The Royal Bank of Scotland Group

2011 Q3 Results

ANALYSTS PRESENTATION

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FORWARD-LOOKING STATEMENTS

This transcript includes certain statements regarding our assumptions, projections, expectations, intentions or beliefs about future events. These statements constitute "forward-looking statements" for purposes of the Private Securities Litigation Reform Act of 1995. We caution that these statements may and often do vary materially from actual results. Accordingly, we cannot assure you that actual results will not differ materially from those expressed or implied by the forward-looking statements. You should read the section entitled "Forward-Looking Statements" in our Q3 Results announcement published on 4th November 2011.

Presenters

- **Stephen Hester (Group Chief Executive)**
- **Bruce Van Saun (Group Finance Director)**

Presentation

Operator

Good morning ladies and gentlemen, today's conference call will be hosted by Stephen Hester, Group Chief Executive of RBS. Please go ahead, Stephen.

Stephen Hester - *RBS*

Good morning everyone, thank you very much for joining us for the third quarter call. As normal, Bruce van Saun is with me and we'll be going through the headlines of what we announced today before we go into your Q&A.

I think, by way of introduction, I guess what I would say to you is that in the third quarter, we, I hope, had a very clear focus on what was important and we believe that we've delivered against that. It was important to keep our restructuring story on track and to make sure that all the improvements in our businesses and the wind-down of non-core were behaving appropriately; I think we've done that. It was vitally important in periods of huge uncertainty around bank capital, around bank liquidity, driven by the outside world that we show a very, very clear blue light, or blue sky, between the RBS of 2008 and the RBS of today and across all of the solidity measures, capital liquidity and so on; I think that we've shown ourselves to be in the better pack of banks in the world facing into these uncertain times. And then, thirdly, in our ongoing, in the ongoing profitability of our businesses, we needed to be as resilient as we could; I think that we've shown that we can deliver a good ROE, 16% ROE in our retail and commercial businesses ex-Ireland, Ireland improving and a performance across the board that is at least in line with competitors which was not once, once not the case, although all our businesses are also showing the effects of the environment in which we're operating in. And then, finally, we needed to make sure that we were supporting customers appropriately; we've done that. And we needed to make sure that we are alive to what changes in the environment are temporary, what changes have longer implications, and are clear on the re-shaping of RBS are required as a result. So that's what we've been focussing on; hopefully we have delivered to you clearly our data and accomplishments across those metrics and Bruce can perhaps go into that a little more now.

Bruce van Saun - *RBS*

Okay, thank you Stephen. We continued to make progress on improving our risk profile during the quarter. Our capital funding and liquidity metrics all continued to improve. Our operating performance declined relative to the second quarter, as market conditions were challenging. While our retail and commercial franchises produced stable and solid returns, GBM's third quarter performance reflected the subdued trading environment and our cautious risk appetite. Non-core continued to make good progress in the run down of third party assets, or TPAs. Group operating profit for the third quarter was 267 million while, on a year to date basis, it is up 300 million, or 15%, to 2.1 billion. The group's bottom line showed an attributable profit of 1.2 billion, reflecting a 2.4 billion gain on fair value of fallen debt. Our capital position improved to a robust 11.3%, up 20 basis points on the previous quarter given our RWA reduction. Our tangible net asset value also increased by 2p per share on the quarter, driven by the fair value of [fallen] debt gain to 52.6p per share.

Looking at the major group P&L items, group income was down 18% on the prior quarter due to a swing in valuation items in non-core and a half a billion reduction in GBM revenues. R&C's NIM was relatively stable in Q3, although we are seeing modest contraction as higher yielding hedges on current account balance continue to roll off and as deposit pricing remains highly competitive. Non-core NIM dropped significantly from 87 basis points in Q2 to 43 basis points in Q3. This reflects the disposal of higher yielding non-core assets, higher funding costs and lower recoveries. Group NIM declined 13 basis points on the prior quarter, namely due to the drop in non-core, which had a group level impact of six basis points and the increase in our liquidity pool, which had a group level impact of three basis points.

Looking at the expense base, we continue to make good progress. Versus a year ago, expenses are 7% lower, and are down 2% versus the prior quarter. The year on year decline reflects our progress in reducing non-core, while the sequential quarter decline primarily reflects lower GBM compensation accruals.

Now given the economic outlook and the difficult trading environment, we are actively working on further cost initiatives across the group. Impairments were down 730 million, or 32%, versus Q2, reflecting a 52% fall in non-core. Core impairments were broadly flat at about 80 basis points of loans and advances. We are seeing broadly stable trends in the corporate book and general improvement across the retail book ex-Ireland. Group provision coverage of REILs remains stable at 49%, as REILs grew by less than 1% in the quarter. Analysing the combined Ulster impairment trend, Q3 11 impairments halved to 600 million. Non-core Ulster's impairment charge benefited from the non-repeat of tertiary land value charges seen in the second quarter, as well as lower charges on the development loan book, as most of this has already been impaired. In core Ulster, impairments rose by 60 million as further declines in asset values in the mortgage and corporate books drove higher losses on defaulted assets. We are encouraged by the improving economic stats coming through from Ireland, but it will take some time for those to play through to employment gains and asset value stability.

In the third quarter "below the operating line items" saw a market positive swing from the second quarter. The widening of the group's CDS spreads drove a large fair value [fallen] debt gain of 2.4 billion in the quarter. The further decline in the value of Greek sovereign bonds triggered an additional 142 million of write downs on our Greek bond AFS portfolio. This portfolio has now been marked at 37 cents. It's worth noting that year to date our direct sovereign bond exposure to the periphery Eurozone countries has decreased by 3.2 billion, or 75%, to 800 million. This exposure now represents much less than 1% of our funded balance sheet. The APS charge was only 60 million in the quarter, and accumulative APS charge now stands at 2.2 billion.

Taking a quick look at the divisional results, we were pleased that R&C results were broadly stable. Year to date ROE for R&C ex-Ireland is 17%; with Ireland, it's 11%. And again we made about a billion of profit in the quarter from R&C. UK retail had another good quarter, producing an ROE of 27%. Income was off 4% on prior quarter as investment income and transaction fees declined, but this was partly offset by a strong direct cost performance down 5%, and a 6% decline in impairments. The business remains focussed on its funding base and the third quarter saw further progress. Customer deposits grew by about three billion to 100 billion, which improved the loans to deposit ratio to 109%.

It's worth noting that our improving online functionality is helping to keep our mobile banking offering ahead of our peers. We now have five times more customers than our nearest competitor. UK retail has recently launched new mobile banking apps across the iPad, the Blackberry, and the Android platforms. UK corporate has launched a number of initiatives to support our customers, including committed overdrafts, specialist bankers for struggling companies and targeted industry funds. The business produced, I'd say, a decent result in a more difficult environment in the third quarter. Non-interest income was resilient in the quarter, and impairments were broadly stable, producing a third quarter ROE in line with its cost of equity.

Wealth continues to implement its revised strategy. In the third quarter of 11, it completed the re-focus on target markets, further developed the product suite, continued investment in a market leading IT platform, and completed refreshing of the brand. This quarter's highlights include a strong increase in non-interest income, good cost control, and good lending activity. GTS's new management oversaw a 19% operating profit increase versus Q2, delivering an ROE of 31%, which is up 400 basis point on the prior quarter. The improvement was driven by strong income growth, good cost control, and declining impairments despite the top-up of an existing single [name] impairment. Despite the early signs of improvement in the Irish economy, Ulster Bank continues to struggle under the weight of high impairments. Nonetheless, on the operating front, Ulster's making progress. They are simplifying their business structure, aggressively focussing on costs and bolstering deposit taking programmes. Both revenues and expenses improved versus the prior quarter.

Citizen's continue its strategy of re-energising the franchise, through new branding, product development and competitive pricing. However, the low rate environment and flat yield curve is a revenue headwind. PBIL was up 3% on the previous quarter given higher revenues. ROE remains stable at about 6-7%. Insurance delivered a solid performance in the quarter, with a return on regulatory capital of 12%. The business continues its significant programme of investment to improve its financial and operating performance as highlighted at the recent investor day. Programs to improve the cost base and optimise the capital structure continue; overall we remain on track.

Turning to GBM, they saw a 29% sequential fall in revenues in the third quarter, which reflects the current difficult market environment and our reduced risk appetite. While this decline is disappointing, our performance is pretty much in the pack of our peer group. Our currency business was one of our stronger performers, delivering stable income on a second quarter. The mortgage business performance was pretty good; while the credit business performance was more disappointing, reflecting widening credit spreads. We've adjusted performance related pay accruals during the quarter. Our year to date compensation ratio is 40%,which is on the light side of our peer group. Given the environment, management will remain focussed on shrinking the cost base and the use of unsecured funding over the next few months.

Turning to non-core, the third quarter saw continued good progress in TPA and risk weighted asset reduction. TPAs fell by eight billion in the quarter, including four billion of run-off and three billion of disposals, while RWAs fell in line with TPAs. We believe we are well on track to achieve our full year 2011 target of 96 billion of TPAs. Non-core's P&L losses increased marginally in the third quarter, as the second quarter significant valuation gains were not repeated. This decline in revenues was largely offset by the fall in Irish impairments.

Let's turn quickly next to the balance sheet. The excellent progress we've made on funding liquidity in our capital base reflects our laser-light focus on improving the safety and soundness of the bank. Our loan to deposit ratio is now 112%, with core at 95%. Customer deposits now represent 59% of our funding structure. These metrics put us in good standing relative to peers. On term debt issuance, year to date we've completed our full year term funding target of 23 billion. Looking into 2012, we will aim to issue around 20 billion, primarily in the secured and private markets. We will remain opportunistic in our approach to our funding needs, based on the prevailing market conditions. We built our liquidity portfolio to 170 billion in the quarter; this is around 30 billion in excess of our short term wholesale funding. Now while this is costly, we believe it is appropriate to be cautious, given Eurozone market stresses. The group capital position remained robust in the quarter, increasing 20 basis points to 11.3%. This reflects the continued steady de-leveraging taking place in non-core. Looking to the end of this year and the advent of CRD3, we expect the impact to be about 20 billion, versus the previous guidance of 25-30 billion, due to successful risk reduction and mitigation.

So to sum up in an environment that we expect to remain challenged for the near term, we will continue to focus on maintaining a strong balance sheet, with robust capital funding and liquidity metrics. We will also push even harder on our cost base. We believe this will give us a solid foundation to further the recovery of RBS. With that I'd like to hand it back to Stephen.

Stephen Hester - *RBS*

Bruce, thank you very much. Let's go straight into any questions you may have.

Questions and Answers

Operator

Thank you, Stephen. Ladies and gentlemen, if you would like to ask a question, please press the star key followed by the digit one on you telephone keypad. We'll pause for a moment to give everyone an opportunity to signal for questions.

We will take our first question from Chris Manners from Morgan Stanley; please go ahead.

Chris Manners – *Morgan Stanley*

Hi there, good morning everyone.

Stephen Hester - *RBS*

Morning Chris.

Chris Manners – *Morgan Stanley*

I just had a couple of questions for you. The first one was on the net interest margin and what you think the outlook is there? Obviously, you built the liquidity buffer and that cost a little bit; you know, is, are you going to wind that liquidity buffer down a little bit so that we can get maybe a stable net interest margin, or do you think that's going to continue to fall as your hedges roll off? And the second one was just on the cost base in GBM. I mean, it didn't look like there was a significant reduction in the cost base in the quarter, versus the revenues down 29%. I mean, if we're trying to think of a costing come ratio where, you know, maybe a couple of years out how should we try and think about the shape of that – what you're aiming for? Thanks.

Bruce van Saun - *RBS*

Do you want me to take the first one and you take the second one, or...? Its fine I can take both, if you want.

Well, first off, on the NIM, I think that the outlook at this point would be stabilising in the mid-180s, although we'll have to see whether market stresses resume. I would like to use some of that build in the liquidity buffer to pay for some of the redeeming debt that we have coming up in the next two quarters so, again, we target 150 in the liq buffer, some of that build is an anticipation of some of these maturities but, again, I think it makes sense in this environment to air on the side of caution. We will continue to see some rolling off impact from the hedges on the current accounts. To the extent we can, we're looking to continue to price the front book and re-price the back book a bit to offset that. So, at this point, I'm comfortable with, at least through the fourth quarter, tracking to, kind of, roughly where we are now.

Stephen Hester - *RBS*

On the cost side on GBM, I mean, we, the, I think it is the case, obviously, that when you get down to these levels of revenues, shifting expenses down becomes more of a structural issue than a bonus issue; we didn't accrue additional bonuses in the quarter but, obviously, we've got a true up at the year end whether we need to take some away from our prior quarter accruals. In terms of the, in terms of the long term cost income ratio, I'm afraid we don't have a piece of guidance to give you. You know, I think it remains our clear perspective that businesses that we run need to cover their cost of capital and, if they don't, we need to keep restructuring them. But, you know, there's so much going on in terms of the dynamics, both the regulation and the funding and the revenue lines, that I think it's hard to be more prescriptive than that at the moment.

Chris Manners – *Morgan Stanley*

Okay, thanks. But, so, basically you're thinking about some, sort of, restructuring unless we do get revenue rebounds?

Stephen Hester - *RBS*

No, it's clear that we will be reducing the size of GBM, both in terms of it's consumption of capital, it's consumption of unsecured wholesale funding, and of costs. But I don't have a, sort of, new dimension to give you today.

Chris Manners – *Morgan Stanley*

Okay, thanks very much guys.

Operator

We will take our next question from Andrew Coombs from Citi Group; please go ahead.

Andrew Coombs – *Citi Group*

Good morning. If I could just dig into three points on the revenues actually; one with regards to the margins in Ulster and also in the US; secondly, GBM; and then also about non-core? So, firstly, on the margins; I mean Ulster you've seen a notable uptick from loan re-pricing, whereas traditionally we'd obviously seen some higher funding costs come through there. Just interested to hear your thoughts on how much further you're going to have to go? In the US, in contrast, we've seen the opposite trends, whereas we had some very positive momentum you've been talking moving closer to peers, so it seems to have stabilised; so interested to hear your thoughts there?

On GBM, interesting on the rates business, particularly you've mentioned a 200 million hit there from counterparty exposure risk management; so perhaps you could just provide a bit more colour on exactly what that is? Likewise, with the credit business; a bit more colour on how much of that drop is due to the mortgage activities, and how much due to the main credit flow business?

And then, finally, on the non-core, you point to accelerating the disposals ahead of the Basel 3 coming in, and your previous guidance has been 250 million of losses per quarter; so, is that in line with your previous guidance, or are you now pointing towards that being slightly higher potentially going forward?

Thank you.

Bruce van Saun – *RBS*

Okay, I got that as a four-parter. I'll try and tick them off part by part. First off on the margin in Ulster, I think there was a blip in the second quarter which actually compressed it, and so we're, I think, back at levels that are more reflective of where we'd expect to be going forward. We have worked very hard to try and price on the loans side and be very disciplined on the deposits side, so we're making a bit of headway there. Probably on driving pre-provision profit improvement going forward, the main action will be on the expense base so we continue to look hard there on how to rationalise the footprint and the expense base. On the US, I'd say there were a few one-offs in the numbers this quarter. We had higher MSR impairment, we had some OTTI impairments on a little slice of our investment portfolio and, you know, that really caused the dip and it halted the forward progress of the business. If you exclude that, I think we're still making good progress in terms of, you know, cross-selling, getting bigger share of wallet from the clients, the NIM is pretty stable, and we're seeing a bit of loan growth on the commercial side which is what we've been hoping for, and the cost discipline remains pretty good. So, again, I think we're stabilised and certainly looking forward to an improving trend as we go into 2012 there.

On the GBM business, there's a few things under the covers there. I'd say that the business that was the most challenged in the quarter was the credit business, with spreads widening; I think that was the Achilles heel for most of the investment banks. Within the counterparty hit that was referenced in the write up, clearly, given where spreads went, you're trying to hedge some of that and so there's a cost to that. I should point out, at the same point, our own derivatives spreads went out and so we had roughly an offsetting credit in the quarter as well. So, if you look at the dip, a good element was that, in the credit business rates was a bit off, mortgages, I thought for the size of book we have, held in pretty well.

The last question you had was on non-core and I think there, as you saw in the fourth quarter of last year, we tried to get a jump on the next year and build our pipeline so we're very active right now, notwithstanding market conditions. Its been reported that we have the aircraft leasing business in the market and so there's things that we're doing so that we get a good start in 2012, that could lead us to have higher disposal losses in Q4, if we get that all in hand. But I think, again, that's largely timing in terms of, you know, pulling forward transactions so we have a good read on what to expect in 2012.

Andrew Coombs – *Citi Group*

That's very helpful, thank you.

Operator

We will take our next question from Ian Gordon from Evolution; please go ahead.

Ian Gordon – *Evolution*

Yes, good morning. I just wanted to follow up on one point – its GBM costs. Clearly your comments, in terms of the direction of travel, are very clear and obviously you're ahead of your peers, in terms of taking remedial action. Just to try and scale the actions you've already got in frame, are you able to give me a rough number for the number of employees formally placed at risk already, and subject to consultation ahead of potential redundancy?

Stephen Hester – *RBS*

To be honest, I don't, I won't because I'm not entirely sure whether I'm allowed to or not. But the already is not far away from what you would have read in the newspapers.

Ian Gordon – *Evolution*

Okay, that's good enough. Thank you.

Operator

We will take our next question from Rohith Chandra Rajan from Barclays Capital; please go ahead.

Rohith Chandra Rajan – *Barclays Capital*

Hi, thanks, just a couple of, hopefully, fairly quick ones actually. Just one on the GBM revenues and apologies, Bruce, you've sort of touched on this to a degree already. Just in terms of the portfolio management performance in the quarter. You know, I guess surprisingly positive and I think the commentary talks about derivatives market gains and I'm just wondering if you could quantify that? And then, secondly, on Ulster in core, the main area of NPL deterioration, you know, in a relatively robust performance seems to be the CRE investment books, so I'm just wondering if you have any comments around that where the NPL ratio's increased to 27% in the quarter, but the coverage has fallen; so I don't know to what degree that's a result of anticipatory provisionally you took in the second quarter? Thanks very much.

Bruce van Saun – *RBS*

Okay, so the first question was on the GBM revenues and there I indicated, in the prior question, that there's roughly an offsetting impact on the derivatives side that is reflected in that portfolio line, so call that around a 250 credit, and then the counterparty exposure debit in GBM was around 210. So the net of that is fairly much awash in terms of is that a true reflection of GBM's performance in the quarter. On Ulster bank, I think the... could you just repeat that again for me?

Rohith Chandra Rajan – *Barclays Capital*

Yes, I was just looking at the investment commercial real estate portfolio within the core business, which seems to have been the main driver of new NPLs in the quarter, about point four billion up, I think, just, but coverage has fallen. So I was just trying to understand, one, new expectation in terms of MPL trends going forward and, two, whether cover's fallen because you built the reserve against that book earlier in the year?

Bruce van Saun – *RBS*

Yes, well, really the move is two big cases that move from watch-lists to NPLs. We largely had that provided for already, so I don't think there's a big underlying trend there. I guess, overall, we are, I think, in a mode where we'll have elevated impairments in each of those books in core until we see the improvement in the economy, kind of, move through employment and then, ultimately, stabilising asset values. So, you know, we called out that we thought the second half overall impairments in Ulster would be lower led by non-core, and their commercial real estate book is largely already non-performing and provided for. But in core, for the time being, I think we have to look at an elevated scenario.

Rohith Chandra Rajan – *Barclays Capital*

Okay, thanks.

Operator

We will take our next question from Tom Rayner from Exane BNP Paribas; please go ahead.

Tom Rayner – *Exane BNP Paribas*

Yes, good morning everyone, Tom Rayner here. I notice the return on equity targets being pushed back rather than reduced and I just wondered if you could comment on whether you think there will be any further restructuring required to, sort of, hit 15% beyond what you've described already in GBM and, obviously, the non-core run-off? I notice that revenue trends in the core business, when you strip out GBM, are pretty flat, so I just wondered if you could comment on what else might need to be done and what impact that might have? Thank you.

Stephen Hester - *RBS*

Well, I guess my language was maybe too subtle. What we've, effectively, we have re-set the target to cost of equity, or in excess of cost of equity. Now, obviously, there are some of our businesses that will do a fair amount in excess of cost of equity but, effectively, we're trying to reduce the 15%, as well as to push it out in time, and I think that the pushing out in time is to do with the economic outlook, and the reduction is to do with the ICB. And so those would be the ways that I would think about it. In terms of our own actions, we expect to have completed the actions that were envisaged in our plan by 2013 - by the end of 2013 - in order to have businesses that are capable of those kind of returns but, whether they are then making those kind of returns we doubt, because we expect that in a slower growth economic environment it's going to be hard for us to grow income in the way we'd expect it. So, ultimately, we think the businesses will get there but, in the near term, they won't have the income growth that we had thought, there'll be some offset on the cost line as we've said, but not enough.

Tom Rayner – *Exane BNP Paribas*

Sure. I don't think it was your language, Stephen, I think it was me not reading your release properly, so apologies for that - I think that is pretty clear. The second thing I was just going to ask about was on APS and whether or not market conditions, as they are, is likely to have any impact on your views on when you might wish to exit the asset protection scheme?

Stephen Hester - *RBS*

It hasn't, it certainly hasn't had at the moment. You know, at the moment, all our stress tests show that we don't draw on the insurance, even in the stressed environment, and, therefore, it's not clear to us why we'd want to pay 500 million a year past the point when we need to for something we won't draw on. So that's, you know, you never know what's going to happen, but that's our working assumption, that's where the logic sits to us.

Tom Rayner – *Exane BNP Paribas*

Perfect. Thank you very much.

Operator

We will take our next question from Edward Firth from Macquarie; please go ahead.

Edward Firth – *Mcquarie*

I just have a quick question on the non-core; I think in the past you've guided us to somewhere round a 10% cost of realisation, if you like, in terms of the capital released against ongoing P&L costs, but if I look over the last four or five quarters, you've probably only done that once. I mean, are we now, in this, sort of, new world, having to, say, suggest that actually it is going to be absorbed capital running off this book? Is that the, sort of, new picture that we should look at going forward, or is there something, sort of, reasonably temporary in the last couple of quarters?

Stephen Hester - *RBS*

No, you're right. I mean we do think the costs will go up, not, I mean, obviously the external world's more difficult, but we're also into the more difficult assets. So, and the other thing to say is that these are broad blends, so there are a whole series of things that don't appear as assets, but that use RWAs and so we,so, for example, one of the big successes that we haven't really talked about in non-core this year was getting rid of our entire correlation book, which has made tens of, actually hundreds of billions of derivative exposure which didn't show up as TPAs - that cost money, it saved RWAs and, in particular, will save RWAs under Basel 3. And so, in a sense, when we give a blend, it's not just asset by asset, it also reflects some of these other positions we've got to get out of that are not on the assets side, but do have risk.

Bruce van Saun – *RBS*

I guess I would also chime in, though, we have capitalised the business in our management accounting with a 12% capitalisation rate and so, if you look at the expected losses from here relative to that amount of capitalisation, and then the increase potentially springing with CRD4 on the assets that we hold non-core, it still should be capital accretive to wind down non-core, I mean that's our operating assumption still.

Edward Firth – *Mcquarie*

So it would be capital accretive against the 12% target?

Bruce van Saun – *RBS*

Yes.

Edward Firth – *Mcquarie*

Okay, great. And so just one other very small point of clarification, in respect of GBM and the portfolio management for income. I guess one of your peers attracted quite a lot of attention earlier this week with, I guess, helping themselves to some hedge gains; is this broadly the same, as you understand it, I mean is this broadly what you've done within GBM?

Bruce van Saun – *RBS*

Not at all. I think the peer and, you know better than I because I didn't listen to the call, but that is effectively tied to hedging their capital, or in their equity position; they had a bunch of gilt, they sold them, they took a realised gain and they allocated that back to the divisions as net interest income. But we didn't do any of that, we don't... if we sell any of our securities portfolio that would stay in other income in the group centre and not be allocated to the businesses. So this is really within trading, you have, you know, positions both that are exposed to counterparties and then your own credit and, when spreads widen, you make money on, you know, on the own side when spread widen, and you lose money, when spreads widen, on your counterparties. And so I think that's generally all just reported in trading results within investment banking results.

Stephen Hester - *RBS*

It's the same concept as fair value of own debt applied to derivatives. And in our case we have, if you like, people who owe us money on derivatives where, when the spreads widen we have to put up provisions, and people we owe money to, when our spreads widen, we have a credit the other way round. The fact that we happen to have booked it two different places, but it's the same concept as fair value of own debt except, in derivatives it goes both ways which is why, as Bruce has said, the two items roughly offset each other.

Edward Firth – *Mcquarie*

Okay, thanks very much.

Operator

We will take our next question from Mike Trippitt from Oriel Securities; please go ahead.

Mike Trippitt – *Oriel Securities*

Morning, two quick questions, actually. Just back to the comments on liquidity; I understand, Bruce, what you said, you've, you know, built up the buffer partly in anticipation of some debt maturities but, sort of, putting that aside, given the current market conditions, would you want the liquidity buffer to go any higher, or have you built it any higher, going into the fourth quarter? And just, sort of, flipping over to the other side of the balance sheet, I appreciate this is a very tough market for term issuance but would you be in a position to start to pre-fund next year, at this stage, do you think?

Bruce van Saun – *RBS*

Well, look, I think what we did in the quarter was actually two things. One was increased the size of liquidity portfolio but, at the same time, we decreased the amount of short term wholesale funding. And the way we did that was through non-core run-down and we had GBM shrink their balance sheet. So that provided the cash, the cash is sitting in the central bank, so that spread widened. I think that's, obviously, clearly a good thing in this environment so, even if we used some of that cash to meet maturing debt in the next couple of quarters, we still are focussed on driving down that unsecured wholesale funding number to the extent we can. So, in Stephen's comments about the investment bank, we're looking to shrink the balance sheet where we can and that, again, makes us more robust and improves that liquidity and funding metric. Sorry, what was the second part...?

Mike Trippitt – *Oriel Securities*

Just term issuance ahead of next year?

Bruce van Saun – *RBS*

Yes, look, we'll be opportunistic. I think the markets, kind of, move in fits and starts; they open for a little while and then they close, and so that's how we've been accessing the market all along, so rest assured we have, you know, collateralised offerings set to go - when the markets open we'll be out trying to do that. So...

Stephen Hester - *RBS*

I think if I could just make the broader point, which I suspect that you know anyway, but I think we are in a pretty good spot. Obviously the continuing run down of non-core reduces our funding needs; anything extra we do in the investment bank will reduce our funding needs, although not per se for that reason. And we have got past the hump of paying back all of the government's support and SLS and CGS and all those sorts of things, which is either all paid back or already in the short term funding figures. And so that gives us the ability to go the whole of next year with no unsecured term funding if we want to, just with an amount of secured funding if markets stay difficult. And so, in that sense, you know, we work very hard and obviously at some P&L cost to be able to ride out, you know, continued difficulties in the Eurozone if that's what happens.

Mike Trippitt – *Oriel Securities*

Okay. Can I have a very quick follow up, I apologise if it is in the disclosure; what do you think your cost of equity is at the moment?

Stephen Hester - *RBS*

Well, I don't get too hung up on it, to tell you the truth, because, you know, it all depends over what period you want to take market vols and betas and so on and so forth; I'm inclined to use 12%, for want of a better number but, you know, I'm not going to die in a ditch over [it].

Mike Trippitt – *Oriel Securities*

Thank you.

Operator

We will take our next question from Jon Kirk from Redburn; please go ahead.

Jon Kirk – *Redburn*

Morning, everybody. Just a quick question on the RBS insurance business. Am I being too optimistic by suggesting that the business has turned a corner now, because you've had, I think, a tick up in gross written premium and the operating profit is, I guess, slightly down on the second quarter but I understand that the second quarter is generally seasonally quite a strong quarter; so we're now running at about 500 million annualised PBT in that business. Is that a reasonable aspiration going forwards, is the first question? And then, just secondly, going back to the non-core business, I know this is difficult but, if there's any guidance you can give us on the outlook for income in that business, given how volatile it has been, it will be very helpful? Thank you.

Bruce van Saun – *RBS*

On the first question on insurance; we're very heartened to see that the new management team is executing the turnaround strategy well and I think we've had three good quarters so far, year to date, and we're building momentum, I think, for more. That's obviously necessary if we're going to have the [shape] to, hopefully, take public assuming the markets are back open in the second half of next year. So I would say, yes, we're heartened; we think we've got a handle on the issues in the business that needed to be fixed. There's clearly some headwinds, in terms of the low rates on investment income, that we'll have to work hard to offset. But I do think the run rate, certainly, we'll print over 400 this year on our way, hopefully, to 500 next year, and that should, I think, create a valuable business that the market will be receptive to.

On non-core, again, what was... could you just repeat that?

Jon Kirk – *Redburn*

Just looking for a bit of guidance on the income line really?

Bruce van Saun – *RBS*

Yes, the income has bounced around a bit. In the second quarter there was really an anomaly there, because we had some recoveries and we held equities. So, sometimes, when we do workouts we end up taking back stock and then we sell the stock and instead of that showing as a recovery and running through the impairments line, that ran through income and really boosted income to levels that we called out at the time and said, look, the impairment number's higher because of Ireland, but the income is at an unsustainable level; if you collapse that, that's probably the way to think of that. So, you know, I think most of the year we've been trying to get PIBL to be at least flat to slightly positive, and then the impairment loss and disposal, any below the line disposal losses, would be the net cost to us of the business and I think that's probably still the right framework to think about the business.

Jon Kirk – *Redburn*

Okay. Thanks. And sorry, just to go back to the insurance business again, could you just give us a couple of minutes on the underlying premium rates and claims cycle there?

Bruce van Saun – *RBS*

Well, I think we're still in a hardening cycle in terms of the premiums, although that's come off quite a bit, so the major increased that you saw the last two years is ebbing, but I don't think we've gone and flipped to softening, at this point.

Jon Kirk – *Redburn*

And claims?

Bruce van Saun – *RBS*

Claims are behaving themselves, so we have put a whole new claims process in place, we're working off a new system, new procedures, our underwriting has been tightened dramatically and claims are coming in right around where we would expect them to be, so we're quite pleased. I think that's a key driver to the improved performance in the business.

Jon Kirk – *Redburn*

Right. Thank you very much.

Operator

We will take our next question from Jason Napier from Deutsche Bank; please go ahead.

Jason Napier – *Deutsche Bank*

Good morning and, again, thank you for really excellent disclosure. I just have two brief questions. The first was, net interest margin in UK retail has shifted down ten basis points in the quarter; that, by historic standards, is a fairly big number. I wonder whether within the context of saying you expect group NIM to be about 185, sort of, flat from here; is this volatility coming from the hedge, do, you know, the allocation of liquidity buffer costs, or is it underlying business? And then the second question, Stephen mentioned that you didn't accrue bonuses in the GBM in the third quarter, I think; I just wanted to confirm whether that meant that this was, whether there was some, kind of, a write-back or whether we should view the costs in the third quarter as being the fixed cost base of the division as it stands at present? Thank you.

Bruce van Saun – *RBS*

Why don't I take the first one, then. On UK retail, the NIM performance is a combination of things actually. So the low rate environment and the hedges rolling off the other five year tractor is going to have an impact – it's modest, but it chips away. That's one thing. We've been ambitious, in terms of our deposit growth targets, and to attract the incremental deposit in a competitive market can be costly, so that's probably been another thing. And then I'd say the third thing is just a bit of a, subtle, mix shift and so most of the new business that we're getting is in mortgages and secured areas and less on the personal unsecured, as we hone our risk appetite. So, I think, those are really what's driving the retail NIM down a bit. I don't think it's alarming, I think it's still at a pretty high level and, you know, if it continues to drift a bit lower, I'd think that's certainly reasonable, given the environment. We'll certainly be looking to improve the asset pricing where we can on the front book. And, on the back book, where we have opportunities, to try and arrest that to the greatest extent possible. Did you want to take the GBM...?

Stephen Hester - *RBS*

Yes, on your costs on GBM; I guess in a very sort of narrow sense, yes, it's, that would be, if you like, the minimum fixed cost of the division. Clearly the things that change from that are, one, when we reduce heads, which we expect to reduce the cost along with the ancillary costs that people have. And, secondly, an element of the compensation is a prior year bonuses that have spread through deferrals into future years so, obviously, if the average bonus pool goes up or goes down, there's a leading or lagging effect in terms of the spreading of those deferrals. And so if bonuses go down, then so, the so-called fixed cost will come down on a lag basis as our prior year bonus deferrals work out of the system. But, you know, there'll be all of those things happening next year.

Jason Napier – *Deutsche Bank*

Thank you. And just to come back on the first, if I might, Bruce; the sequential revenues reported, sort of, you know, for personal advances, for mortgages, and cards are all down between one and six percent on books that are at least an aggregate flat. Does that, sort of, give us a sense as to what the hedge means in the background? I mean, should those be up? You were, sort of, saying mix might be the contributor, but I wouldn't have expected advances NIM to be down...

Bruce van Saun – *RBS*

Yes, I think it's mostly the hedge and it's a bit of competitive factor, but you could, Richard could give you more details on that later.

Jason Napier – *Deutsche Bank*

Terrific, thank you.

Operator

We will take our next question from Robert Law from Nomura; please go ahead.

Robert Law – *Nomura*

Morning everybody. I'd like to explore two areas, if I may, please, on non-core and then the margin. Firstly, in non-core, Bruce, can I just ask you to clarify the helpful answer you gave earlier about the budgeted maximum loss, given the capitalisation in non-core. If I use Basel 3 RWAs in non-core of about 165 billion, capitalising that implies under, or up to 20 billion of pre or post tax remaining exit cost out of non-core; is that roughly the kind of ceiling that you're indicating?

Bruce van Saun – *RBS*

No, I think we've been fairly clear on the guidance of impairments going forward and, where we haven't filled in all the blanks, is on disposal losses. But we had said, you know, 20-30 billion were the tram lines for disposal losses, and I think we're probably at 17 or so, at this point. The run rate's come down, particularly now that Ireland is pretty impaired, so what it hinges on really is what happens to PBIL, and what happens to disposal costs. If you compare that to capitalisation of 12% of what we have on the balance sheet today of 105 billion, then, yes, there'll be some up-pick from CRD4, which we're trying hard to try and mitigate, I think we can ultimately keep the exit cost, certainly, within that capitalisation. That's all I said.

Robert Law – *Nomura*

Right, so...

Bruce van Saun – *RBS*

I wasn't giving you a forecast as to here's a new guidance as to what it's going to cost to get rid of non-core, I was just simply saying I think...

Stephen Hester - *RBS*

I thought well within.

Bruce van Saun – *RBS*

It will be well within those numbers.

Robert Law – *Nomura*

So, that's fine, I'm just trying to clarify what it's well within? So, what's the number of capitalisation you have against non-core? 12% of 105?

Stephen Hester - *RBS*

Robert, I think we're in danger of going off on a red herring, because I don't think this was where, what Bruce was, sort of, trying to... he wasn't trying to give a piece of guidance, he was, and so I don't think it's a, sort of, helpful build up. As we said, I think the way to think about non-core is, to the extent possible, keeping income PBIL flat; there will be quarters when it doesn't go flat either if we have recoveries, or if we have a particular disposal losses. Impairments we expect to come down, year by year, and then the issue will be in terms of the asset reduction, how much is achieved by run-off – it's been roughly 40-50%; how much by sale, and the bits by sale, how much do we lose when we sell something, and I think it is coming to the point where we may be losing, you know, we may be selling things around 90 cents in the dollar when we sell them – not in every case, but at an average. And so then it's just down the pace of how much we sell in each year and those are the things we have to manage.

Robert Law – *Nomura*

Okay, thank you. And I can use that... that was my next question, is the scale of losses you plan to incur in Q4...?

Stephen Hester - *RBS*

Well, in Q4, as we've signalled, we are trying to do some particular things that will be RWA, rather than asset intensive, in terms of their effect or in terms of their relief, and so we've given you what the asset target is for the end of the quarter – we're not going to give you an RWA because we're still doing stuff – but there'll be some costs of getting the RWAs down faster both...

Bruce van Saun – *RBS*

That's built in the pipeline into next year.

Stephen Hester - *RBS*

And so that's why we think you'll see a jump in fourth quarter, which won't be reflective of the run rate, but will be reflective of particular things we're trying to do for the year end capital ratios.

Robert Law – *Nomura*

And we, how do we think about that?

Bruce van Saun – *RBS*

Well, you know, last year we, if you go back and look at what we did, we built a very significant pipeline and we probably had a jump of say half a billion pounds in magnitude in order to achieve that. And so, again, it's a moving target because you don't know what you're actually going to get done, but again, it's not, it's entirely feasible if we get done what we're trying to get done that we could have something in that postal code. From our standpoint, you know, we're not managing non-core, it doesn't really factor into your view of our earnings, it's more how do we work off that portfolio and how do we do it in a capital friendly way. And so, if the timing accelerates from 2012 into the fourth quarter of 2011, so be it.

Stephen Hester - *RBS*

But it will be clearly capital accretive. Anything we do will release more RWAs than it costs.

Robert Law – *Nomura*

Thank you. Now on the second area I just wanted to explore was further on the margin and you've guided that you think you might stabilise in the 184 level, and I wondered could you please summarise some of the issues on that particularly, what's happening with the re-pricing of wholesale funding, and also some help on what's happening to average interest earning assets, because is the decline in that likely to accelerate from the, kind of, run rates we see here of, I think, 5% year on year, because of the use of the liquidity portfolio?

Bruce van Saun – *RBS*

Well, again, I think we have, the cross-currents are well identified in the terms of the R&C, which has 85% of our net interest income and so there we have the lower rates tractoring through and it will have an impact on the NIM, to some extent, trying to offset that to the extent we can with pricing initiatives, particularly on the assets side. So that's going to be the story on R&C. At the group centre, there's a few moving parts and so the build up in liquidity is costly. If we use that liquidity to pay down maturing term debt, which is the plan, that can be mildly positive as a use of funds. We do have, you know, wider spreads, we suffered that last quarter; how that plays out into the fourth quarter remains to be seen. But, again, that's, those are the, kind of, big dynamics. Non-core and GBM have always been a bit of wild cards; non-core, I think where it is now is probably not going to be any worse, you just have the earning asset reduction taking place and affecting the overall level of NII, but probably not having as big an impact on the NIM. And GBM bounces around a bit but, in terms of it's relative size and impact on the group calculation, it's not that significant.

Robert Law – *Nomura*

Thank you.

Operator

We will take our next question from Manus Costello from Autonomous; please go ahead.

Manus Costello – *Autonomous*

Morning everyone, I have three quick ones please. Firstly, your provisioning, your impairment in the core business was flat or very, very slightly up in this quarter versus Q2. I know there are a few one offs in GTS and in the US, but I wondered if you could give us an indication of whether or not you think the underlying trend in impairment in core is still down in Q4 and into next year, because I think most people are expecting a fall-off in core impairment next year? Secondly, on your sovereign exposures, I saw that you reduced your Italian sovereign exposure quite substantially; I just wondered how you did that? It looked like there was an increase in short positions; I just wondered if that was a cash flow position or if you'd bought CDS protection or exactly how you managed down that Italian position so aggressively. And, lastly, briefly, could you give us a comment on your intention with regards to turning on coupons on sub-debt next year please?

Bruce van Saun – *RBS*

Sure. First thing on the impairment trend; I think we've always been, I think, calling for "gently falling impairments" is the word that we put in quotes and so you've seen that, I think, broadly, but the counters to that are really Ireland has not behaved as we had hoped on the core side and, I guess, Manus, it makes it hard to call the overall core with Ireland still, I'd say, a bit of a wild card. If you just put that to the side then for the moment and do a quick round up, I think the UK retail impairment picture is solid and I think if we look at UK corporate we get hit with some lumpiness, but that the problem characters in the migration into workout is still gently down, so I would expect to see things still elevated, but not misbehaving in UK corporate. GTS we've had a one off which is highly unusual for that business which shouldn't repeat next year when you look out to next year, so you'd have a chance for a pretty good sized pickup in GTS. In the US, I think, the trends there are also positive and that would continue into 2012, barring something unforeseen in the economy. So, I think, putting Ireland to the side, you'd say that gentle fall is still an appropriate picture. I should also point out GBM is a bit of wild card; they can have recoveries, as they did this quarter and then they can get hit with the occasional scud missile in any given quarter, so I'd, kind of, keep that one to the side for the moment as well.

Manus Costello – *Autonomous*

Okay.

Bruce van Saun – *RBS*

On the Italian position, it really was hedging up the position and putting on a cash trade, cash short there to effect that reduction. And then what was your last point again?

Manus Costello – *Autonomous*

Just any statement on the coupons?

Bruce van Saun – *RBS*

I think it's early to say. Obviously, in our recovery, we're trying to be a normal bank again and so, as part of that, we need to be paying our coupons and paying a cash dividend and all the things that would certainly evidence that we've made it to the final stages of recovery. I think, at this point, we'll just have to see where we are; if the world looks pear-shaped because of horrible Eurozone outcomes, that may give you one answer; and if the world starts to feel a bit better, that would give you another answer. So I'd probably have more to say on that when we get to the results meeting.

Manus Costello – *Autonomous*

All right. Thanks Bruce.

Operator

We will take our next question from Michael Helsby from Bank of America; please go ahead.

Michael Helsby – *Bank of America*

Yes, morning everybody, I've just got a couple of questions. Firstly, clearly that the revenue outlook is a hell of a lot tougher and you mentioned in your comments about potential costs initiatives; I was wondering if you could give us any type of ball park figure, at this stage, what level of cost savings you think you could draw out? And also, just on costs, if you could quantify the deferral element in the GBM cost line in Q3; that would be very helpful.

And then just on, second question, is I think it's really interesting, across the board and when we look across the sector, that the Eurozone is, you know, isn't just impacting sentiments, it's having a real impact in the P&L from trading, from NIM, and clearly in activity levels; I was just wondering, when you're sat round in your board meetings, do you sort of try and wrap all of that together in terms of quantifying what level of drag that is having on the P&L at the moment? And, if you do, I was wondering if you could share some, sort of, ballpark numbers with us? Thank you.

Bruce van Saun – *RBS*

I guess on the first one, your question on cost initiatives; you probably recall, Michael, that we had an overall program of two and a half billion, that was set roughly three years ago, that we now ratcheted that up a bit to three billion. That program does not fall straight through the bottom line obviously, because we have to make investment in making our core franchises stronger, and we're using some of those savings to fund that, and we have normal inflation and other things that we're offsetting, but I think we made excellent progress on that and we're probably one of the few banks you can look at on the three year trend and have actually shown a decline in absolute expenses. Having said that, I think we have to up the anti, given that the revenue headwinds that we face; we're going through our budget process now, we've given some rough targets out to the businesses and I think we'll be in a position to give you more guidance on that in the annual results meeting. But, rest assured, we're certainly working hard at it and I think there's more that can be done there.

With respect to your second question on GBM, the deferred element in the quarter was about 50 million; year to date, it's about 170 million and so, clearly, carrying that through is one of the reasons that that expense base becomes sticky this year. So, anyway, that's the number. On the Eurozone impacts, you know, Stephen, I don't know if you want to comment more broadly?

Stephen Hester - *RBS*

Well, I think the simple answer is, we don't sit around in our board meeting doing anything other than drinking coffee and chatting; but we don't have a number when we do that. But the way I think I would express it is, the Eurozone obviously hits most directly on the liquidity line and on the investment banking revenue line but, frankly, I think, we were having disappointing growth outcomes in any event across mature economies, before the Eurozone intensified. You are seeing that in the US and the UK and so, if you like, the broader damage to retail and commercial revenue growth, I think, has got quite a lot to do with things that we were happening in other countries in any event. And, you know, it simply remains the case that banks you know mirror the economies that they serve and, if those economies don't grow very much, then it's hardly good income growth.

Michael Helsby – *Bank of America*

Fair enough. Thank you.

Operator

There are no further questions at this time; I would now like to hand the call back to Stephen for any closing comments.

Stephen Hester - *RBS*

Very good. Well, look, thank you very much for participating and listening. I hope we've managed to answer your questions; you know where to find us if you have any more. And as you know, there is exclusive, extensive disclosure in the IMS and also in some summary slides, if any of you haven't caught up with those yet, that are on our website. So we look forward to speaking to you again in February, and thank you very much for attending. Bye bye.

Operator

Ladies and gentlemen that will conclude today's presentation. Thank you for your participation, you may now disconnect.