Q313 results investor presentation

Philip Hampton, Chairman
Ross McEwan, Group Chief Executive
Nathan Bostock, Group Finance Director

1st November 2013

Agenda

Philip Hampton	Introduction
Ross McEwan	Strategic update
Nathan Bostock	Internal Bad Bank (“IBB”) explained
	Appendix I. Q313 results explained
	Appendix II. Sir Andrew Large SME review

Introduction

Philip Hampton, Chairman

Strategic update

Ross McEwan, Group Chief Executive

My early priorities

Resolve Good Bank / Bad Bank

Resolve capital position with the PRA

Reset relationship with HMT, PRA, UKFI and the Chancellor

Make progress on the Dividend Access Share

Sharpen our focus on customer business – update in Feb'14 alongside FY13 results

Long-term priority:
Making RBS a great bank for customers and all stakeholders

RBS has made tremendous progress

Robust Balance Sheet	✓ ≤100% Group loan:deposit ratio achieved ✓ Funding and liquidity metrics transformed ✓ Requirement for future wholesale funding limited ✓ Funded balance sheet halved, now at £806bn from £1.6trn
Dramatic change in scale and scope	✓ Business mix shifted to c.80% Retail & Commercial, with UK focus ✓ Non-Core process complete in 2013, consistently exceeded targets ✓ WorldPay, Sempra sales completed ✓ Direct Line exit on track ✓ Rainbow exit progressing – pre-IPO investment agreed
Reduced reliance on the Government	✓ Special Liquidity Scheme facility fully repaid ✓ Credit Guarantee Scheme funding fully repaid ✓ Asset Protection Scheme exited without claims ✓ In discussions with HMT on exiting the Dividend Access Share and simplifying the capital structure

Building a great bank for customers

Restoring capital strength	▪ Continue to strengthen capital base – target fully loaded Core Tier 1 ratio of c.11% by end 2015 and 12% and beyond by end 2016 ▪ Accelerate Citizens divestiture – significant capital accretion expected ▪ Relentless focus on reducing risk and hence RWA and stress loss intensity
Further de-risk legacy bad assets	▪ Accelerated de-risking = stronger capital = better, safer bank ▪ More predictable earnings ▪ Creation of an Internal Bad Bank ("RBS Capital Resolution") with a clear run-off plan
Sharpen our focus on core franchises	▪ Full strategic review of ongoing businesses, expect update at FY13 results ▪ Rebuild earnings via revenue initiatives ▪ Review of cost base underway ▪ Initial target mid-50s cost:income ratio

Citizens

A good business with significant potential…	…but not essential for RBS forward strategy

Significant scale in national context

- 9th largest branch distribution
- 7th largest ATM distribution
- 2nd largest in-store franchise

Positioned for success and financial improvement

- Repositioning of major business lines and profitability improvement underway

- Citizens is not fundamental to UK R&C business
- Limited connectivity with Group
- RBS is not the right long-term owner
- IPO will accelerate to H2 next year
- Plan to exit the business fully by the end of 2016
- Significant capital benefit expected

Establishment of an Internal Bad Bank ('IBB')

What we've done

- Worked with HMT and their advisors to identify high risk and capital intensive assets from across the Group
- Explored a range of external and internal options for the management of this portfolio
- Identified an internal solution as best for all stakeholders. IBB to be established in Jan 14 with estimated £37-39bn of assets
- Target exit majority of IBB assets by end-2016

Why

✓ Increase capital ratios

✓ Normalise credit costs and reduce tail risk

✓ Reduce regulatory stress capital requirements / stress loss buffer

✓ Accelerate improvement in profitability

Sharpen our focus on core franchises

Strategic Review	▪ Launch of full review into ongoing businesses ▪ Focus on market-leading customer franchises ▪ Core franchises centred on the UK, but critical to improve the link to our international network to remain distinctive ▪ Expect update at FY13 results
Customer service	▪ Making RBS simple and easy to do business with ▪ Benefiting customers with appropriate operations and IT systems ▪ Making life simpler for employees ▪ Driving revenue growth
Cost & efficiency	▪ Focus on improving performance and effectiveness of the bank ▪ Moving cost:income ratio – initial target mid-50s ▪ New plan for cost reduction to be announced at FY13 results

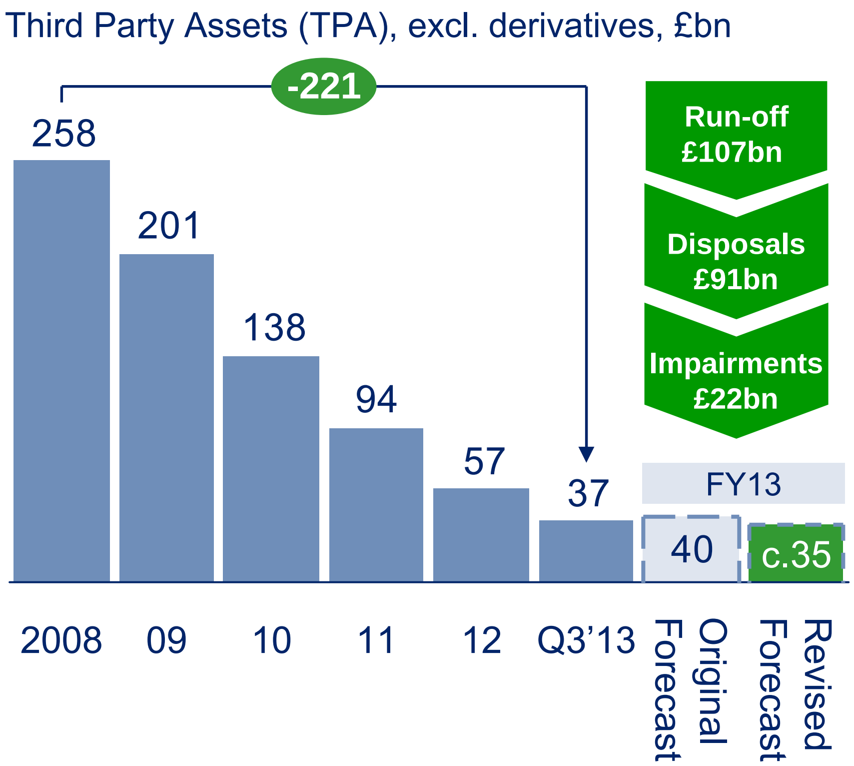
RBS Group

Internal Bad Bank (“IBB”) explained

Nathan Bostock, Group Finance Director

Non-Core has beaten its asset reduction targets

Non-Core has achieved its plan…



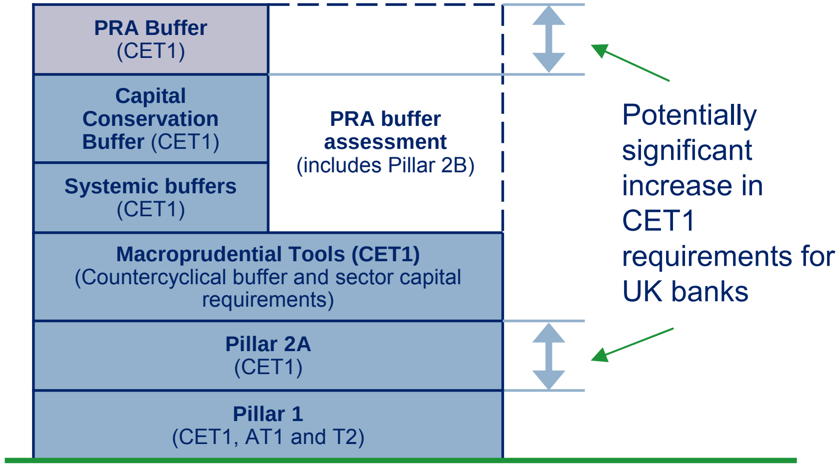
- Non-Core has delivered its plan three months early
- TPA reduction of £89,000 every minute since January 2009
- The majority of reduction has come from negotiating repayments from customers
- Every asset class has been reduced

…however, de-risking of legacy assets and capital needs to go further

- Despite progress to date, RBS has much higher NPLs than peers
- Impacts negatively Pillar 2 / stress capital requirements
- High concentrations of unproductive capital

Industry regulatory capital requirements are increasing

CRDIV	Under CRD IV the treatment of capital deductions for Expected Loss minus Provision will move from 50% CET1 to 100% CET1
PRA proposed implementation	CP 5/13 consultation was published by PRA in August 2013 with two key proposed changes - Inclusion of Pillar 2A and Pillar 2B Stress Buffer in CET1 requirements - Acceleration of 100% deduction from CET1 to 1 January 2014 Final proposal due December 2013
New Bank of England stress regime	Bank of England announced in September 2013 the introduction of extensive stress testing regime similar to US CCAR – including firm specific tests and greater public disclosure



Consequences

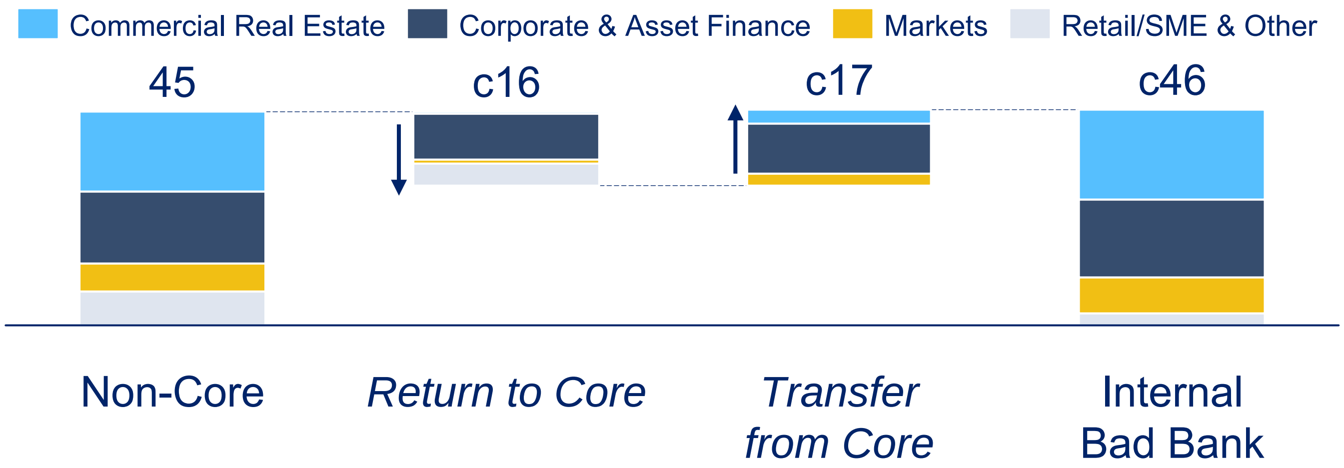
1. Absolute capital levels will need to be higher earlier
2. High risk-weighted assets have major impact as they will exacerbate the absolute capital required and the stress impact
3. Inclusion of PRA Stress Buffers and firm-specific stress tests will make stress a key driver of bank target CET ratios

The IBB significantly mitigates impact of 2 & 3

The Group funded balance sheet was reviewed in detail to identify assets with high capital intensity or which performed poorly in stress scenarios

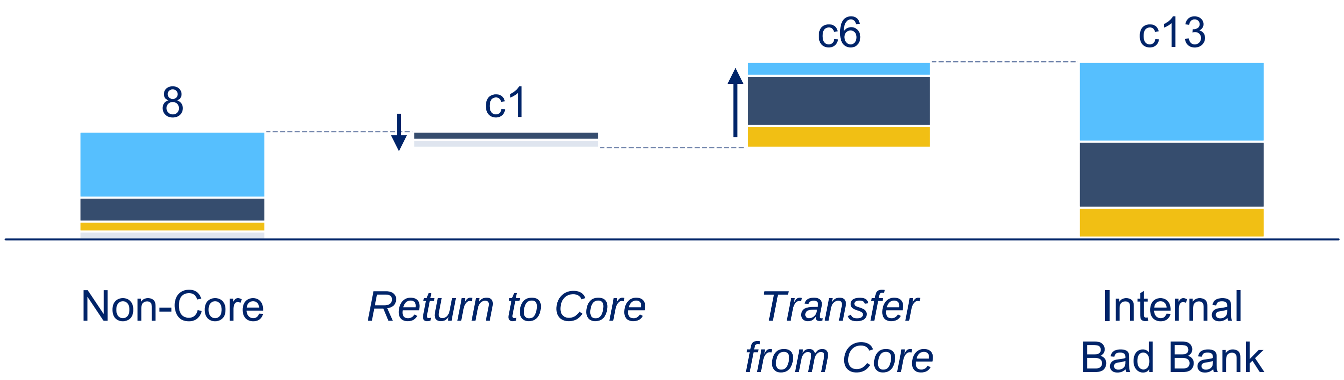
TPA (H1 2013)

Third Party Assets (TPA)[1], excl. derivatives, £bn



Capital Requirement (H1 2013)[2]

£bn



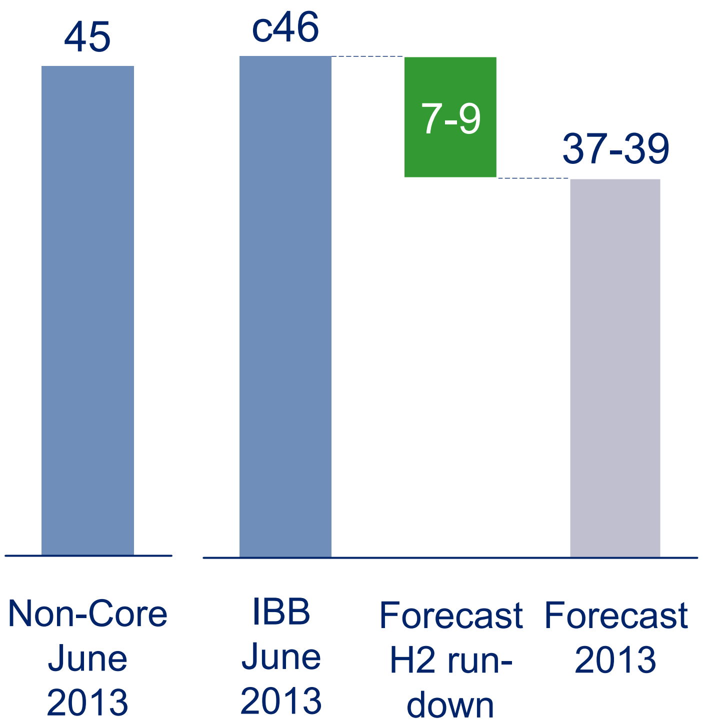
- IBB is c5% of Group funded assets and c20% of capital requirement
- These assets are the disproportionate drivers of the Group's capital intensity and performance in stress scenarios

[1] Net of provisions. [2] RWAs plus capital (Expected Loss and Securitisation) deductions.

Material component of IBB's capital are Expected Loss minus Provisions deductions

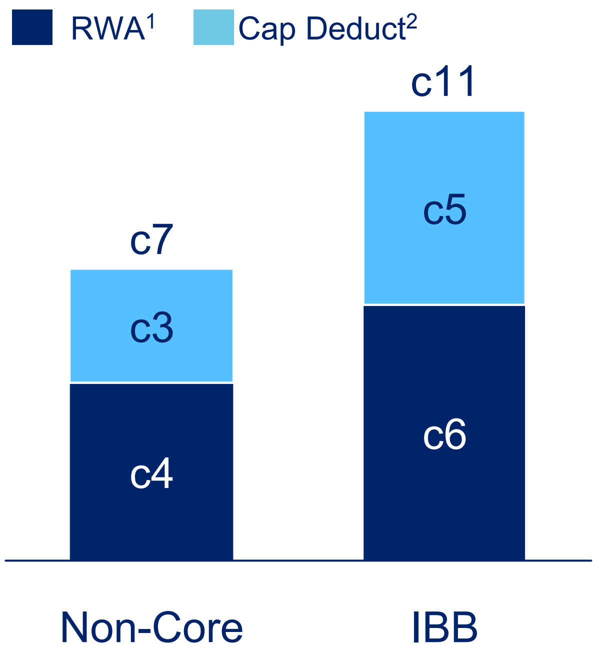
TPA (H1 2013)

TPA, excl. derivatives, £bn



Capital Requirement (forecast at IBB inception, Jan 14)

£bn



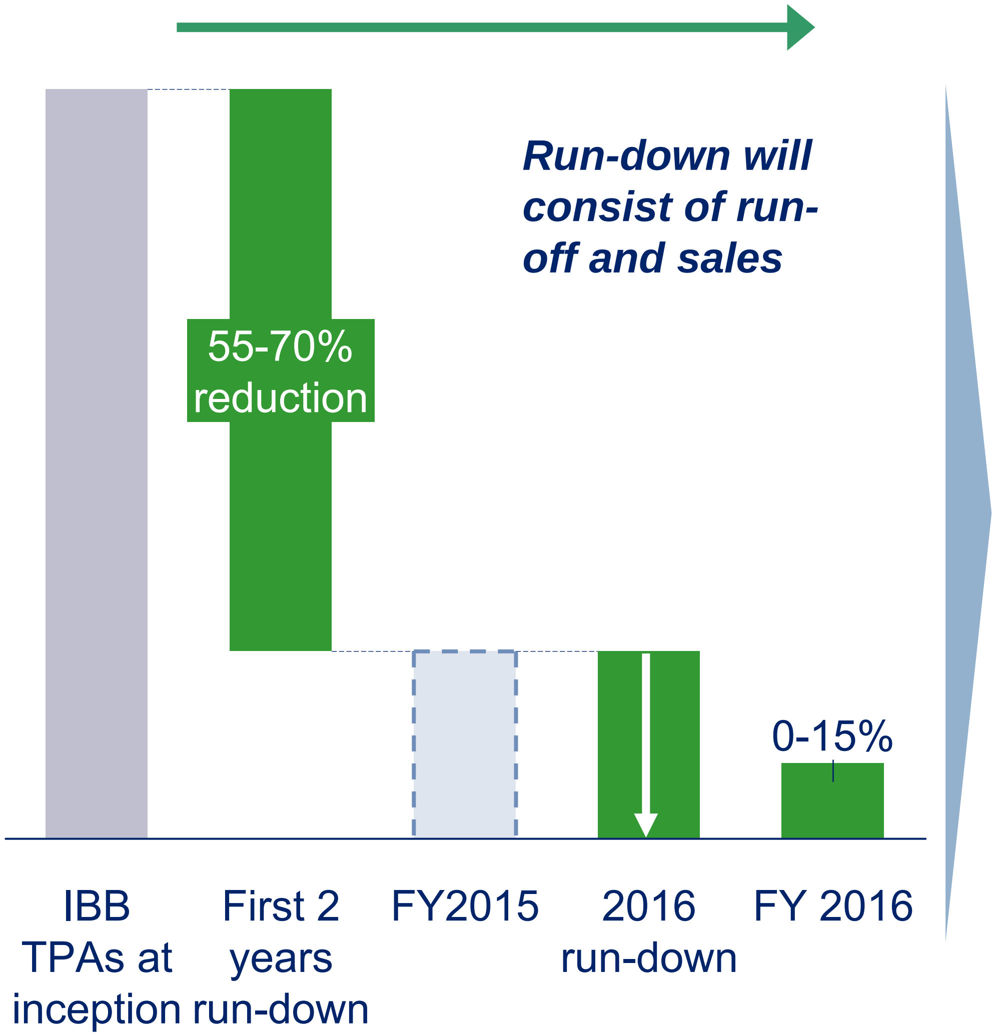
- Internal analysis suggests this pool of assets could contribute a material component of the forecast PRA Stress Buffer
- Of the Capital Deductions, c£3bn relates to Ulster Bank defaulted assets

The previous strategy to work out assets over a longer period to maximise cash recoveries is no longer the optimal plan given increasing industry regulatory capital requirements

[1] Based on 10% of RWAs. [2] Capital deductions – excess of Expected Loss over Provisions and Securitisation deductions.

We will accelerate run-down of IBB assets – a major change in strategy for defaulted assets

Third Party Assets (TPA), excl. derivatives, £bn



	Managed run-off	Sales
Previous plan	Realisation of assets and release of capital at maturity	Realise assets through the cycle to optimise cash recoveries
IBB	Realisation of assets and release of capital at maturity (2014-16)	**Acceleration** ▪ Brings forward impairments ▪ Generates disposal losses

Bulk of impairments and disposal losses will be in the period to 2016

Forecast at IBB inception, £bn

Lifetime impairments

The timing and level of lifetime impairment is implied by:

- Capital deduction for Expected Loss minus Provisions = c£5bn
- RWA Capital = c£6bn
- Depending on assumptions, lifetime credit costs could be c£5bn - £6bn
- c50 - 60% of these lie beyond a 3 year outlook

Disposal losses

- The incremental cash cost of disposals could be c£1.5bn - £2.0bn over the disposal plan
- Taking account of the RBS cost to hold the position in the original plan the incremental economic cost is likely to be materially lower

In conclusion:

- RBS will suffer lifetime credit losses if the assets are held to maturity
- The incremental cost is the difference between RBS and the buyers funding cost to hold the asset to maturity
- **But there are offsetting economic benefits to the disposal plan**

Value creation from reduction in Stress Buffers, de-risking and simplification

Shareholder value impact of disposals

- Incremental cash cost of sale c£1.5bn - £2.0bn
- Cost is materially lower when RBS cost to hold is taken into account

In addition, further benefits from acceleration

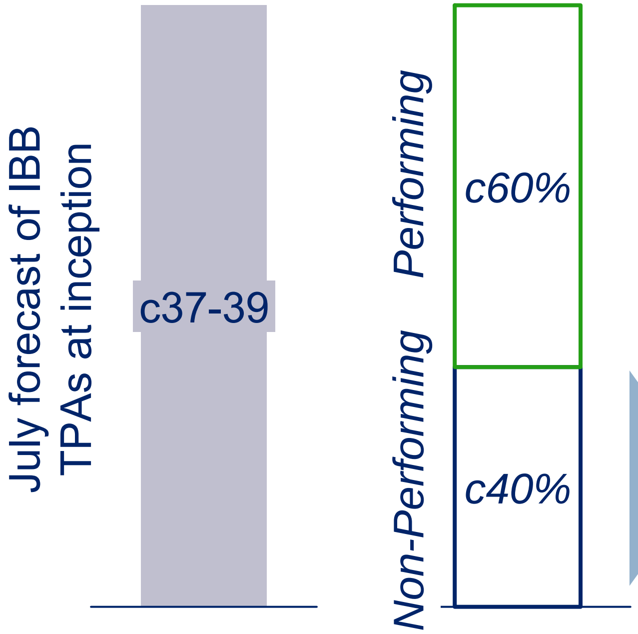
- Portfolio is c5% of RBS Group funded Balance Sheet, but c20% of its capital requirement
- Portfolio generates 40 - 50% of cumulative impairments in a stress case
- In order to view the acceleration as neutral you would need to believe the Stress Buffer held against the sales element of the plan is 80-120bps of CET1
- Simply holding the assets would require c£4-5bn of unproductive capital over original plan life, which could otherwise be used to support profit-generating activities – this is approximately £500m per annum declining of lost profit

Value of Stress Buffer release combined with hold cost of previous plan should be at least neutral vs. incremental cost of disposal. In addition:

- ✓ Plan is expected to be capital ratio and RoE accretive
- ✓ Reduction in NPL ratio from abnormally high 9-10% starting point (UK competitor at c3% at H113)
- ✓ Volatility in future Stress Tests materially reduced creating higher certainty of future capital trajectory
- ✓ Materially simplifies the balance sheet

Accelerated disposal of defaulted assets will cause re-assessment of likely cash flows and increased impairments in Q4 2013

Third Party Assets, excl. derivatives, £bn



- Expected Loss capital deduction[1] of c£5bn held
- Decision to accelerate is likely to require c£4.0bn - £4.5bn impairment to be recognised in Q4 2013 – impairment split 60:20:20, Ulster (inc. Non-Core), Non-Core, and Other
- The provision reduces Expected Loss capital deduct by £3.5bn - £4.0bn, creating a FLBIII CET1 ratio reduction of c10bps

2013

- c£4.0 - £4.5bn impairment in Q4 results
- c60% relates to impairments from beyond the forecast period[2]
- This will reduce capital deducts[1] and have a marginal FLBIII CET1 effect

2014 - 2016

- Impairments on performing assets of c.£1bn
- Disposal cost c£1.5bn - £2bn
- c£1.5bn of costs[1]
- c£2bn FLBIII CET1 released

2017+

- Major reduction in future impairments due to removal of assets
- Higher available earnings and RoE
- Lower Stress Buffers
- Normalised NPLs and much simpler bank

[1] Expected Loss minus Provisions. [2] 2014 to 2016. [3] Including operating and funding costs within existing RBS plan.

IBB has been created as a key component of the Group's response to changing capital regime

	Impact of IBB on RBS		
	Short Term	Medium Term	Effect
TNAV	↓ £4.0bn - £4.5bn	↓ £1.5bn - £2.0bn[1]	-
FLBIII CET1 Ratio	↓ c10bps	↑ c40-50bps	✓
Risk Weighted Assets	-	↓ c£60bn	✓
Capital Deductions	↓ £3.5bn - £4.0bn	↓ c£5bn	✓
Return on Tangible Equity	-	↑ c90bps - 120bps	✓
Stressed Impairments		↓ 40 - 50%	✓
NPLs as % Gross L&A	9% - 10%	2.5% - 3.5%	✓

- IBB causes a TNAV reduction in the short term in exchange for a material improvement in the capital position, de-risking, and simplification
- With higher industry capital requirements, accelerating asset removal is the optimal plan for delivering value to the Group's stakeholders

[1] Disposal cost impact.

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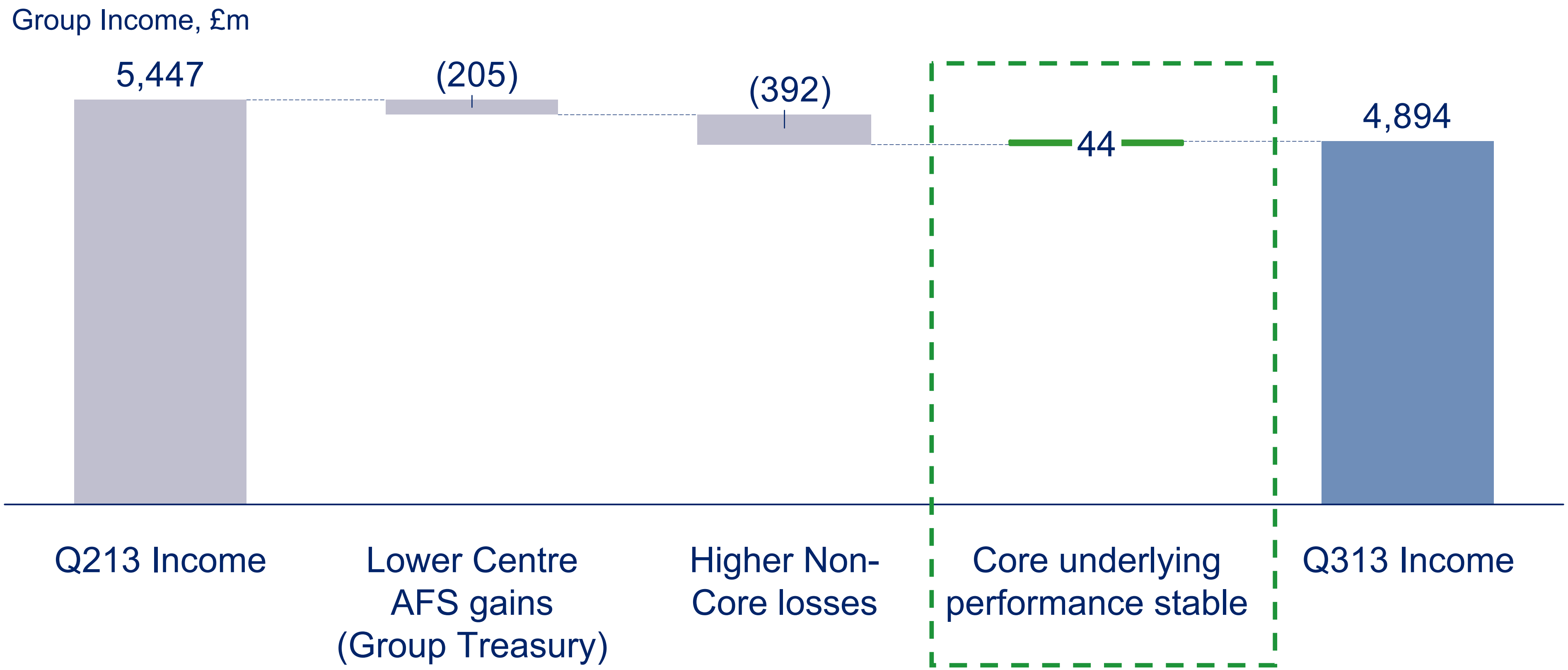
Appendix I

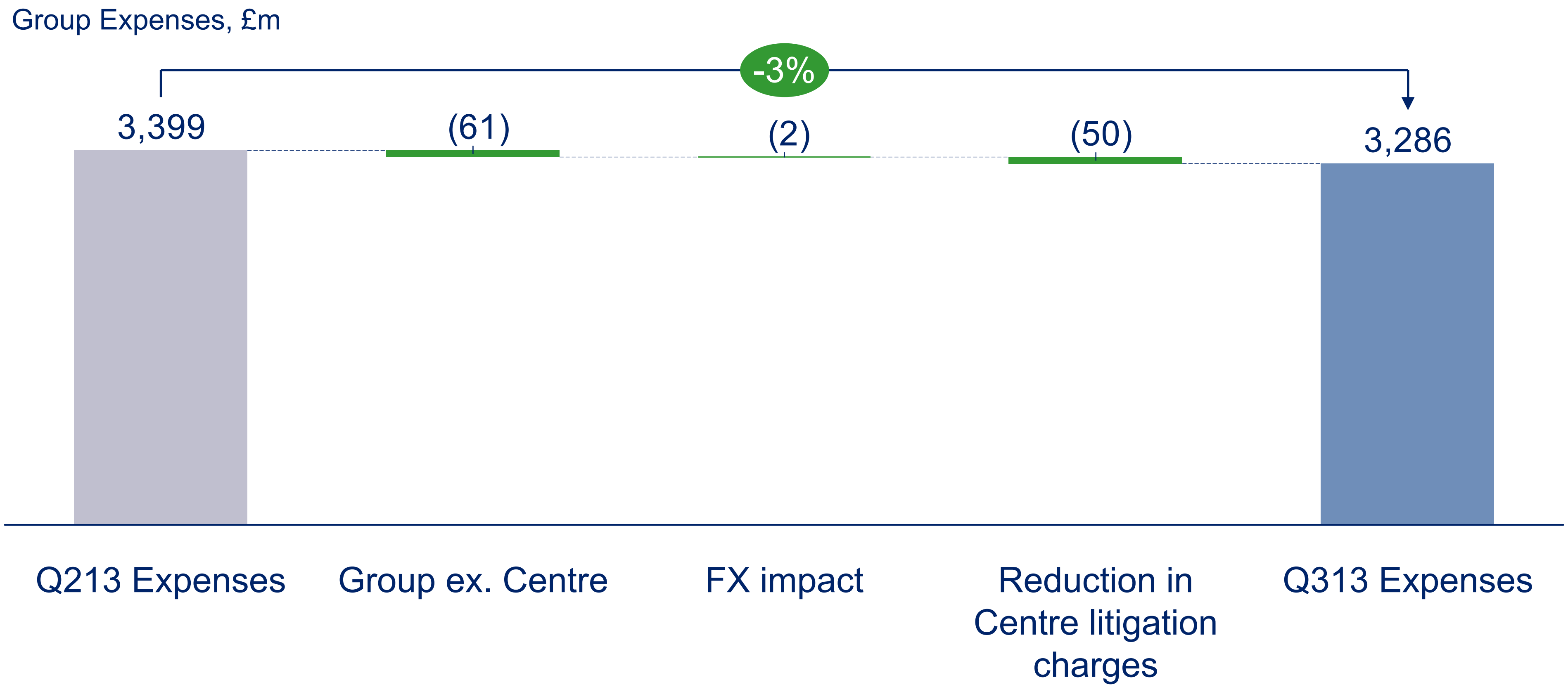
Q313 results explained

Underlying income trends stable



- Q/Q decrease in income driven by lower AFS gains and higher Non-Core disposal and trading losses
- Underlying income stable supported by improving Core NIM

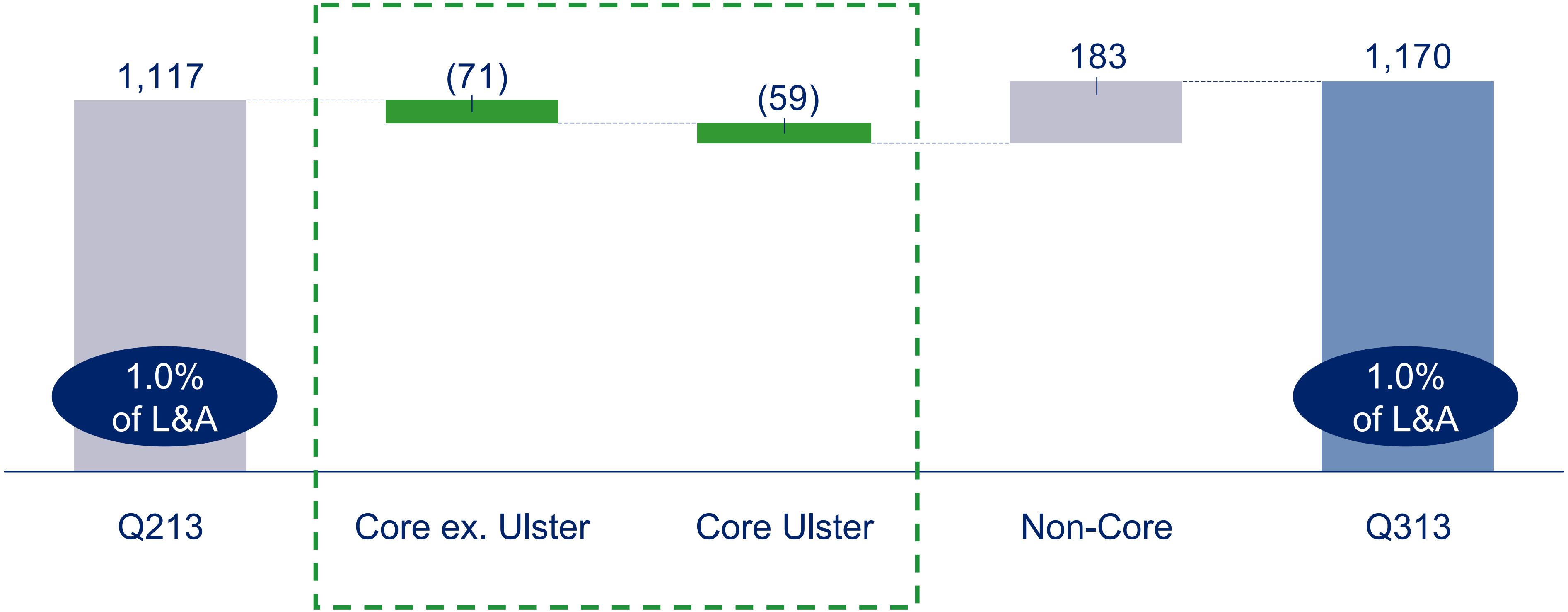
Consistent cost reduction



- Core cost:income ratio broadly stable at 63%
- Review of cost base underway, expect update at FY13 results

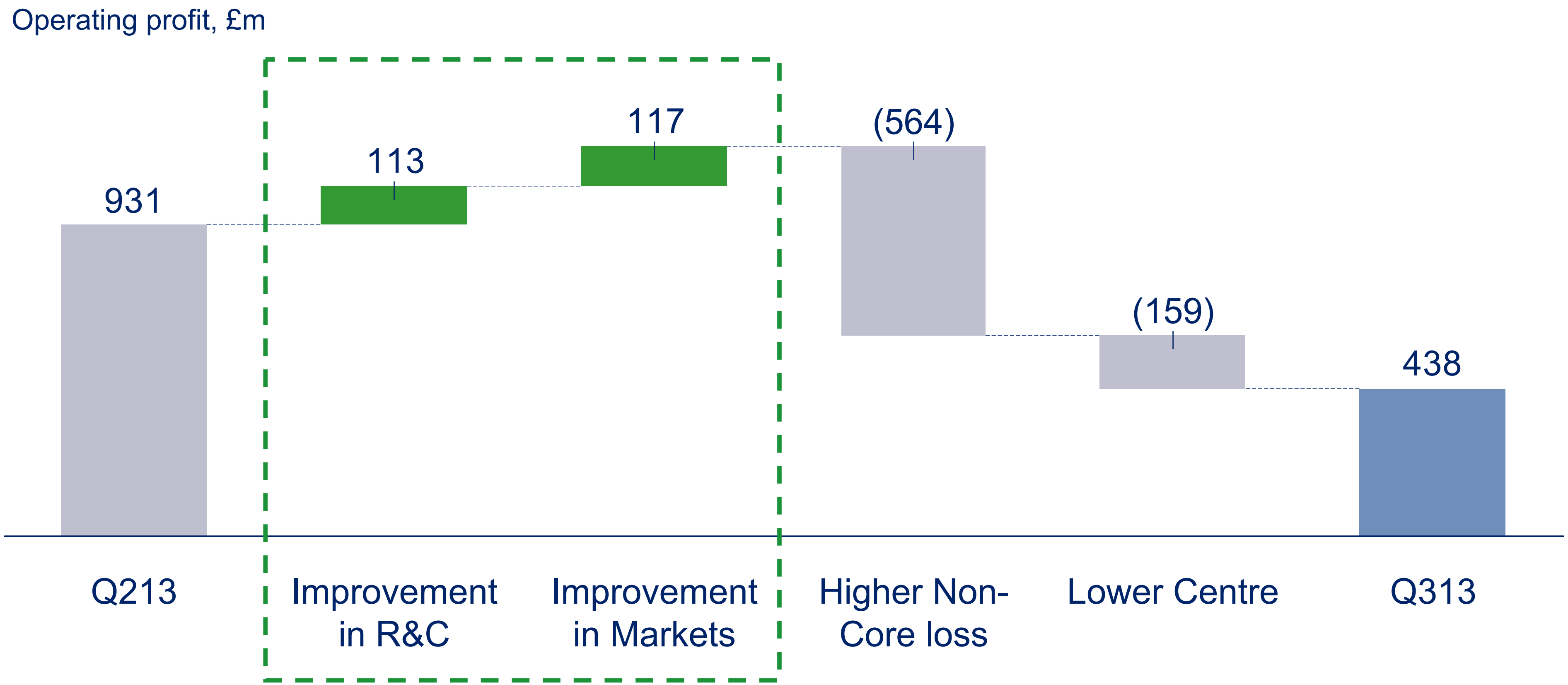
Impairments down in Core

Group impairment charge, £m



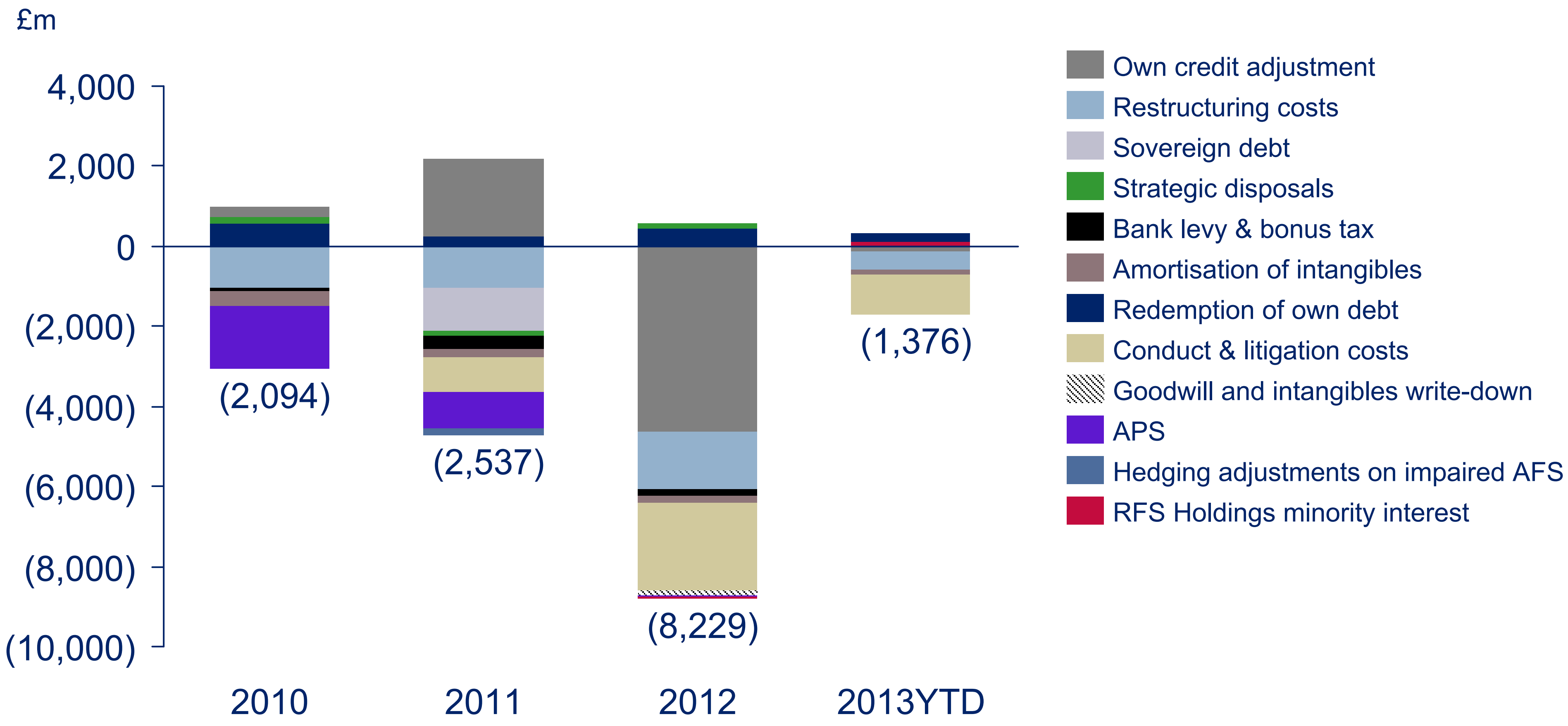
- Core Ulster reduction reflecting lower Irish retail mortgage arrears
- NPLs down £1.8bn, coverage ratio improved by 100bps to 53%
- Non-Core impairments up reflecting more prudent view on Ulster CRE Development book

Operating profit – Core improving Q/Q



- R&C improvement supported by lower impairments
- Higher Non-Core loss due to disposal activity and absence of previous recoveries
- Centre primarily reflects lower realised AFS gains

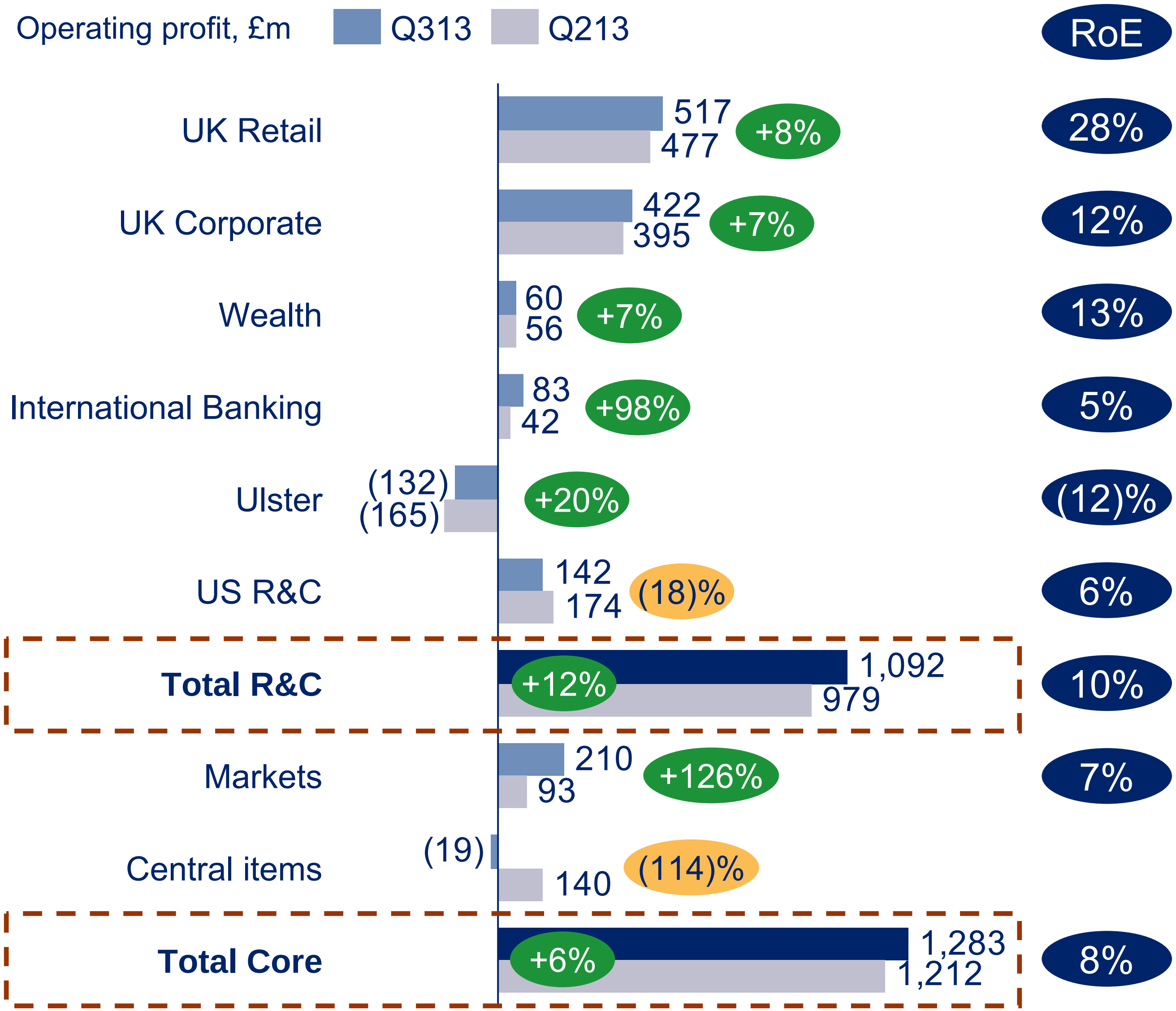
‘Below the line’ losses reduced



- Currently expect overall restructuring costs of c.£900m to £1bn in 2013
- £250m PPI top-up in Q313. Total provision £2.6bn of which 73% utilised

RBS Group

Core performance improved Q/Q



- Most Core divisions up Q/Q driving 6% growth in Core operating profit
- Improved R&C result driven by a decline in impairment losses
- US R&C down as reserve releases subside
- Markets up driven by improved Rates, tightly managed costs and lower impairments

Robust Balance Sheet

Loan : deposit ratio

94%

Q213: 96%
Q312: 102%

Short-term wholesale funding

£35bn

Q213: £37bn
Q312: £49bn

Liquidity portfolio

£151bn

Q213: £158bn
Q312: £147bn

Tier 1 leverage ratio

14x

Q213: 14.3x
Q312: 15.4x

Funded balance sheet

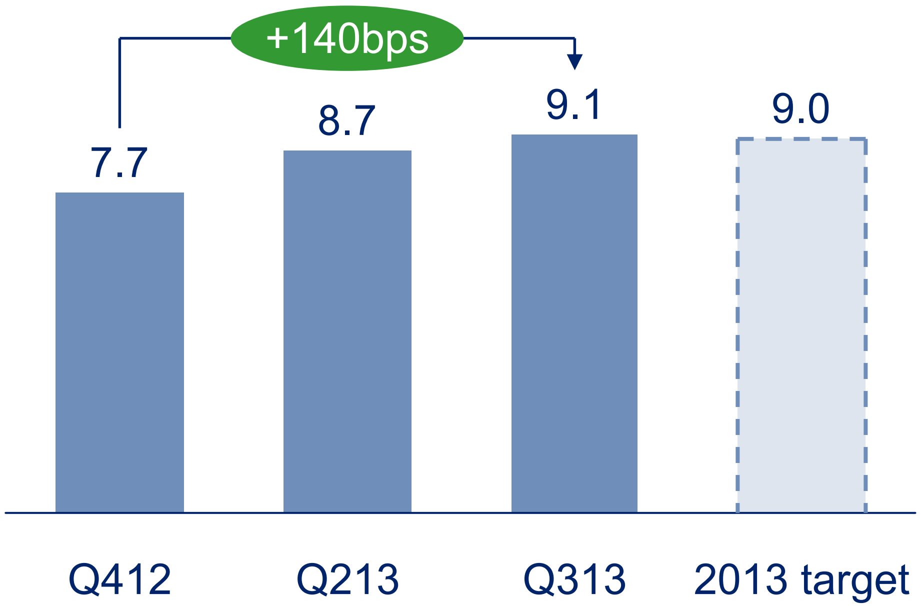
£806bn

Q213: £843bn
Q312: £909bn

Continuing to build capital and reduce leverage

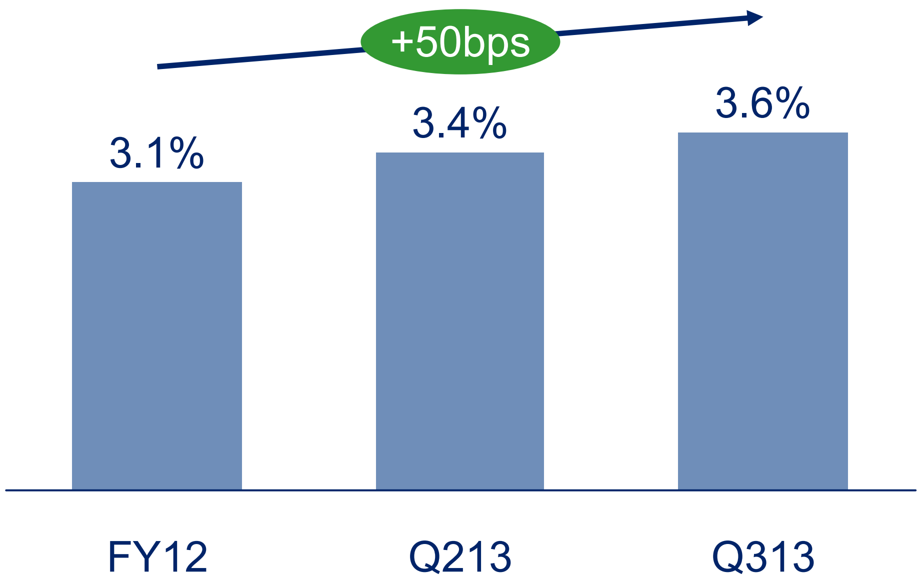
We are at our FY13 FLB3 CT1 target

Group 'fully loaded' Core Tier 1 ratio, %



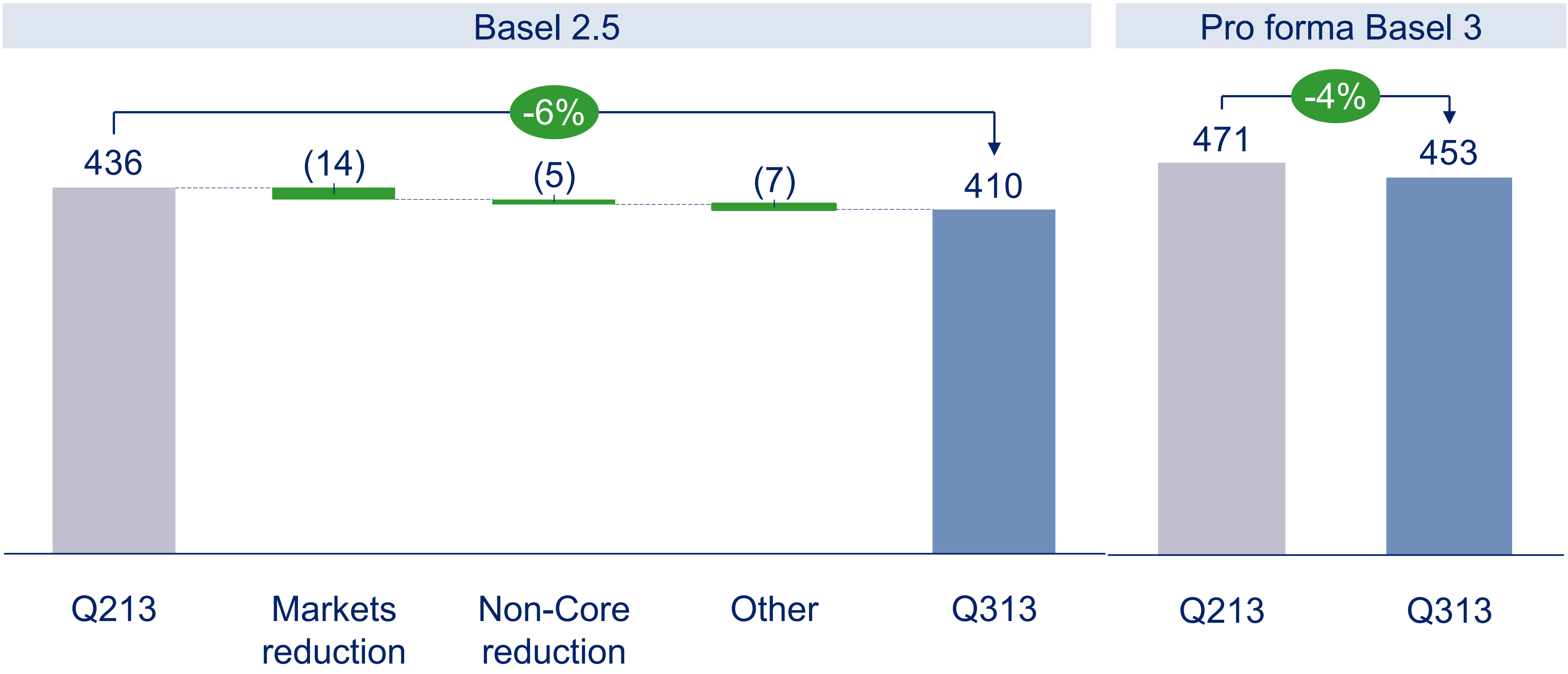
Leverage ratio continues to improve

CRR full end-point measure leverage ratio, %



Risk reduction progressing

Risk Weighted Assets (RWA), £bn



- Markets restructuring on track
- Non-Core year-end reduction target already delivered

Appendix II

Sir Andrew Large SME review

We will act on the SME lending review findings

We aim to be the #1 bank for SME customer service

SME lending growth is our priority

Background of Sir Andrew Large review	▪ Objective of the review was to enable RBS to enhance support for SMEs and economic recovery, while maintaining safe and sound lending practices
Result	▪ The report states that we have succeeded in delivering a number of critical changes to our SME business since the onset of the crisis ▪ We successfully rebalanced and stabilised the balance sheet laying the foundations for sustainable growth ▪ But the report demonstrates that we still have lots to do

We have now launched a comprehensive review of our business to address recommendations of Sir Andrew Large report in full

The results of the review will be announced around the time of our FY13 results in Feb 14

Forward Looking Statements

Certain sections in this document contain ‘forward-looking statements’ as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘believes’, ‘should’, ‘intend’, ‘plan’, ‘could’, ‘probability’, ‘risk’, ‘Value-at-Risk (VaR)’, ‘target’, ‘goal’, ‘objective’, ‘will’, ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited to: the Group’s restructuring and new strategic plans, divestments, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), return on equity (ROE), profitability, cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; discretionary coupon and dividend payments; certain ring-fencing proposals; sustainability targets; regulatory investigations; the Group’s future financial performance; the level and extent of future impairments and write-downs, including sovereign debt impairments; and the Group’s potential exposures to various types of political and market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: global economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the disposal of assets to be included in the internal “bad bank” and the disposal of certain other assets and businesses as stated in the new strategic plan or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislative and regulatory proposals in the United Kingdom (UK), European Union (EU) and United States (US); the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of LIBOR and other interest rates and foreign exchange trading activities; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group’s operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; the implementation of recommendations made by the Independent Commission on Banking and their potential implications and equivalent EU legislation; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the Group; reputational risk; the ability to access the contingent capital arrangements with HM Treasury; the conversion of the B Shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group’s activities as a result of HM Treasury’s investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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