

RBS Analyst Presentation

Tuesday 4th November 2008 @ 9.30am

Presenters

- Sir Tom McKillop
- Stephen Hester
- Guy Whittaker

Sir Tom McKillop: Good morning ladies and gentleman and welcome to this morning's presentation and discussion in connection with the circular and prospectus associated with the capital raising which we first announced on 13th October.

As you are all well aware financial markets have been experiencing unprecedented dislocation and volatility, indeed I believe there are over 40 countries in which the Governments have now intervened to try and bring stability to the financial system. And the Bank of England's recent financial stability report listed some approximately £4.5 trillion worth of funds having been allocated to assist in this process around the world. So these are very, very serious times indeed affecting countries and companies all over.

The UK in many ways has taken a leadership role during much of this period and the Treasury has announced comprehensive measures and a comprehensive package to try and help stabilise the financial institutions here in the UK. That package includes liquidity and funding support and of course the availability of capital to banks. The RBS Board acted quickly and reached a very clear decision that we should access those funds and do so in a significant way. We want to ensure that the bank is in a strong position to face whatever is coming in the future.

The capital raising itself, as again I'm sure you're well aware, is £20 billion. £15 billion of that in ordinary shares through placing and open offer, and £5 billion in preference shares to the Treasury with a 12% coupon. On completion of this capital raising RBS should be amongst the best capitalised banks in Europe and that will allow us to position ourselves to absorb any impacts in this economic downturn. It should allow us to defend and indeed grow the core franchises which are very good businesses and support the risk reduction and group restructuring initiatives that you will hear more about.

Along with the capital raising we have made management and Board changes, Stephen Hester is appointed as our new Group Chief Executive and officially takes duties up on the 21st November, but as you will see he's already deeply engaged. John Hourican has been appointed as the Chief Executive of GBM and we are also intending to appoint three new non-executive Directors, those appointments will be made by the Board, it will be in consultation with the Treasury.

Alongside the capital raising and the management changes, we are also launching our strategic review of all of our businesses and that will be an iterative process it will take place over the next six months or so. But to tell you more about that and indeed other matters, this morning I'm now going to hand over to Stephen and Guy in due course; Stephen.

Stephen Hester: Good morning and thank you for coming, its a pleasure to see some old faces in the audience. I hoped I had seen the last of you, but no such luck, so all I can ask is please be nice for a while anyway. This is just to introduce and then principally Guy will go over the numbers that we have released today and I will come back and talk about strategy, but just simply to say I'm really looking forward to this. I'm full of vim and vigour; I think, that there is a real job to be done and there is a real success story to be unveiled that's sitting there currently not as recognised as we can make it.

In just the last few weeks when I have been trying to come into my new job as well as do my old job, I found throughout the RBS Group a huge level of support from my new colleagues. I'm very confident in telling you that RBS will embrace change and that we have the support of all the people around the Group in doing that. We are trying to accomplish a difficult thing, but a simple thing to describe, to rebuild the success story of RBS focus of course firstly on shareholder value. But we can only do that through having happy customers and we can only do that, through restoring the pride that our people have had and will have again in this institution.

The journey is in essence a simple one; we need to take action to peel back the things that are today impeding your view of the real RBS and allow the real RBS to be seen and to thrive. But of course there should be no doubt that in the next few months we'll see continuing negative news flow around our industry as well as around RBS and we have to get through that period. So with that I will hand over to Guy and the numbers, but simply to reiterate RBS has been and will be again a world class financial institution and that is our goal, thank you.

Guy Whittaker: Thank you very much Stephen and good morning ladies and gentleman and welcome; I would just like to take a few minutes now to talk about the current trading outlook and provide some update on credit trends and credit market write-downs. I will share with you the quarter end capital position as at the end of the Third Quarter and then add just a few comments around the outlook for the remainder of the year and into 2009.

For the nine-month period to 30th September our Group has showed an underlying income which was in line with the same period of 2007, if anything just very slightly ahead. Our costs similarly were about flat to the same period in 2007, if anything very slightly lower; claims particularly in the insurance business were significantly lower than in the previous year and as a result we saw a rise in our pre-impairment profits of seven percentage points for the first nine months of 2008.

As, I'm sure you're well aware and part of the reason we're here, we're seeing economic weakness across many of the markets in which we operate, this has accelerated into the Third Quarter and on a post impairment basis our profits fell 8% versus the prior period in 2007. At an underlying level the Group overall was profitable and within that each and every one of our business and customer facing divisions was also profitable in the Third Quarter. We announced an additional £200 million in write-downs against previously identified credit market exposures after some reclassification; I will explain the impact of that a little bit later on.

Our core Tier 1 after the capital raising pro-formed for the £15 billion of equity and £5 billion of preferred stock would be 7.9% on the 30th September at the core Tier 1 level and 11.6% at the Tier 1 level.

Across our retail and commercial banking businesses; in the UK we saw a continuing growth in income although the rate of growth is slowing slightly for the nine month period versus that which we achieved in the first half. In the US we saw modest income growth versus the same period in '07, in Europe, particularly in Ireland; and in Asia, whilst ahead of 2007 in income terms, growth rates there have slowed as a result of the economic environments they are facing.

In the pre-impairment line, profits in retail and commercial banking was about similar to the same period in 2007, economic weakness has lead though to a

marked rise in impairments and we have seen declines in year-to-date profitability in the US and in Europe, with a modest rise in the UK.

Our GTS business continues to perform strongly with good growth in trade finance and international trade. RBS Insurance is performing well with profits growing nicely; our manufacturing costs trends for the nine month period are very much in line with those that we disclosed in the first half results back in August.

Within GBM we saw a very good performance in many of our customer and flow businesses, particularly strong performances in rates and in currencies, although equity and debt markets were slow, in the origination side and also in respect to asset valuations. There were a number of discreet specific events related to counterparty and sovereign risk, which cost GBM £700 million against its income line in September and as a result we saw the year-to-date pre-impairment profits for the division fall by 11% versus the same period in 2007. The market dislocation was continued into October and has cost an additional £1 billion on a number of say discreet and specific market related events.

The impairments are rising - albeit from a very low base - and the run rate of impairments for the Third Quarter is about 50% higher than the run rate that we saw in the first two quarters of 2008. Notwithstanding that the division recorded a small operating profit for the quarter.

We saw some partial reversal of the deleveraging that had taken place in Q2 both in nominal and at a risk-weighted level. In the nominal terms the large drivers were an increase in repo activity and settlement balances related to high levels of business activity, particularly around rates and currencies in some parts of the securities business. As well as the significant impact of the weakening Pound, thereby increasing, in Sterling terms, the value of some of our US dollar denominated assets.

On a risk weighted basis we also saw the balance sheet grow again partly down to a foreign exchange movement around £7 billion or so and also the expiry of a number of risk mitigating transactions within GBM which added about £17 billion to the GBM risk weighted asset total. We do expect to see further risk mitigating action on this balance sheet during the course of the Fourth Quarter and we do have a nominal target for the funded balance sheet at the end of this year of around £700 billion.

On Group credit quality, loans and advances increased about £28 billion during the quarter to £637.5 billion; of that £17 billion or 60% related to the same foreign exchange rate movements which were partly behind the growth in the risk weighted balance sheet. So 17 billion of 28 down to foreign exchange, a little less than 2% headline growth rate in new customer lending activity. Non-performing loans, as a proportion of loans and advances, rose from 1.47 to 1.72% and the annualised charge for impairment went up from 46 basis points to 51 basis points, that would imply about a 62 basis point charge off rate for the Third quarter. Provision coverage came down by 5 percentage points reflecting the fact that many of the problem loans we are seeing are highly collateralised in their nature.

Just in overall credit trends we have indicated at the half year results and then again when I met with many of you in September, that we continue to see a steady increase in trends, in transfers of loans out of performing loans into our corporate restructuring unit, from the low base that we saw in the Second Quarter of 2007. I think the cases are reasonably spread, by industry, by sector and by geography, but the case flow is rising, we saw 377 cases move into SLS during the Third Quarter of 2008 we saw 228 in the same period in 2007. That represents a rise of about 65% in the UK's flow rate over the course of the last 12 months. I think we remain cautious in this economic environment and the outlook for 2009.

In credit market write-downs, we took a £200 million charge to income during the Third Quarter taking the 5.9 billion credit market write downs, we took £200 million charge to income during the Third Quarter taking the 5.9 billion credit market write down number up to 6.1 for the year ending September 30th. CDO pricing during the period was stable, indices sort of moved in a horizontal manner. We took an increased provision against some of our monoline exposures. We have, as previously discussed, taken actions to reduce the balance sheet and the exposures in our Retail Mortgage Backed Securities portfolio, Leveraged Finance portfolios, as well as some of the collateralised loan obligations.

We did take the opportunity of the amended IAS39 ruling which came out during the quarter to re-classify a number of accounts and I'll explain the impact of those in a moment. The overall effect of these was to reduce the impact income by approximately £1 billion, although you see there was a charge against equity. Since the end of the quarter the indices in many of these asset classes has fallen

further, and I think it is entirely reasonable at this stage to expect there will be some further markdowns during the course of the Fourth Quarter.

As I said earlier we re-classified assets under the amendment to the IAS39, it covered £24 billion worth of assets. Each of those were subject to a review for their eligibility as well as for our appetite to hold the risk contained with these assets. £14 billion were classified from trading into loans and receivables; 3.7 leverage finance, 5.8 in corporates and 4.6 in unlisted debt securities. 10 billion of our debt securities will move from trading into available for sale, a combination RMBS, CMBS and some CLOs detailed there. The effect was to raise income by £1.4 billion in the quarter, against an increase in impairment charge by £200 million, for a net affect to income of £1.2 billion in the Third Quarter, of which £700 million was charged through equity via AFS reserves.

Our capital ratios at the end of the Third Quarter; core Tier 1 was 5.2%, the Tier 1 ratio was 7.9%, down about 50 basis points from the half year principally on the back of RWA growth. The effect of the capital raising that we announced on the 13th October and confirmed today would lift those ratios to 7.9 core Tier 1 and 11.6 on a Tier 1 basis. Clearly this moves the Group from a phase of capital rebuilding into demonstrable capital strength. It puts our ratios at the high end of our peer group across Europe and around the world, it puts us comfortably above the regulatory stress testing levels which were part of the calibration exercise, it is designed to strengthen confidence for investors and customers in the Group to prepare us for the future; and we are as I mentioned earlier targeting RWA reductions in the Fourth Quarter.

In terms of timing, the record date for the share register was as of last Friday, the entitlement date is 8 o'clock next Monday morning 10th November. There will be a general meeting to approve the capital raising on 20th November; and the offer closes on 25th November with trading in the new shares beginning from 1st December.

Looking forward; the Group contains many attractive customer franchises which continue to produce attractive pre-impairment returns. The economic weakness which we are facing across many of our major markets is driving the impairment outlook higher. The market dislocation which is well covered and well discussed is expected to have an adverse impact on near term results. However in time I think we all remain confident the inherent value of the Group's profitable core franchises will reassert themselves as financial conditions improve. Now I would

like to hand back to Stephen to share with you some of his thoughts for now and the immediate future. Thank you.

Stephen Hester: Thank you Guy, well I know what you would really like me to do is just give you two numbers which is earnings per share in three years time and the bottom of the book value; and I can't do either of those and by the way there is no bank CEO in the world who could do either of those two things, whatever their body language to the contrary. So unfortunately we all have to muddle through in the absence of the certain knowledge of those two things. Nevertheless in the last couple of weeks we've put together some thoughts on direction of travel for RBS; and I wanted to just share those with you.

I think the essence of the investment case in some respects was just summarised by Guy. Post the strategic review of the risk reduction, the implementation of that, we intend to show to you a powerful group of stable, profitable, market leading customer franchises. You can see even in relatively difficult markets the sorts of profits that those have in the past been able to produce. Of course we have to see what the future banking markets offer, but I think the core of the Group is strong and there for all to see.

We do, as Guy mentioned, courtesy of the underwritten capital raising today, have capital ratios at the top end of the peer group; and I can just give you some background on that, on the sizing. This sizing is really about confidence. It's not about clever fiddling with this scenario, that scenario, the other scenario; all of that in a sense is for the birds although we did go through it. It's really to make a statement of confidence that by being at the top end of the peer group, we should be able to absorb the unexpected; which will of course happen to us and everyone else. To retain support and confidence which is critical and the ebbing of which, both for us, and other financial institutions led to where we are today. Then once we get through these difficult times to allow us to grow in the future.

The offering price of the shares is just over 60% of tangible NAV. Hopefully that of itself provides a piece of valued data. We will be showing to you in the coming months a restructuring story, we believe there are opportunities to shrink and sell weaker operations. There are certainly opportunities to cut costs and reposition and of course in doing that we hope to regain your confidence.

I do believe that once we get through the difficult times that the world economy is going to throw at us; that there will be credible growth opportunities from our businesses and a capital base to allow us to exploit those.

The risks I think are very well known and they're impossible to quantify in truth as I say both for us and for anyone else. We are going to have sharply rising cyclical credit costs across our industry worldwide. There will be one-off shocks that financial markets will throw at us and other financial institutions. Clearly the liquidity issues are going to cost us more in terms of cost of funding for a period of time; and the business as usual trading levels will be impacted to some extent by a weaker world economy. We and all banks will suffer from these issues.

There is also in RBS's case, I would say the likelihood of restructuring charges as we find attractive ways to reduce our cost base and produce attractive paybacks therefrom. Of course there are some uncertainties about balance sheet risk reduction and one of the important things that we are going to have to do, and we will provide you full transparency of this once we have the plans, starting with the year end result, but we are going to have to balance how fast we get to where we want with the need to take out risk, with the cost of taking out risk, and thinking about shareholder value as we go through those trade offs. There will be some things we can do quickly, and some things that take more time, but we will report to you with clarity on that path.

Clearly the strategic review that we're announcing will take some time and there will also be ingredients within that, but I think if you listen to what we're saying today you'll be able to guess 80% or 90% of what we're going to do from applying the strategic biases that I will talk about in a second.

My initial priorities: obviously coming up to speed fast with the businesses and people and risks. We have already kicked off a group wide strategic review - soup to nuts - which will take us into the Second Quarter of next year, although I do expect an interim update at our year end results in February. Part of that will also be balance sheet and risk reduction and charting the path and the timing; again we will give an update in February '09 with a much fuller level of credit and risk exposure data; and similarly, across the piece, looking hard at our businesses for where we can become more efficient and again update in February. Of course, around all of this what we hope to be able to do is to report to you regularly, clearly with transparency and to be making steady progress against the goals that we set out over time, thereby earning back your confidence.

Strategic biases; you can call it mothers and apple pie if you like, but we want to apply these to our business mix. We intend to rebuild the Group around our businesses that have both growth potential and clear competitive advantage. They are likely to be customer driven franchises, with existing attractive market positions, although in every case I'm sure things we can still do better. We intend to keep global reach and presence, but that doesn't mean to say we have to be in every single country. We intend to downsize and exit businesses where the risk adjusted return potential seems to us to be poor over time; and in so doing and anyway to reduce our balance sheet and risk concentrations.

We will be broadly targeting AA credit rating territory over the medium term, in terms of the sorts of capital ratios and risk concentrations that we carry. What that actually means in capital ratios frankly no one knows; the world is going to find its way to that over the next year or two. Clearly, as I have mentioned, efficiency is very, very important, but all of this is going to be driven by people and obviously one of the important jobs we all have is to look at our bench strength to improve our bench strength where we can, but frankly also to really engage the people at RBS - very, very good people - to rebuild morale and to empower our people to go out and do their jobs well.

I think the last slide from me - what does success look like in the absence of being able to give you any numbers and any targets at this stage? You have to make do with words. Obviously the first priority is just simply to get through the market and economic stresses that we will experience for some time; that the market will experience for some time, preferably without crisis. All of this must be about the delivery of attractive shareholder return; part of that - we're very conscious - is the resumption of dividend payments which we understand exactly why and how they are important to investors and financial institutions. I've talked about our broad creditworthiness ambitions and along with that obviously go sizing of capital and balance sheet and risk profile. Of course over time we will be advancing hypotheses on ROE and the growth rates. For now I will throw out that it's my view that something around 15% return on equity is likely to be where the financial services industry ends up coming out of this, but we will see whether that's true or not.

Obviously one of the priorities that we have is to get the prefs off our back; they're an expensive debt which we would rather not have, and clearly at the same time to allow the Government, if it ends up with any shares over the next month, the ability to profitably sell those in the coming months or years. As I

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have mentioned before, if we accomplish these things we hope and anticipate that we will have approval from our key constituencies - our shareholders, our customers and our staff. That's really what I wanted to say and I guess with that we're very happy to take questions which Tom will compere no doubt.

Q&A

Sir Tom McKillop: Thank you very much Stephen and could I remind everyone to give their name and affiliation.

John Kirk: It's John Kirk at Redburn & Partners: I think you said, Guy, that you're expecting risk weighted assets to fall in the Fourth Quarter. I wondered if, with that in mind, if you could comment on some of the things that I see as headwinds against that. The first would be FX movements again looked to have been quite adverse particularly Sterling against Dollar since the end of the Third Quarter. There is also this risk mitigation expiries within GBM; could you tell us how much more there might be of that to come? Thirdly any BASEL II pro-cyclicality impacts; and then finally any other commitments to lend, any other commitments sitting on the balance sheet that maybe drawn down over the next few quarters?

Guy Whittaker: Taking those in some order, some FX impact possibly; the sensitivity is about some 5 basis points for a 10% decline, at the core Tier 1 level; you can figure out the rest from that. Risk mitigating trades; I think what has expired has expired, so I think we would have sought to replace some of those; the timing and the market circumstances perhaps haven't been there, but I think there will be an opportunity at some point during the Fourth Quarter to put some of that on. There are some, again as we adjust in to BASEL II world, some model calibration approvals which are moving through and we expect that will give us some benefit in the Fourth Quarter. Against that you rightly say the pro-cyclical impact is kicking in as impairments rise; estimated to have added about 1% to the Third Quarter RWA, so about 5 billion for the period just finished. One would expect if the environment deteriorates in the Fourth Quarter, you would see some of those headwinds. Notwithstanding that, there were one or two levels of inventory as well related to parts of our trading businesses which were a little higher than we would have liked and certainly higher than we anticipate they will be at the end of the year. The combination of all of those will perhaps not get us back down to the June 30th levels, we'll at least try and see September 30th as a near term high watermark.

Tom Rayner: Its Tom Rayner from Citigroup: two questions please, the first one is just a follow on from John's question. The impact of the currency moves I imagine didn't affect the ratio much; it affects risk weight but is offset on the capital. I would just like to understand more what the risk mitigation was all about. Were these hedges that were somehow put in place quite recently, which made the half year ratios perhaps look a little bit favourable, which has now just unwound, or are there counterparty issues which have meant that the counterparty no longer exists therefore the hedge no longer exists? I would just like to understand what was going on.

Guy Whittaker: We've got a combination of both of those, Tom; there are some hedges which have been on for some time which duly ran off. There were some hedges which we had on in place where the counterparty was no longer present and therefore they expired for different reasons. Within the portfolio of 230 or so billion Pounds worth of loans that we have in GBM we would seek, I think, at all times and have done for quite a number of years now actively managed the risk and the risk weighting associated with that. This would be part of the ordinary course of business; as it happened we've seen some expiries in Q3 that ran off. The market was particularly adverse during the latter parts of September we would expect to replace at least some of those during the course of the Fourth Quarter.

Tom Rayner: I suppose it's hard to give a steer on the ratio towards the year end without giving a profit forecast, is that right?

Guy Whittaker: It is exactly right, yes.

Tom Rayner: On the second question, more for Stephen; it's two issues really; one I would just like an update on your views on the issue of Government interference, because it appears that they've set up a body which seems to have the purpose of interfering. I would just like your thoughts on how the relationship with the new Government body will work; also on the restructuring, just thinking back to your days at Abbey, some people felt that the assets in the treasury book were sold down maybe too quickly, given what then happened. I wonder if you could comment, if you've got more time to work with RBS than maybe you did back then at Abbey National.

Stephen Hester: Sure, well thanks for those two questions; the honest answer of course on the Government is, first of all it remains to be seen what shareholding they do or don't have, and secondly it must remain to be seen how they and Governments the world over behave towards our industry. I think a generic observation I'd make to you is in my judgement the overwhelming thrust of Government and political pressure in our industry will apply to all big players regardless of their shareholding. There are a whole series of sensitivities that come out of the events of the last year that will apply to all banks, and frankly there are very few banks out there that don't have Government shareholdings, whether their own Government or some other Government involved. I think we can see industry-wide sensitivities that we will have to be conscious of in the way we manage our businesses, but I don't think they're specific to RBS.

I would say on the specifics in the Government, the Government have a) been very clear in terms of their public statements, how they expect to be us run namely as a normal private sector enterprise. They've buttressed that with the announcements yesterday and I'd refer, albeit I understand it's anecdotal to my own experiences, John Kingman in fact was the person who called me last February to ask me to become Deputy Chairman of Northern Rock. That was a 100% State owned entity and therefore with no external shareholder sensitivities and not once in the six months that I was on the Board there did they seek to have us do something non-commercial. Indeed I chaired the Remuneration Committee and not once did I have a proposal turned down by the Government in respect of the proposals I was making for the then executives. I am cautiously optimistic that the political constraints that we will operate within will be political constraints that in effect apply to a whole industry.

On your second point on Abbey, I hopefully make it a practice in life never to try to do things the same way twice because no set of circumstances is the same. I think when we look at the case of RBS, apart from having an infinitely greater and more powerful set of franchises and expertises, we also are in a different position that start now with a capital base right at the top end, courtesy of the Government and courtesy of some shareholder value destruction, but part of the reason why certainly the Board of RBS wanted to go big, if we had to go at all, on the equity side, was to give us some options in terms of the path that we take from here and the pace of that path.

We are very conscious of this trade-off; it's a difficult trade-off because for all that one may not like the prices one can get today, it can get worse tomorrow as well as better and so we will try and feel our way through that trade-off of risk concentrations that we feel we need to get out of versus longer term positions that we feel it's more productive to work our way through and we'll give you transparency on that.

Jonathan Pierce: It's Jonathan Pierce from Credit Suisse; I've got two questions, the first is back on the Equity Tier 1 ratio; I'm assuming you're still quoting this excess expected loss from Tier 1. Can you tell us what the excess expected loss has done since the interim stage so we can piece the true Tier 1 together?

Guy Whittaker: We have talked about thirty to forty basis points, its forty or so basis points at this point.

Jonathan Pierce: The second question is on the tangible net assets; in the same way you've given us the sensitivity on the Equity Tier 1 for movements in the dollar/sterling rate, can you tell us what the tangible NAV does for every 10% move in that rate at this point?

Guy Whittaker: Not off the top of my head, I'll come back to you on that one Jonathan.

Sandy Chen: It's Sandy Chen from Panmure Gordon; I just had two questions; one, focusing on synthetic CDOs and CLOs I was just trying to put some numbers together. I think you have 777 million of net exposure on CLOs, but you've transferred, I think, 6.9 billion in CLOs to the AFS. Could you give a gross number on the total CLO exposure and maybe, while you're at it, maybe the synthetic CDO exposure as well?

Guy Whittaker: The CLOs we talked about wrapped by monolines are the 6.7 number that you mentioned. The 700 – sorry on top of this just navigate through what table you're looking at, Sandy.

Sandy Chen: Appendix 3, Credit Market Exposures as at 30 September; I think it was listed as 777 million. I'm just trying to put that together with, a bit further along in the slide presentation, where I think there was mention of 6.9 billion of transfers of CLOs into the AFS line item. What I'm trying to get at is the exposure.

Guy Whittaker: If you take the combination of those two; there are the CLOs which are part of the gross exposure to monolines; the notional exposure to monolines is also listed in a table and the CLO component of that is listed out. That 6.7 billion relates to part of the overall 24 billion of notional monoline exposure; then the 700 is separate CLO exposure in its own right.

Sandy Chen: I guess my question related to that is that if monolines and credit derivative product companies and other hedging counter-parties come under stress, similar to what seems to have happened in part of the risk-weighted asset growth, what's the impact in both the P&L and on capital i.e. RWAs that you'd expect.

Guy Whittaker: We have on page seventeen some additional disclosure which is new around the credit derivative product companies. We had notional exposure to them of around £19.9 billion as at the end of the September 30th; the mark-to-market on those assets was around £2.6 billion. They're all rated AAA with one small exemption which was AA plus at that time, and we would reserve for them using a similar methodology that we would apply to monoline exposures.

Sandy Chen: So, for example if the credit derivative or product companies came under pressure because corporate default rates are rising, you might see a similar pattern in terms of write-downs taken against that gross exposure.

Guy Whittaker: We would expect to provide for that exposure over the course of the coming months, yes we would.

Sandy Chen: Just another question on goodwill; it seemed that you flagged that there might be a review of the goodwill item and given that it's, I think, 27.5 billion in intangibles sitting on the balance sheet as at 30th June, is there any guidance that you can give in terms of possible range of goodwill impairment?

Guy Whittaker: No, we're not giving any guidance; there are three big blocks of goodwill on the balance sheet. There's the goodwill that is relating to various acquisitions in the United States; there's the goodwill relating to our share of the ABN transaction and also, at a consolidated basis, you would remember there's the goodwill associated with the share that was acquired by Fortis and all of those would be subject to review during the Fourth Quarter.

Mike Trippett: It's Mike Trippett at Oriel; two questions; one on the SBO portfolio in North America; I think you said the provisions were up, or that the balance of

provisions was up 7 billion. I just wondered if you could give an idea of what the scale of that portfolio is and where we are in terms of the provision cycle.

Guy Whittaker: The SBO portfolio declined; the net number now is a little less than \$7 billion. I think it peaked at somewhere just around 10 about eighteen months ago. Current provision balance against that is just over \$400 million, which is 2.7 times the non-performing loans. There was no particular reserve build against that portfolio in the Third Quarter and it's charge off rate seems to be performing now very much in line with our expectations; there was some reserve building earlier in the year.

Mike Trippett: The same question just on the capital raising itself and tying up with Stephen's comments about exiting or downsizing businesses that don't make the risk adjusted return on equity. It does beg the question, how do you allocate this 20 billion of capital raising across the businesses? How can we look at this; should we just assume that it is done on a risk asset basis per division, or should we be looking at it in terms of an economic capital? I'm just trying to get the idea.

Stephen Hester: I think for now just apply a risk-weighted asset. One of the things that we want to do is to move forward in our presentation to the outside world of bottom lines of businesses and allocated capital against them and that will be part of the output of the strategic review, but for now just do it the simple way.

Guy Whittaker: There are some indicative returns, slides put in the appendix that came with the presentation which was just saying roughly where they are today.

Robert Law: Robert Law at Nomura; can I have a couple of areas please; firstly in the GBM business, can you give us the size of the own debt gain year-to-date and in Q3 and confirm that the AFS movements were restricted to the reclassification effects that you mentioned.

Guy Whittaker: I'll take that one as well; own debt gains for the Group as at September 30th were just a little bit over £2 billion - that was up from 800 at the half-year. We all saw the spike in CDS spreads at the time and one would expect at least the increase in Q3 to have completely unwound and a little bit more in the first three weeks of October as CDS spreads came back in. On the AFS re-class there's around I think net £1.4 billion; around half of that relates to the reclassification. A significant chunk is related to Bank of China and then the balance are some other small AFS reserves and they are actually, by coincidence, broadly offset by foreign exchange gains through reserves for an equal and opposite amount.

Robert Law: Secondly, I wanted to talk on the hedge funds; could you comment on the size of exposures there and whether you have had or expect to have any counterparty issues or impairment issues related to that?

Guy Whittaker: I think the overall answer is that we would expect to; I'm sure there will be cases going forward - I'm racking my brains trying to think if there's anything of any materiality that we have incurred to date and there's nothing jumping out at this stage, but I think the likelihood of something is reasonably high at this point.

Robert Law: Any size of exposures?

Guy Whittaker: All of our trading with hedge funds is on a collateralised basis. It really is a matter of the event and movements in collateral surrounding that event as to whether it would record a loss. Obviously our collateral management is under intense scrutiny and we try to maintain over collateralised positions at every possible circumstance, but I think it's unreasonable to expect it in every case that will always work out to be so.

Leigh Goodwin: It's Leigh Goodwin at Fox-Pitt Kelton; just a question on the impairment trends and the comment that I think you made that we're seeing a sharp rise in impairments in some areas. You gave us a bit of a breakdown in terms of GBM, which highlighted a couple of areas which Stephen obviously will know quite well; building, construction and so on. I just wondered if you could give us some indication of where you see the trends in those areas and how worried we should be about the exposure to commercial real estate.

Stephen Hester: I think that it would be fair to say that those two areas worldwide are going to be some of the areas producing significant losses for all financial institutions. If you look at the derivatives markets, at the likely declines in values here, in the States and Europe, that would be borne out, but sizing it is frankly futile at the moment. I think the thing that is important to note and that's why we put a slide in the appendices updating the half-year disclosure is that the most exposed component is speculative development land, both commercial and residential and that represents a tiny component of what we have. Very large amounts of distressed debt in this area can at least service the loans even if they do bust their covenants and can't be re-financed easily, so there ought to be the ability to manage a lot of this through. Yes, it will be the source of significant loan losses here and everywhere else.

Leigh Goodwin: Maybe just to follow up – thanks very much for that colour – but in terms of the information you provided and the increase that you were flagging, was that mainly UK, or is it Spain, or is somewhere else, or is it broadly spread?

Stephen Hester: Commercial real estate will hit us and everyone everywhere; in the US its worse; in the UK its worse, in continental Europe its worse; and in Shanghai its worse, so the world looks quite similar from whatever geography you look at it.

Guy Whittaker: Just trying to maybe give a bit of context in there, the commercial property related impairments in the Third Quarter around £250 million or so maybe gives a little context of some other rather larger numbers being bandied around by other people yesterday, that would put our Third Quarter numbers in some kind of context for you.

Simon Pilkington: Simon Pilkington at Cazenove; just one question on how easy it is to reduce the total assets GBM in Fourth Quarter; I wondered if you could just give us a feel for how much assets fell from the Third Quarter to the Fourth Quarter last year, because clearly there is always a seasonal element in that number.

Guy Whittaker: I don't know off the top of my head of last year, but a significant part of that's related to financing activities and settlement balance around trading events and those typically go quiet towards period ends. Early indications - it's a little early for the October balance sheet - but we're thinking it could be £60 billion lower in the month of October versus the September data. We've put the target out there because we think it is doable and achievable, by in some cases less financing some cases just lower levels of inventory. As part of the review, clearly bringing that down over time to a more sustainable basis will be a focus and these things don't typically go in single straight lines.

Sir Tom McKillop: Are there any further questions? If not, thank you all very much and please enjoy a coffee with us outside along with an opportunity to chat further.

End.

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