and to RBS which is why our expectation is that we will recommend it. So I don't want to take anything away from that and we shared in a sense many goals, because unless the banks are more financially stable, the economy is hurt. And unless they are more financial stable they can't make the additional lending that was called upon to fill the gap and so I would say that as it relates to asset selection, the Government has been encouraging of us putting in the most stressed assets subject to their due diligence. And so if you like we really have not been having any disagreements with them about asset selection. They drove us to a bigger pool than we put forward but that was because they wanted the lending on the other side. You know the differences of view we would have had would been more about the other aspects of the insurance.

Mike Trippitt: It is Mike Trippitt at Oriel. I wanted to understand the logic of the pool and the asset protection scheme of £300 billion within the sort of non core division of RBS the asset pool is £240. So I think you have said that about 47% of the asset protection scheme assets would be within the ongoing sort of core businesses. Does that sort of suggest that there is an immediate kind of replacement where you have had higher risk assets carrying quite high losses that you are—it sounds like you're almost immediately going to put sort of lend behind those in terms of creating room for more lending within the core business. I don't know if that is the right interpretation, but also I am just trying to understand what the mix-

Stephen Hester: Sorry, Mike. I am not entirely sure of the point you are making.

Mike Trippitt: What I am trying to understand is why the 47% of the asset protection scheme assets refer to the core businesses and you are saying that that is being done to make way for the UK lending commitment. So I am trying to understand the risk profile of the lending that will continue.

Stephen Hester: You've got quite a mixed bag; so let's take UK mortgage book. We by and large, we have one of the safer UK mortgage books out there. On the other hand there is a sliver of our UK mortgage book that is stressed or that may become stressed in the next year if house prices continue to fall. And so even though that is a core business and is part of the ongoing core division there would be a sliver of the UK mortgage book that we would have put in APS for two reasons. One we would put most stressed bit in, but secondly we were also solving for a certain risk asset relief in order to be able to put some risk assets back on and so we probably moved the cut off point beyond the stressed bit to still stressed but less stressed in order to solve for a given risk asset result.

Mike Trippitt: 47% of £300 billion is a lot of slivers thought. I am just trying to understand-

Stephen Hester: It is a lot as I say because one, just because something is a core business doesn't mean to say it doesn't have stress. You know our UK and US and Irish corporate loan businesses have enormous stresses, although they are core businesses. So there can be plenty of stressed assets in core businesses, but there also are assets that are less stressed in core businesses that to solve for a given risk weighted asset reduction in order to be able to commitment responsibility to a risk weighted asset increase that we added to it. And you know, obviously when we give you full detailed, when we a) have ourselves full details then b) can make it available to you, you will be able to get more granularity. I appreciate all I can give you at the moment is words, but you know unfortunately this thing was still being sort of fiddled with into the early hours of this morning. So we just simply don't…you know we have a term sheet that is what we have.

Jonathan Pierce: It is Jonathan Pierce at Credit Suisse. The first just so I understand the deferred tax credit issue, you are saying that you will handover essentially £5.4 billion deferred tax credit now, or rather on admission to the scheme.

Stephen Hester: That is what the Government are asking for.

Jonathan Pierce: So NAV and equity will fall by 5.4 and then moving forwards, are you saying you will give up all of any tax credits associated with the UK losses? Is that how we should think about it for a period of two to three years?

Stephen Hester: That is what the government are asking for. It was an ask that was inserted late yesterday, which has not had any ability to be defined, codified, made clear as to how possible it is or isn't or exactly how extensive it is. So I can't tell you much more than that, because this thing went down to the wire, but as I understand the concept that it is being asked and it is no more than a concept until it is codified and we don't have to agree to it in the sense that shareholders don't have to agree to the whole scheme. Is the concept would be that losses that arise between now—UK—between now and when we return to profitability, which might be this year, or might be longer depending on the view you take of the downturn, would also in a sense not ultimately be deductible. I.e. we would start paying tax as soon as we are profitable again in the UK.

Guy Whittaker: It is around 800 which is a foreign tax asset.

Stephen Hester: Yes, so it is 4.6 of the 5.4 that goes.

Jonathan Pierce: And then a second question just on this further potential £6 billion issue of B shares. Under what sort of circumstances do you envisage taking up that option?

Stephen Hester: I think we would regard the overriding priority for everyone as being financial stability, because from that everything derives and so I think that we will be thinking of it in those terms and taking account of what is happening to our ratios but not just our Core Tier one ratio, also thinking about the equity to leverage ratios and the outlook that we see.

Robert Law: Robert Law at Nomura. I have a number of questions also on the scheme please. Firstly can I probe a bit more about the relative stress within the different buckets you have now got if you like? I mean you talked about expected loss I think or likely level of credit stress in the various buckets, could you comment on how you see that in terms of the assets in the asset portfolio scheme; the asset in the non core bank and the assets that are retained in the core bank?

Stephen Hester: I can't quantitively comment on it. It is our intent to put in descending order our most stressed and RWA intensive assets into the APS. We have had a crack at it so far and it will be refined subject to obviously Government due diligence and control before the scheme is entered into, assuming it is entered into. But I can give you no quantitive assessment of that, in part because we haven't finished the process and in part because it is an exercise of gazing into the future and I am very, very reluctant to do that quantitively.

Robert Law: Will you take any reserves against assets put into the asset protection scheme initially?

Stephen Hester: Not as an initial transfer, obviously there is an initial reserve taking the Core Tier one as I have explained, but conceptually and again all of this—anything I say now I might unsay in a week or two's time when everyone will work through the details, this has just happened in a compressed way. But conceptually until we get to the first loss piece we will behave completely normally because its for our tab and it is only once you get to the first loss piece that we obviously still behave normally in respective of 10% but where the accounting will then need to take account of like the government receivable that in effect we get to make-

Robert Law: But you're not going to provide against the elements of the first loss piece?

Stephen Hester: Well our Tier one, immediately is hit in the way that I described, so in that sense there is an immediate provision in our capital, but it is not clear to me why we would provide for a loan that hasn't yet gone bad on the other side of the P&L.

Robert Law: And unrelated, can you comment what is your plan for UK lending prior to the additional lending you are now going to make or in other words what-

Stephen Hester: Our budget was broadly flat on end of 2008 balance, so think of it as just an increase on the 2H08 balances.

John-Paul Crutchley: Hi it is JP Crutchley from UBS. Just maybe a slightly longer term question in terms of what is the eventual game plan in terms of exiting the B shares if there is one. Is your expectation at this point that at some point eventually they will convert to ordinary shares and we look at things on a fully diluted basis and they will all just be A shares? Or do you expect if the bank returns to profitability that you could buy those back at a price from the Treasury and has that been discussed and how that mechanism might work? And in terms of Guy's slide in terms of capital when he was talking about Core Tier one, was that intending to be just A type capital or was that aggregate and the assumption there would still be some A and B shares outstanding? So it was just assuming things do actually get back to some form of normality, how should we think about the shares in the group going forward long term?

Stephen Hester: The slide was written I am afraid before we had any idea of A and B shares, so it wasn't that clever. I guess the Government has not agreed or discussed with any formula as it relates to repurchase and so that would be an open book if and when we had those capital riches. I suspect it is slightly tautological that if we are doing so well that we have got those capital riches the share price is likely to be allowing them to distribute it via increasing the free float and so I suspect it will end up being in a sense a circular answer that there isn't a deal. And clearly from our point of view, if we were feeling safe in our financial stability goals and felt we had excess capital on top of that and felt we could do an accretive deal for ordinary shareholders we would do that. That will be a happy problem to have when it arises.

Michael Helsby: It is Michael Helsby from Morgan Stanley. Just two questions, firstly on the non-core assets thanks very much for giving us the revenue and the cost break out of that, I was wondering if you could give us an idea of how much of that is an annuity type revenue and how much is flow revenue? So where you can just time the reduction in the cash flows coming from that. And also if I look at slide 37 where you give us some comments on the net interest margin outlook, I think it is noticeable that widening asset sort of spreads and re-pricing for risk premium isn't in your outlook. Is that just because it has been offset somewhere else or is that on top? There is quite a big margin reduction that you are flagging for 2009.

Stephen Hester: On the first I am afraid I don't have a break down for you, but my sort of off the cuff answer would be it will mostly be recurring revenues. The trading businesses that are in here are the ones that were doing badly last year anyway in credit areas and so on. And so most of this will be in a sense loan and quasi loan and loan asset and stuck securities which will mostly be "recurring" albeit it subject to credit stress.

Guy Whittaker: On the second point there, there are pressures on the margin, particular low rates start to kick in towards deposit floors and saving accounts and some of that is already taken into consideration in the '09 plan. And obviously there are scenarios where rates are even lower from here and there are still risks to the downside, so I think funding cost as you know for banks remain high. Competition for deposits is high and while front book pricing is going up, it fulfils this overall tightening in 2009.

Simon Willis: Simon Willis from NCB. Two quick bigger picture questions if I could. From the view point of an investor, or maybe an objective analyst I think you could argue that the last few months have seen a coach and horses driven through IFRS accounting and moving the goal posts on some of the Basel II background for capital ratios. Looking in particular at the capital base, the slide Stephen that you set out including the new capital and then looking at the first loss element, if I look at that in relation to the commercial property portfolio which I think from memory was £97 billion up from £91 last disclose-

Stephen Hester: That's FX by the way.

Simon Willis: If you take for each 10% loss, you might chose to look at from commercial property portfolio in relation to the capital base going forward. Can I ask whether there has been or there might be any changes in recognition of impairment in areas such as commercial property?

Guy Whittaker: Not envisaged. I mean we have provided on the basis everything we know at this juncture, not expecting a step change in that at this juncture.

Simon Willis: Thank you and secondly and briefly, is there any meaningful risk that the first loss element at 6% falls foul of EU regulations?

Stephen Hester: I have no ability to judge the risk. I think all EU Governments are in a state of heightened discussion with the EU, all sorts of political ebbs and swirls. So this is subject to EU approval. Obviously it is subject to that, yes.

Robert Law: Sorry I should have asked it on the way, but can I ask how the loss scheme works? So you have got a 6% first lost scheme…if you end up on particular assets being above that, are you capping the loss on each particular asset or-

Stephen Hester: No it is a pool. So all losses of whatever percent on it and all the assets in it are for our account until you get to the threshold number and then 90% of losses thereafter, whatever percent they are and whatever asset switch over.

Sir Philip Hampton: Okay I think since the strategy is all about execution, then we need to go away and execute. So thank you all very much.