The Royal Bank of Scotland Group

2010 Annual Results

ANALYSTS PRESENTATION

Held at the offices of the Company

280 Bishopsgate London EC2

on Thursday 24th February 2011

Presenters

- **Sir Philip Hampton (Chairman)**
- **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 Philip Hampton, Chairman of RBS.

Philip Hampton – *RBS - Chairman*

Good morning, ladies and gentlemen, and welcome to RBS's Annual Results for 2010. The figures are, of course, a big improvement on last year, and a dramatic improvement on two years ago, quite easy to achieve, really, since two years ago. Essentially our Core businesses are all making profits that are reasonable to good, in my view, and our Non-Core division has been getting on really effectively with the job of reducing the risks and improving the structure of the balance sheet.

It's fair to say that we had a pretty fair wind, I think, compared with what we expected a year ago, both affecting the Core businesses, and the Non-Core businesses, but we've also had great efforts from everybody in the business, led, of course, by Stephen and Bruce – you'll hear from them in a moment, but Stephen's top team, and I think one of two new entrants, are also in the front row, taking a little bit of time off from the frontline that they normally inhabit.

One further comment very briefly from me: I was talking to the investor relations team just yesterday, saying the thing that's missing from normal introductory remarks from a chairman is a point about the dividend. Our dividend, of course, remains a very large round number, but I do think that if we continue to make the progress that we are currently making, then it will start to be at least a glimmer on the horizon. I long for that day, and that will mean that we are clearly and definitively back where we should be in capital markets. So I'll hand over to Stephen.

Stephen Hester – *RBS - CEO*

Thank you, Philip. You can see up there, and I can't see down here. What's going on? My eyesight doesn't work quite that far. This doesn't work anyway. I'll wing it. Never mind. Forgive me if I have to keep going round like that, going to take my hard copy slides. Thank you.

Well, as Philip mentioned, the essence of what we are saying today, and clearly Bruce will go through the figures in more detail, as I know most of you want, is that the RBS strategy is on track. We are, if anything, ahead of where we thought we'd be at this stage of our plan. We beat all our budgets over the last year. Maybe that's because they weren't set right, but we did, and we think within that, of course, a headline moving from £6 billion operating loss to nearly £2 billion operating profit, an attributable loss still, though not in the fourth quarter, but thanks only to the payment or provision of payment on the Asset Protection Scheme.

And, as Philip mentioned, within that, we really have two things going on at the macro level at the bank: the burnishing and improvement of the business that will drive us in the future, our Core businesses. We think the customer franchises are strong. I'll talk about these. And there is, of course, a real improvement in the balance as Retail and Commercial comes back, and across the Group our cost investment programmes are aiding that, and then the other thing, reducing risk, terrific progress, both for the bank's balance sheet and liquidity as a whole, and in the specific, if you like, risk concentration that we've earmarked and set aside in Non-Core.

And, again, in financial terms, although Bruce will be covering this in much more detail, you'll see the metrics of the Core business. As Philip said, actually compare business by business, reasonably well already with our competitors, but clearly not where we believe they can be and where we want them to be, so £7.4 billion operating profit, a return on equity, albeit it's attributed equity within our total mix, just over our cost of capital, but with a much better balance between the Retail and Commercial businesses, which are now recovering as the economy improves and as we do things to them, and GBM, which still has a pretty decent ROE. I'll come back to that.

And interest margin, you know, unlike many banks, we've been able to get our cost down even in Core in addition to the Non-Core reductions, and we've reached our own self-described gold standard of taking in a pound of people's deposits for every pound of loan we're making in the Core business, and we're fast approaching that for the Group overall, and, as I said, at the overall level, risk reduction going well in Non-Core, and in our capital strength.

Now, I put this strategy slide up, not because it's new, it isn't new, it's exactly what you've seen on each occasion that I've stood up, but because I think it's important that we do anchor our discussions on this transformation journey for RBS all the time, in the fact that we know how we're trying to play our cards. We believe that if we accomplish our goals, that it will represent something that is both achievable and attractive, has the ingredients of what makes companies, and in our case, banks, attractive, and we're sticking to it, and we believe it is achievable.

All of that said, across the different dimensions: management, disciplines, balance, return, risk, the type of customer focussed business we have, all of that said, we will continue to be pragmatists. We're obviously not blind. There are threats out there in the world. There are occasions when we have to reassess strategy on a micro level and perhaps on a macro level in the light of whether there'll be regulatory changes or others, but for the time being, this represents the way we think we can play our cards best, and what we think would be a good result for our customers, and our shareholders.

When we look at the targets that we set out at the beginning of our five-year, if you like, initial phase journey, we think that we have made more than two years' worth of progress towards these targets. And you can see in the top of the page that there is a mixture, and it's very important, if you like, to the way that we're managing RBS that we're looking at inputs, as well as outputs. We're looking at the balance between measures, and not just simply growth, not just simply profits, but the way we accomplish it, and you can see across, I think, all the balance sheet measures, a terrific progress in the return measures on the right track, and when you move into the individual divisions, the same is true.

We have deliberately not changed our 2013 targets at this juncture, with one exception I'll come back to. That's in part because we don't want to, if you like, duck and weave, and by slight of hand, adjust things. We want to be able to be judged, and for you to judge us from what we said in the beginning, in part because we think that they're also still achievable and appropriate, and in part because there are, we think, in particular in 2011, hopefully is the finalising of some of the key external influences, not just the part of the economy, but in terms of regulation, and hopefully in terms of outcome of the ICB that will influence some of these targets, and, therefore, if we have to revisit them in the light of those things, we'll do that in a year's time, after the three-year marker bar plan, but for the time being we think that they're achievable.

So let's, then, in terms of my slides, divide the remainder of what I'm going to say into these two components: what is happening in our Core business, and then what is happening in risk reduction. And, as we have said, we think that the Core results were solid. I suppose that's code for slightly down, but solid, and increasingly well balanced, and we think that they compare well for this stage of our journey, business by business, against those we compete.

Of course the key feature is a strong increase in Retail and Commercial profitability despite heavy losses still in Ireland. GBM down to the levels that we thought were normal, and, indeed, that we were budgeting for the year in terms of markets being weaker, and we've talked about the good cost re-engineering loans and deposit ratio that we've accomplished.

Across pretty much every one of our businesses, the new management teams we've put in place in 2009 have now had a year or year plus under their belts, so I think we're increasingly seeing traction from the initiatives that have been put in, which, of course, need humans to drive them, and I hope that that will carry through and become more visible as each year goes by.

This other slide, again, is not new, but I think it is important. The Core business of RBS, the business that we're driving forward, we believe is an enduring picture. We're putting in place disciplines that will last for many years, businesses that have the resilience to last and power us for many years, and a business mix that makes sense, as I said, something about which we will be pragmatic and thoughtful, but we believe makes sense.

And, as you can see, there is a real balance here, whether that be two-thirds Retail and Commercial, and one-third investment banking, whether that be two-thirds of our business that has some kind of international flow of influence, spread of business, and one-third in the UK, or actually 40-60, whether that be the sharing of costs, of the synergies that are in our IBC submission we put out from these Group balances, we think that this makes sense. Actually last year and this year showed some of the strength of that balance of different bits of the business carried us more strongly than others, and that's what we're pushing forward unless and until anything happens to make us reconsider that.

The key aspects then of our performance start with customers, and again every one of our Core businesses was selected, and is being managed to be based on big customer driven markets where we have leadership positions, all of which we'd like to do better in nevertheless. Now, of course, almost because of that self-definition, the changes year to year are often going to be small, even though they're going to take an awful lot of effort to create. That was good on the downside in terms of the resilience we showed in difficult times, but I think that we can see that on a range of measures, each one of our businesses is starting to make progress. It's solidifying its positions, starting to improve with some of the customer satisfaction, in particular, measures that the lead indicators of the amount of business we do, and in many cases, most cases, the base of the business, the type of business we're doing is broadening out.

Again, thinking across how our business is doing, and, of course, one of the things that is important to all of you is how credible are the return targets, what kind of value can these businesses produce. We've put here, if you like, the three central targets that we've established for each of our businesses: return on equity, cost income ratio, loan deposit ratio, not only to show you that we're making very good progress across all of these, in fact in loan deposit ratio, we’re more or less where we need to be; in aggregate, we are where we need to be in aggregate, but also to show if we just simply look at the return on equity, there are only two of our divisions that are not already at their cost of capital, and the, and obviously Ulster Bank is very much a story of impairment. In the case of Retail and Commercial, I’ll come back to that, there’s a story both of the economy recovering, and of the things we’re doing ourselves to improve income and the productivity of our costs, but we think that this should give us encouragement that we’re not on the wrong path in believing that there are strong and credible returns, not just that we can get now, but that we can get in the future from our Core businesses.

Let me canter quickly through, and I appreciate, as normal, these slides are a bit busy, but they’re busy, not really so that to confuse you now or so that I’ll talk for a long time to each one, but so that you can take them away for reference. Clearly, the star of the show in business terms for us over the last year was the recovery from low levels of our Retail profitability, but I think that what we’re pleased with is not just that recovery and that profitability, but how we’re doing it. So we’re doing it first with customer focus, and although early days, that’s showing through both in terms of, if you like, customer satisfaction measures where they are in absolute terms, year on year, and relative to our competitors, and in terms of the balance, our weak suits in our Retail franchise from a product standpoint, with deposits and mortgages, our strong suit was obviously current accounts and loans, and our weak suits are improving, but they're improving in a balanced way

And we’re doing all of that through a huge amount of investment which is both cutting cost, which not everyone is accomplishing in the Retail markets, and investing in the things that can improve our customer service and drive our revenues. As a result, that is financially rewarding us, but doing it, I think in the right way.

Our other big UK division, obviously UK Corporate: a similar sort of story, though less marked in the year, that is to say that, we do obviously have a leading market share in this area. Some of that is in the process of being divested. We’re overcoming all those uncertainty and disruption which will continue through this year, and you can see we’re overcoming, and not just in the minds of our customers, where they continue to feel, on balance, that we’re doing a good job, both absolute compared to the past and compared to competitors, but we’re also developing the business with better balance, without the two key vulnerabilities that put us on the wrong track in UK Corporate in the past; that was too much real estate, and an unbalanced funding model.

So we’ve got fantastic performance as we’re really broadening our relationship with clients, getting the deposits up very close to matching the loans we make, and in the market where it’s very difficult to shift the balance, and in a market where our lending commitments from the government, if you like, put some handcuffs on us in terms of shifting the balance, we are managing, nevertheless, to rebalance with our property concentration gradually going down, and our lending to other customers going up. And you can see all that also is improving profitability. We're about at the cost capital for this business. We need to, and believe we can go further.

Our US Retail and Commercial business, again, I think the picture, hopefully, that you're seeing is there's some consistency of approach for what we're doing with each of our businesses, and that's we're starting with the customers and, if you like, shorn back to its 12-state region, which was the key, the refocusing of our Citizens' business. In our 12-state region, we're making progress on customer matrices, both in corporate and in Retail. In active terms we need a rebalancing. We have no issue on funding. In fact, we have more deposits than we have loans, so, our issue is really how do we do more business with our customers. That's an increase towards the Commercial side, but by both growing, and, of course, we were in loss last year. We have an important margin rebuild to do. We've done a lot of that, and we also then have more penetration to drive revenues further with impairments coming down to, if you like, continue the ROE progress upwards.

In the investment bank, clearly, along with many investment banks, although each have their own business mix and fortunes, our results are down year on year from what was always, in our view, an artificial, an unusual high in 2009. I think we've consistently said to you, that we thought, if you like, a normal and neutral market year for our investment bank at this stage of its development with about £8 billion of revenues for the year. We hit £7.9 billion in this year. Whether that's luck or whatever, you can tell me, but that was broadly in line with, as I say our budgets, what we expected.

And I think that, within that, what is very important given the outlook for investment banks, is that the return on equity remains decent, just under 17%. If you add the pieces of our GTS, our cash management business that depends on the investment bank's clients, then it goes higher still, and the cost income ratio, which is, I think is going to be very, very important as we move forward into a world where there are pressures on capital and on income, is amongst the best in its industry, and so this is, at least, I think a solid position, a decent achievement in the markets that we had, and given the pressures, and if you like the tail from the restructuring of RBS that's upon us, and that we're very cognisant that the investment banking part of our industry has a series of increasingly well defined, but still not fully defined headwinds on cost of funding, on regulatory capital, and potentially in income and margins in some of the businesses also affected by regulatory change. And none of us can know for certain, therefore, exactly how this will work through in the coming years. I think that's a feature of all investment banks, one of the reasons why, if you like, the balance two-thirds Retail and Commercial; one-third investment banking we think is advantageous to us.

But, nevertheless, our starting point from the results that we've produced in 2010 we think gives us a solid base and a line of sight on what we know today to understand how we can at least get back to the cost of capital pro forma for the reduction in ROE for the different regulatory things that are coming back, the work to get from our cost of capital to stay above 15% or to go back above 15% ROE, which we believe is important and necessary, still, if you like has work to do for all of us, it's still in the realm of uncertainties for the industry as a whole. But we think that we have a reasonable position to do that, and a solid and defensible set of advantages in doing it.

And, of course, we're not mentioning every single business, but the other two businesses that I bracketed together here, GTS and Wealth, again, I think we're doing much the same things, but it's really worth noting that these businesses, in addition to their own merits and their own rights, they really are additions to the Group base they're sharing, and overhead they're providing deposits to those of our businesses that are less strong in deposits. They're producing high ROEs as part of the mix, although they're each dependent on other aspects of the business, and so I think we like them, not only in their own right, but as, if you like, glue and strengtheners for the overall balance of RBS.

Let me turn to the risk reduction side of the agenda, and the, as I mentioned, the one target that we are, in fact, changing today, is the pace of rundown on Non-Core. And that is to say that having beaten our targets in this last year, instead of aiming to reduce £218 billion in 2011, we believe that we can get below £100 billion, which has some psychology to it, if nothing else, and that's our aim. And the endpoint, of course, remains to get rid of all of it or at least substantially all of it.

Now, in addition to the good progress that we've made in running this down, as you know we've made terrific progress in EU mandated disposals last year, and I think those are critical, although one of them is yet to be closed, and clearly the Insurance sale is pending, A, the turnaround of that business, and B, getting the right sort of value, which we continue to target for a late 2012 commencement of execution.

And, although Bruce will mention this as well, what we're trying to do in the, if you like, the pie charts at the bottom left of this slide, is to show that actually while there is an mix change as we run down Non-Core, every single bit of Non-Core is down in double digit percent, every single portfolio.   The real estate overall percentage is increasing, i.e. it's going down less fast than the others. That was always obvious given the nature of those assets, but it is going down, and we're comfortable with the balance of what we're doing although cognisant that there are plenty of impairment losses, and losses on sale ahead of us as we complete the process in the coming years.

But aside from the risk reduction that is, if you like, exemplified in the specific concentrations of Non-Core, I think one of the things that we feel is a job really well done, more to do, but where we've made the most progress, is funding, liquidity and capital, which is, of course, in the sense of the Group balance sheet, not just Core or Non-Core. And that is to say that we've moved ourselves on these big macro, if you like, ratios which were at the heartof much of the banking crisis, the weakness of banks. We've moved ourselves from outlier to in the strong pack of the world's banks. You can see that in the loan to deposit ratio where, as I mentioned, we're already in Core at our gold standard, and even for the Group as a whole, we would be better than all but HSBC in the UK and many other European and other banks.

When you look at the funding need, our dependence on short term wholesale funding is dramatically down. That was the thing that ultimately brought us down, and is now pretty much in balance with our liquidity resources, and when you look at those on the, if you like, on the other, the balance sheet view of life, we have managed to, I think, get a nice fourth quarter increase in capital ratios, 10.7% Core. Of course some of that is dependent on APS so we're not, if you like, under any illusion that that's capital that we have to grow or replace, but we also have the benefit that our RWAs are not static. A whole bunch of them are in Non-Core, and over the coming years we hope to run them off and sell them off.

The leverage ratio is already better than our targets for 2013, in line with the strong international peer Group, and as I say, when I think when you take all of these things together: capital, leverage, funding profile, we've moved ourselves from being outliers. We are still outliers in risk concentrations, in real estate in risk concentrations, in Non-Core, so there's a reason why we've got plenty of work left to do in terms of risk, but I think that the macro shape of the balance sheet and the key things on which it rests are increasingly in good shape.

As we've mentioned it remains our goal to exit the Asset Protection Scheme in the second half of 2012. It's not economic to do so before then because we're committed to a certain amount of fee paying. Even to do it then will require regulatory approval, but we believe by that stage that the risk transfer that the scheme will be offering us will be negligible and it will be the right thing to do as well as, putting it in shareholder terms, as well as symbolically important.

So, finalising what I had to say and before handing over to Bruce, the RBS planned targets expressed in a slightly different way. What we're aiming to do are not changed and I believe are the characteristics of a strong, malleable, sustainable bank for many years into the future that can reward customers and shareholders, whether that be starting with the customer, the kind of markets we're in, the market positions we occupy in those, the balance of those businesses, the returns that we get from them, the risk profile from those returns, or the management disciplines that go into it. And, clearly, all of that we hope will in turn translate to a bank that investors feel comfortable with in terms of transparency, and the way we behave, and one which is increasingly wholly earned or well on the path to whole ownership from the private sector.

Finally, outlook: it would be uncharacteristic of me not to give you an honest balance here, but I will do it back to front. We do think that RBS will continue to make progress. We do believe in 2011, and in the subsequent years, that we, that our efforts to strengthen Core will keep going, and we'll make progress there and our efforts to reduce risk will also keep going. We'll make progress there and overall that that will be consistent with the path that we've set out.

Now, we're also conscious that by doing that, in addition to producing results, we produce extra resilience and there are times that we're going to need that resilience. There've been times in the last year when things went wrong in our own businesses; that might be worse results in Ireland and Insurance than we were anticipating, it might be the issues that we're in, if you like, trading markets around the Eurozone. There will be issues that arise in 2011. They may be economic issues in part of impairments. They may be issues from the path of interest rates, although generally interest rates going up provided it's not done, if you like, in an extreme way, we think it's positive for banks.

The real estate, the impairment issues, probably Ireland is our biggest wildcard. Bruce will talk some more about that and the real estate area, but they seem set to be in the right direction although there's a possibility clearly for volatility. And then it would be wrong to say that we can't get negative impact from regulation, and it's clear that, being in banking is becoming more costly, both in terms of cost of funding, structure balance sheets and capital. It's not clear exactly where that will end and the impact on return on equity and the other key matrices for banks. We think that it's still consistent with our targets, but there's a possibility for shocks there, and the Independent Banking Commission clearly has, if you look at it terms of reference, a well-balanced set of terms of reference, both on competition, on stability, and on competitiveness of UK financial services on the contribution to the economy of the UK financial services, and on the contribution to the Exchequer, including, of course, the value of RBS shares implicitly in that, but I think it is, clearly at this stage unclear whether the Banking Commission will validate the path of international reform or seek to go further in a way that harms some of those objectives.

I mentioned path to full privatisation. We have absolutely no information that you don't have. Of course the choice of when, whether and how to sell our shares is entirely that of the government through UKFI and our working assumption is before the IBC results are known, and digested any action taken as a consequence, any share sales would be unlikely. But nevertheless it is our job to try and prepare the company such investors who want to own those shares away from the government, we do think it would be a win-win when that process can commence, and we think actually will enhance our attraction to investors to know that, and so we're trying to do our piece as we go through 2011, and get closer to the time when these things can come onto the radar screen. So with that, let me hand over to Bruce. Thank you.

Bruce

Thank you, Stephen, and good morning everyone. I plan to run through the financial highlights for the Group for Core and Non-Core and then I'll also talk about the progress that we've made in improving the risk profile on both the left side and the right side of our balance sheet. I'll then offer a few concluding remarks before turning it back to Philip to conduct the Q&A.

Starting off with the consolidated Group financial highlights, for the full year note that revenues were up 10% paced by net interest income growth and lower Non-Core trading losses. Our expenses were down 4% as we delivered impressive operating leverage. And impairment losses fell by 33% reflecting economic improvement as well as our risk mitigation initiatives. This resulted in an £8 billion improvement in our operating profit. What I'll refer to as below the line items, swung the other way. I'll give you some more on that later. But the attributable loss still narrowed by £2.5 billion. I should point out that if you add back the after tax costs of the APS charge, we were break even for the full year, and note that we were break even in Q4 on a reported basis. Our funded balance sheet has shrunk by about £60 billion, paced by GBM and Non-Core in Q4 and Non-Core for the full year. Core Tier One was a strong 10.7% at year end as we brought risk weighted assets down in Q4. And our TNAV was about flat for the year.

So breaking down the P&L, our net interest income was up 5% relative to 2009. Now, there are two things going on here with offsetting impact which, fortunately, net out to be positive. The first, our NIM was up 14% to 2.01% for the year, and stabilized at 2.05% in the second half. Asset re-pricing in the Retail and Commercial franchises has powered this expansion, offsetting the drags from improving our liquidity and funding position as well as margin compression on deposits. At the same time, earning assets have dropped by 8%, paced by Non-Core de-leveraging, and this is part of the cost of improving our risk profile and making the bank safer.

With respect to non-interest income, Core revenue was down 12% as GBM returned to a more trend line revenue performance compared to the exceptional levels in ‘09. However, Non-Core had a £5 billion swing from a loss in 09 to positive in 2010 as trading performance improved dramatically reflecting both tightening credit spreads as well as our de-risking of the complex trading books. The net impact was an increase in non-interest income for the Group of 15%. Expenses fell by 4% over the course of the year as our £2.5 billion cost program delivered £1 billion in incremental savings in 2010. This was partially offset by expenses related to our significant investment program; £6 billion of change management over five years which is designed to strengthen our Core franchises.

The impairment trend has been favourable in 2010. Non-Core is down 41% versus ‘09 and Core is down 19%. But one business counter to trend has been Ulster Bank where we took £3.9 billion of impairments in 2010 versus £2 billion in 2009. Now, we expect impairments in Ireland to remain high through the first half before likely starting to gently fall. For the Group overall, we see continued good signs in the lower case load moving into our work out Group. And while non-performing loans or REILs have increased over the year, this is largely due to property. Excluding property, REILs are 8% lower than the year ago quarter.

So now turning to the so called below the operating profit line items, we’ve been seeing huge volatility in the fair value of own debt on a quarterly basis but for the full year, the swing was only £300 million as our spreads widened modestly. 2009 saw some chunky items such as the big liability management gain and a gain on pension curtailment and 2010 had the £1.55 billion hit on APS. So these items swung by £6.6 billion year over year, erasing a big portion of that £8 billion improvement in operating profit. Note that for the quarter, these items were less of a drag driven by the gain on our GMS disposal.

So breaking out our Core performance, we were pleased with the progress in our R&C businesses which nearly offset the anticipated fall in GBM revenues given their exceptional year in 2009. Note the good cost control as well as the lower impairment losses which helped the bottom line. In Q4 our pre-impairment profit, or PBIL, was up 3% led by net interest income growth and lower claims. Impairments increased by £150 million, primarily from provision strengthening against the Ulster mortgage book. By division, as Stephen indicated, the big star was UK Retail who performed well across all P&L drivers. This included higher net interest income due to higher NIM and balances, lower costs as well as lower impairments. UK Corporate saw a 30% improvement in operating profit largely due to significant NII growth from asset re-pricing as well as an 18% drop in impairments. Deposits also grew strongly, up 14% year over year. Wealth has fought margin compression over 2010 but it appears to have bottomed out with Q4 showing an 18% rise in sequential operating profit and good deposit growth. GTS was up 12% for the year, reflecting net interest income growth and good expense management. Note we've shown you the impact of the GMS business disposal on GTS's underlying results in appendix two of our results document.

Continuing on, Ulster Bank's loss has more than doubled to £761 million as impairments rose by 79% to £1.2 billion. The economic situation in Ireland remains challenging and we're diligently managing our exposures. As I mentioned, we took a £100 million latent charge against the residential book in Q4 but otherwise results were stable. Note that the Ulster PBIL is up 42% year over year led by an aggressive cost program. The Citizens business had a nice turnaround in 2010 with the bottom line improving by $647 million. We've been able to grow net interest margin and we've been able to control our expenses to achieve a 38% improvement in PBIL. Impairments have also fallen with the improving US economy.

GBM had a resilient year in the face of a challenging external environment with revenues close to our £8 billion per annum target and a 16.6% ROE. We continue to tightly manage risk, the balance sheet and expenses and to execute our highly focused strategy. Q4 performance relative to Q3 was slightly better than peers adjusting for business mix. For the year, GBM's compensation ratio was 34%. Total compensation declined over £200 million relative to last year which reflects the return to more normalized top line results.

Lastly, our Insurance business performed poorly in 2010 with a £300 million loss but we are encouraged by recent trends in underlying performance. The second half was a modest loss but adjusted for prior year issues and unusual weather. We are now run rating at a profit of £270 to £300 million per annum. Our new management team is now fully in place. They have a sound turnaround plan and they're executing well against that. Non-Core losses declined by £9 billion in 2010, significantly benefiting our overall performance. This was a combination of better trading results as well as lower impairments. Both of these benefited from a better external environment as well as our risk mitigation initiatives. Third party assets or TPAs dropped 31% over 2010. It's 37% if you take into account the £12 billon of signed but pending deals at year end. In Q4 we ended up with £600 million of higher losses than Q3, reflecting some real estate write-downs, some changes to accounting assumptions, as well as disposals.

Impairments in Non-Core are down dramatically year on year but it's interesting to see the underlying components. Commercial real estate is the main area where we still see highly elevated impairments. 85% of second half impairments were CRE related. Other areas are actually showing favourable trends, including some recoveries. The Non-Core run down has made excellent progress. We've made strong reductions across each asset class and we are tracking within our target parameters for the program. We are more than halfway towards our ending TPA target of about £30 billion in 2013. The pipeline looks good for 2011. Much of the progress in 2012 and 2013, however, and the associated costs, will depend on the recovery of the broader Commercial real estate market in the UK. The Non-Core run down in 2010, on the top of this slide, was a blend of natural run off and disposals. That said, this clearly was a big year for disposals aided by an improved economic environment as well as low interest rates. Per Q4, on the bottom of the slide, the story was largely disposals. We closed several of our Retail and Commercial country exits. We closed significant aspects of the Sempra JV divestiture and several portfolio sales of largely corporate assets.

Let me now move onto focus on some of the balance sheet improvements that we've made in 2010. On funding and liquidity, what a difference a year makes. We've dramatically brought down our level of wholesale funding, we've turned out a good percentage of that, we've grown our deposits, we've reduced our funding gap and we've improved the quality of our liquidity reserves. We are now ahead of the strategic plan on each of these measures but we're not complacent. The world is still unsettled and we have continued work to do. The keys to much of the improvement to date have been our success in de-leveraging through Non-Core run down and our ability to issue term debt in a variety of shapes and sizes. We expect this will continue to underpin our plans over the rest of the plan period. Our 2011 issuance plan calls for £20 billion of issuance compared with £38 billion in 2010 where we got a little bit ahead of the curve. We expect our issuance to be balanced across both public and private, secured and unsecured and geographical dimensions. We factored replacement of the maturing CGS debt into our plans and would expect to have that fully repaid by mid-2012.

Net RWAs increased modestly over the year by 5% as regulatory factors and less APS benefit slightly offset the benefits of the Non-Core run down. Our Core Tier One ratio remains robust at 10.7%. We feel we are positioned well to absorb looming regulatory changes and still support our businesses. We've updated our estimates on the impacts of CRD3 and CRD4 on our capital ratios based on the calculations and clarifications that came from the Basel Group. Bottom line, this is pretty much in line with where we thought. But while the overall impact is manageable, there's a fair amount of work to do in GBM around mitigation as well as the need to assess product strategies given adjusted capital intensity. APS has been in the news a bit and we just want to make sure we're clear on our position here. One of the issues clearly is the timeline for exit of the APS program. We currently receive a 1.2% benefit in our Core Tier One ratio from the scheme and we get further benefit in various stressed scenarios. But nonetheless, as we de-risk and we recover, we'd clearly like to exit the program. Our baseline planning scenario is to exit once our fees are fully amortized in late 2012. This will, of course, be subject to regulatory approval.

We continue to stay very focused on reducing our risk exposures. Good progress has been made across all major measures, whether it's country, sector or single name loan exposures. We've also trimmed some lower rate of exposures within our government portfolio. And while we've done a lot to improve, changing our portfolio takes time and we have further work to do. Note that there's lots of good data on the risk story in our full results document.

Something else that's been in the news a lot lately is Ireland so it makes sense to do a deep dive on Ireland. Our exposure there clearly merits close inspection. We've tried to be very transparent and granular on this slide in showing our loan exposures and the coverage ratios in both Core and Non-Core. We've suffered our biggest losses to date on the Non-Core CRE development lending book. 75% of that book is now REIL. Given the weak Irish economy, another area we've been watching is our residential mortgage exposure in Core with REILs up modestly versus the 6.5% at the end of Q3. Overall, we feel comfortable with our provision coverage for each of these books. We do anticipate further REIL increases and therefore provisions will remain elevated. But there are some encouraging underlying trends in the economy and we're hopeful that impairments will start to trend down in the second half of the year. We do remain committed to the Irish market which should be attractive in the medium term once the current economic situation is sorted. In spite of major headwinds in 2010, our operating results pre-impairment have continued to be quite favourable with expenses down, PBIL up and deposits stable.

Another laggard in 2010 has been our Insurance business which fortunately seems to be turning around on an underlying basis. Our new management team has focused on improving really all aspects of the business, pricing and underwriting, claims processing and the size of the expense base with a goal towards getting back to a 15 to 20% ROE performance. We are focusing on less risky drivers in the motor business and as a result, we will take some top line contraction but we should benefit from much better performance on claims. Making certain adjustments to second half claims, which we show here on the top right, we're probably in high single digits ROE territory currently. That's better but there's clearly more to go in 2011 and 2012.

So to sum up, we're pleased with the progress we've made so far. Our Core Retail and Commercial businesses are recovering well. They're gaining strength while GBM has remained resilient in spite of numerous external challenges. Our Non-Core and our EU disposals have progressed well, substantially improving our risk position and making us less complex. And our balance sheet looks much better than it did across all key measures, be they liquidity, funding or capital, so good so far but still lots to do. With that, let me turn it back to Philip to conduct the Q&A.

Questions and Answers

Philip Hampton

Thank you very much Bruce. I hope you found they were two very comprehensive presentations so I'm sure there are no questions but if there are, perhaps you could give your name, rank and serial number before you kick off.

Ian Gordon – *Exane BNP Paribas*

Yes, good morning. It's Ian Gordon from Exane BNP Paribas; if I can have two or maybe two and a half questions please? Firstly on the US business, you talked in your remarks about the falling retail balances, falling deposits, high unemployment and the double dip in the US housing market. Again, other than the distant dream of rising US rates, could you just provide a little bit more colour on the actions you're taking to get the business fit for purpose or allegedly fit for sale? Then in GBM, I note your (unclear) guidance of around £8 billion for 2011 revenues and your guidance has been rather good here in recent periods. Just going back to the Q3 call, I thought Bruce made some interesting comments around your product build out in GBM. So should we be thinking here about some offsetting impacts from RWA management or is £8 billion maybe a big round number not worthy of too much detailed analysis? And then finally, just a point of clarification; you've reiterated your intention to exit APS in late 2012. Should we think about a cancellation of the contingent subscription around the same time or could or should that happen earlier? Thanks.

Bruce

On the US business, we certainly will benefit from a cyclical recovery. We have an asset sensitive balance sheet so higher rates will benefit us. Improving real estate markets also will further benefit impairments so you're right to say that a big part of the walk on where we are in mid single digit ROEs back up to double digit ROEs comes from that cyclical recovery. In addition, though, there is certainly, there's a new management team in place. They do have a very concrete plan to run each of the businesses, both the Retail business, Consumer business and Commercial business better. We're investing in MIS to learn more about our customers, to do more cross-selling to our customers. We've benchmarked ourselves against best in class institutions in the US and we have programs in place to basically do the blocking and tackling better and generate more organic growth. So I think it's a combination of both the cyclical recovery plus some of those more mundane but equally important blocking and tackling initiatives. The second one, do you want me to keep going or do you want to take GBM?

Stephen Hester

On GBM, I think that in the short run, probably the big round number is the most constructive answer we can give you, if you like, of 2011 although there will be lots of volatility within that as is the nature of the beast. January and February have started stronger as they traditionally do but I think, you know, it would lead us still to be in that kind of zip code. And as you observed, our plans for taking the business forward do contain a balance. Part of it is about strengthening things we're already good at. Part of it is about restructuring those things in order to mitigate some of the regulatory headwinds, the kinds of ways in which inventory is held and the ways in which risk is held. There's a lot of technology investment which is relevant both to that and to the cost of delivery and, if you like, our core market shares, our core products to our customers. And then there remains part of the plan to strengthen some of the areas that are, if you like, contiguous to where we're strong and allow them to make decent returns. And for that, what we're doing, emerging markets would be one of the examples, bits of our credit business would be another example although clearly some of that is already very strong, and the equities business would be a third. But I think those kind of build outs are unlikely to move the dial dramatically in 2011. So we would be looking in the same kind of zip code, markets permitting.

On contingent capital, I guess we'll make decisions all the time on shareholder value compared to the risk profile and the FSA stress test. If I was a betting person I would say that we will prioritize getting out of APS before we prioritize getting out of contingent capital. I think that's the right shareholder order of priority. And so my guess is that the contingent capital would, if you like, be an item for another day. And of course the other thing that we will watch very closely is the growth of what I call the private contingent capital market which I believe will grow successfully, and the regulatory picture as it relates to the value of that versus the value of holding straight equity, you know, because clearly one of the things that all banks will have to do is to kind of optimize that balance once it becomes clear what balance is required.

[Aaron Ibbotson] – *Goldman Sachs*

Two questions, the first one maybe to you, Philip. I'm just intrigued by your comment on dividends. I was just wondering if you achieve your targets, say, already by 2012 or at least you're back to good profitability, would you consider paying a dividend even against Stephen Hester's wishes, for some reason the B shares haven't converted into ordinary shares? That's my first question. The second, just a couple of questions on below the line items; first of all if you can update your expectation of the UK bank levy. Secondly, just could you give us an idea of what type of restructuring charges you are expecting to take for 2011 and '12 and if you can confirm that you are not expecting to take any in 2013? And finally, just if you can give an update on, sort of, preference share dividend and other below the line items, coupon payments, that will reappear sometime in 2012 and 2013? Thank you.

Philip Hampton

Yes, on the dividend, I think the words I used were it may become a glimmer on the horizon, so I'm looking anxiously at the horizon but it's certainly premature to start it now and obviously we've got a lot of ground to cover in terms of conversion of B shares and all that sort of stuff before it really becomes a reality. But our progress has outstripped our expectations and if we continue to do that, maybe some of the thoughts here will be accelerated. But it's certainly not for now and for this year. Bruce, do you want to do the second point?

Bruce

Yes, on the bank levy, we had some guidance in the document today that 350 to 400 was, if you took a snapshot of the balance sheet at year end, we'd be in that territory. Obviously we continue to work to reduce some of the drivers of that and so hopefully that's the high water mark for that tax but that's a rough ball park for what it would be in 2011. I think the restructuring charges, we would expect them to stay reasonably elevated, maybe down a tad in 2011 but we're still going through significant change and that's in business services, GBM, UK Retail, so there will continue to be, I think, a high level of restructuring charges In 2011 before those start to tail off a bit. But there are likely to continue to be some in 2012. And then lastly on the preference share dividends in 2012, you know, at this point, if we continue on the trajectory that we're on, we would anticipate turning back on those coupons because obviously if we're going to pay a common dividend, we have to have those coupons turned back on. The EU stop ends in May of 2012 and we would be basically through all of those coupons by about November of 2012 and then we would be in a position to consider if we wanted to reinstitute a common dividend.

[Aaron Ibbotson] – *Goldman Sachs*

Can I just clarify then; so in 2013 roughly what are you expecting the coupon payments to be because I know you've exchanged quite a few of them?

Bruce

We haven't given guidance on that. It will be quite a bit lower than it ran when we had them all outstanding. But we can maybe take that one off, and give you some colour on that.

Philip Hampton

And if we can just advance a little bit on this row here, so if you can just come forward over here?

Mike Trippitt – *Oriel Securities*

Thank you. It's Mike Trippitt, Oriel Securities. Two questions, one on the Non-Core. If you could just talk a bit more about the fourth quarter, two aspects, one was the accounting adjustments on the monolines, is that effectively a one off accounting adjustment? And if you take that and the fair value of the write-downs, do they apply to assets which are still on the balance sheet at the end of the year or are they in any way associated with crystallizing options on the run off?

Bruce

The first question on the accounting adjustments, those are on very complex trades and periodically we will look at certain assumptions we have underlying those trades, including the estimated life of those positions that surround complex asset backed securities and mortgage backed securities. I think in general we're very prudent in terms of how we look at those positions but we've made additional extension of life assumptions on some of those positions and we took about £160 million charge which I would say is additional prudence that, I would certainly consider that a one off. We've gone through the book. We've bought BlackRock in to actually model all those positions and they're very consistent with where we have those positions marked.

On the fair value write-downs, there's some year end marks relating to some real estate positions which are held in partnerships which kind of come through late in the year. We try and estimate those, so I think there was a bit of catch up related to that aspect more than having those related to some of those disposals. There was about, you know, overall kind of above the line, in Non-Core results around £260 million of disposal losses in the quarter. There was about another £220 million which was over in the below the line items netting off against that GMS gain. So the total disposal cost was around £500 million in the quarter which we had flagged on the third quarter guidance.

Mike Trippitt – *Oriel Securities*

Just to follow, would it be, I was just thinking about the sort of trade off in your mind about accelerating the Non-Core. We sort of think about this as increased disposal costs in 2011 but offset by obviously a lower overall Group funding cost as those assets run down. Would it be reasonable to assume disposal costs increase?

Bruce

I think we take that as we go. I think we've been very disciplined in terms of balancing off the need to reduce risk and also preserve shareholder value. So, right now the £12 billion that we, of deals we've signed, all of the associated costs with those disposals were recorded in the fourth quarter so that's part of that £500 million. That's been reflected. We still have about £30 billion of total run down beyond that, so if you start at 126 and our target is 196, there's about £30 billion to go. About 60% of that is incremental disposals and 40% of that is natural run off. Natural run off has no cost associated with it. We'll have to see how it plays out in terms of the costs associated with those additional disposals of what's in the pipeline to hit those targets. But again, we're balancing overall getting to the number at the end with not pushing on a string and waiting for markets to value assets appropriately where they think that's fair value to trade them.

Raul Sinha - *Nomura*

Morning, it's Raul Sinha from Nomura here. I can't help being worried about your Irish impairments despite additional disclosure you've given so if you could give us some guidance on how big your provisions might be going forward, that would be really useful. Just considering, for example, the commercial real estate book and looking at the development part of that across Core and Non-Core in Ulster and it looks to be about £10 billion in size. You've got £2.8 billion provisions on that which implies let's say a haircut of 28%. If you look at what NAMA is talking about, that looks to be in the range of 60% haircut. Even the most conservative lender in Ireland is about 44% of a haircut. And somehow reading those two numbers would imply that you need roughly £3 billion of provisions more. Would you be able to help us with some guidance around what we might expect?

Bruce

Well, I think the chart on slide 38 of the slides that I went through lays out pretty effectively what those coverage ratios are. That development book at £6.3 billion in Non-Core has 44% provision coverage which is pretty consistent with where the market is. The market is probably mid 40s to mid 50s. We indicated that we think REILs in that book are at 75%. That will continue to go up so we'll continue to provide heavily against that through 2011. I would anticipate, though at some point everything that's going REIL has gone REIL and you've got your provision to a level you're comfortable with. Again, these are secured properties. The ones that were, had very thin security, that had maybe just land are written down very heavily but then there's other ones that are fairly well advanced and either close to having tenants or those would be less impaired. So I think we're in the pack and I think we're comfortable with where we're provided at this point.

Raul Sinha - *Nomura*

I thought coverage ratios of 40 or 50% are actually across the whole book rather than just the commercial real estate book.

Bruce

No, these are the percentages right here. So you can see those little boxes on the top lay out exactly what the coverage ratio is by asset class. And you have to remember one thing is that if you make comparisons with other banks, you have to go apples to apples and not apples to pears because we do have a very sizeable residential mortgage book here which is £22 billion of our £50 odd billion. And that book only has 7% REILs and so you would not expect to have the kind of provision coverage against that book as you would against corporate or commercial real estate.

Michael Helsby – *Bank of America, Merrill Lynch*

Thank you. It's Michael Helsby from Bank of America Merrill Lynch. I've got two questions. Firstly, if you look at slide four, one of the targets that looks have changed is, it looks like you've gone from a Retail and Commercial ROE of 15 to 20 and I think also you've moved to a 9% equity allocation. So I was just wondering, is 9%, do you think that is consistent with where you think the regulator will finally pop out? And also is that consistent with what you think you need to get to your double A rated credit rating? And the second question is on loans to deposit ratio. I think you've done a phenomenal job in the UK getting the loan to deposit ratio down. I think if I add in Wealth, it looks like you're about 100% loan to deposit ratio now in the UK. I think, the question is really are you now in a position where you think that can sort of stabilize? I think one of your big competitors; it looks like it might be trying to emulate what you've done. So can you take a foot off the gas in terms of deposit gathering?

Stephen Hester

Just taking your different questions, just on the last one first, I think that we, in the aggregate, don't need an improvement in the Core loans to deposit ratio anymore, although we obviously do want Non-Core to run down to get the Group down. There are still some improvements in individual businesses but what we really want is for there to be growth in the economies we serve so that we can both make more loans, extend more services that produce fee income and match that with further deposit growth. And so it's clear that an element of, if you like, getting to where we wanted to do a large element has happened. But what we would really like is something that produces an income growth for us whilst doing all the things we're doing on expenses and clearly that's part dependent a little bit in economic terms. Now, there still are, you know, we're still not quite at target for UK Retail and not quite a target for UK Corporate but you're right; you know, we've made very good inroads.

In terms of the allocation of capital and where the regulatory debate is going, you know, we don't know. I mean, you have on the one hand the big US comps trying to say that 7% is where they need to be in Core Tier One ratios and so on and so forth. You have people debating, you know, ranges well up north from that. And then I think you can have a range of arguments about Retail and Commercial versus investment banking and clearly most people have got their guns trained on the investment banking side in terms of capital support. But also if Retail and Commercial, you know, it's a focus of obviously great public sensitivity about not being allowed to go down, about being protected and so on and so forth. It's going to have to have the right capital structure. So we don't know the answer. We just didn't want to be accused of, if you like, over cooking our ROE numbers by keeping things low when clearly our Group Core Tier One ratio is a fair amount in excess of these, and even though a lot of that should apply to the risk of Non-Core, it was really just to say well, look, this is still a picture that's got to unfold but let's keep on the cautious side of life and even for those more stable businesses, let's nudge it up slightly. But, you know, where it's going to end up, there's a denominator and a numerator that's moving and I don't think we have better information than you do.

In terms of the rating, I guess that also I think is very sensitive, but in a funny sense it's not just sensitive to capital issues and to on-going earnings and franchise issues, which all bank ratings are sensitive to, but also the whole sets of debates around mechanisms in which losses can be attributed – bail-ins, all these kinds of things – and so I think what we feel we need to do is make sure that the different dimensions of our business, whether that be franchise, whether that be earnings, whether that be leverage and so on, compare favourably with the best people against whom we compete.

And obviously in a sense what the rating agencies make of that then becomes out of our hands, but the issue for rating for us is really a competitive tool, that if people are to deal with us either as counterparties or putting their life savings with us or whatever, they mustn't feel insecure in dealing with us.

So our issue is really about relative financial strength rather than an absolute number, which I think will still move around as the rating agencies grapple with, you know, on the one hand much safer banks from the regulatory and capital and balance sheet reform that's happening, and on the other hand, if you like, a new set of moving parts in terms of how the capital structure might operate in a crisis.

Michael Helsby

Thanks. Can I just come back onto the point you raised on loan growth? I know that the, clearly I think all the UK banks have a big challenge from the deleveraging in the corporate sector, but that looks like it's now sort of coming towards an end. With the targets that you've been set, do you think we should expect loan growth to turn positive in 2011 in the corporate book? And, Bruce, I was wondering if you could give us any guide, just touching on your revenue point, about the sensitivity to the Group margin for interest rate rises?

Stephen Hester – *RBS – CEO*

In terms of the corporate book, we actually in our release, and I forgive you for not having got to that page yet, give the fourth quarter data. As you can see, in the fourth quarter there still is a net repayment. So, in other words, the most recent trends are, although gross lending is outperforming the targets, there still is a net deleveraging going on and so that's the trend. Obviously if that trend reverses no one will be happier than us and we're certainly available and there with the resources to support it, but that's where we are today.

Bruce, do you want to…?

Bruce – *RBS*

On the asset sensitivity we do have a table in the company announcement that shows a 100-basis point rise by a shock would increase our net interest income by a quarter of a billion and so that number was higher last year. One of the reasons it was higher is because we took in a lot of capital from the government really late in the year, around Christmas, and we had it invested in cash in effect and so as we put that money to work and swapped it out the curve that created more base net interest income. It's one of the reasons our net interest income was up so nicely last year, but it's muted some of that asset sensitivity.

I do think in our planning scenario for this year we're still looking for a couple of modest increases in UK rates in the second half of the year and nothing in the US. Obviously if that accelerates and there's another one that could be favourable to our outlook given the asset sensitivity.

Philip Hampton – *RBS – Chairman*

Can you come down here? Maybe you ought to move the mic along the… that's great, thanks.

Rohith Chandra-Rajan – *Barclays Capital*

Thanks. Rohith Chandra-Rajan from Barclays Capital. A couple, please. One on GBM and one on sort of the UK Retail and Corporate businesses. Just on GBM, the 16.6% ROE that you disclosed, I'm just wondering about the Basel III implications of the £80 to £100 billion RWA inflation, how that's allocated between Core and Non-Core, what the impact would be on GBM ROE not withstanding any mitigation effects that you may be putting in place.

Bruce – *RBS*

Okay, sure. We break out that split between GBM and Non-Core at about 60/40 GBM Non-Core. So the 140-ish number of RWAs in GBM would increase to about 200, so that 16.6 pro forma comes down to about 12% if you overlay that.

I think in terms of our overall mitigation, obviously rundown is a big part of it in Non-Core. In GBM there'll be some modest rundown. There's model work that we have to do, so one of the ways to mitigate the counterparty increase is to move to, from standardised models to advanced models and we're, we have that process underway. Those obviously would have to be signed off by the FSA, but we're making good progress there. And then we'd also look potentially to hedge some of our counterparty exposures once the full rules are clear and our models are in place; there may be opportunities to trim further on that.

At this point we're not calling out a significant revenue impact. There could be some revenue impacts, particularly from the hedging, but I think those would be manageable and so what you're really left with is, how do you walk back to the targeted ROE of 15%, which I think all investment banks have to grapple with. And that's something that we'll be looking at, what the post regulatory change ROEs for each of the desks and each of the activities that we have are, and how do we rejigger and adjust the business model to bring it back to the 15%.

We have time on our side to do that. We have smart people in the Group, as do all investment banks, and so we do have confidence that over time we can figure out how to sustain an attractive ROE in the business.

Rohith Chandra-Rajan – *Barclays Capital*

And of the £140 billion RWAs, can you sort of say how much is currently standardised versus advanced?

Bruce – *RBS*

I don't know if I have that on the top of my head. Do you, John, or…? We can take that offline and…

Rohith Chandra-Rajan – *Barclays Capital*

And another quick question on UK Retail and Commercial really just on the margin progression. So UK Corporate kind of was flattish in the fourth quarter, Retail saw continued progression but also a big increase in the deposit base in the fourth quarter, very helpful from the funding perspective. I'm just wondering what that means as we move into this year in terms of margin progression for those businesses.

Bruce – *RBS*

Look, in Retail, as we've said, the sort of, the driver of the net interest income progression this year was asset re-pricing. We've pretty much spent most of that, so we're about 90% through on our asset re-pricing.

With respect to the liability side, we've had, I think also born most of the brunt of re-pricing and hedges rolling off, but, you know, what we're waiting for now obviously is an increase in rates and that could give us an opportunity to further improve NIM.

The NIM overall at slightly over 4% is getting to levels that, if you look at the five-year high for Retail's NII it was probably 420, so I'd caution that trees don't grow to the sky here, but I do think there's a little bit further room once rates start to rise for the NIM in Retail to go further. As Stephen indicated, what will drive NII, I think ultimately it's going to be deposit balance growth and then continued asset growth that goes with that.

Rohith Chandra-Rajan – *Barclays Capital*

Thank you.

Philip Hampton – *RBS – Chairman*

Good. I think we're starting to thin out a little bit. We'll take a couple more.

Chris Manners – *Morgan Stanley*

Good morning, everyone. It's Chris Manners from Morgan Stanley with a couple of questions. Firstly, I was just having a look at slide 28 and the rundown of the Non-Core assets. It strikes me that the rundown of the third party funded asset, £63 billion, was very good, that the pace of the rundown of the risk weighted asset only shedding £17bn was a little bit slower. I was just trying to work out, you know, when do we see that big down step in risk weighted assets in Non-Core, particularly because you've got CRD3 coming in at the end of 2011?

And the second question was just on your exposure to Irish financials. I see that you reported around a £3 billion exposure to Irish financials. If we include the central bank in your lending book, I was just trying to work out if there's debt that you hold of Irish banks as well that could be a potential concern? Thanks.

Bruce – *RBS*

So on the Non-Core, you're correct, the TPAs have come down faster than RWAs. Some of that RWA relates to regulatory changes and so we have a situation, particularly in some of the GBM structured credit product and exotic trading book, where the measurement of RWA intensity relative to underlying economic sometimes gaps out.

And so one of our challenges here over time is to figure out how to effectively collapse that difference with what we think the underlying economics are and that could be risk mitigation trades, i.e. capital relief trades, or an early disposition of some of those positions. So that's really the principal thing that's causing that gapping and, as you say, the CRD4 will further exacerbate that a little bit. So that's been the principal cause for that difference.

Your second question was on Irish financials. I think most of the exposure that we have in Irish financials is, would be through GBM and through counterparty arrangements where we feel comfortable with any secured lending arrangements we have there.

I don't know, John, if you want to add to that?

Philip Hampton – *RBS – Chairman*

Good. Any more questions? Lots more. They all come up from the undergrowth. Okay, let's go over to the extreme right-wing arguments that may, we have over there.

Manus Costello – *Autonomous*

Thanks. It's Manus Costello from Autonomous. I just wanted to follow on from Ian's question about the US. One of the key strategic reasons you've always had for maintaining Citizens in the Group is because it improves the funding mix of the Group and yet now we're looking at a net stable funding ratio of over 100% and improving. I just wondered how you see Citizens fitting into the Group now given that one of those key strategic priorities seems to be fading.

Stephen Hester – *RBS – CEO*

Well, I think that the balance that Citizens gives to the Group remains an important attribute, whether that be in terms of funding, whether that be in terms of geography, or whether that be in terms of our Retail and Commercial balance versus our investment banking balance and the additional synergies we can get from that, so balance continues to be a reason.

However, what we've always also said about every single one of our businesses, the argument is no different for Citizens than the others, is that each of our businesses has got to be attractive in its own right to shareholders, in addition to being additive through synergies and through balance.

Now, clearly, as Bruce has pointed out, we've made more than a $600 million earnings turnaround in the last year in that business. We're back in the black but we're not at acceptable ROE for the long run and we think that the business has the capability to do better. We think that that's the most valuable thing that we can do for shareholders, is to move it better. And if we are right in being able to make it very valuable in its own right, in addition to valuable as part of the mix, then the same argumentation will go as would go for our other businesses.

Philip Hampton – *RBS – Chairman*

Okay. Let's take another one over there. Yes.

Ed Firth – *Macquarie*

Thanks. It's Ed Firth from Macquarie. Could I just ask you, going back to the Non-Core, I think at the beginning you gave us some estimate as to what you thought the total cost of the Non-Core runoff was going to be in sort of broad terms. Could you just give us some sort of idea in terms of your planning assumptions now of what you think the total costs are going to be for running down the remaining assets?

And I guess a sort of subsequent or a related question, is there an interest rate sensitivity to that? I mean, if we enter a rising rate environment would you expect costs of the Non-Core runoff to increase or decrease?

Bruce – *RBS*

Well, I think where we have given guidance is the range of impairments that we would likely anticipate over the period 2009 to 2013. We, we've posted that early on in the recovery as a rough £20 to £30 billion in total cost and I think we at this point have incurred about 75% of that and are on certainly a down path and our current view would be that we'd end up hopefully, barring unforeseen changes in economic conditions, to be on the left side of those goalposts.

We haven't commented specifically on the frictional cost of disposals and I gave an answer earlier that obviously we take that as we go and manage that in terms of the balance between hitting the end target and then also preserving shareholder funds and we have to some extent. Commercial real estate was always the asset class that was going to go towards the end. You may have noticed in the charts that we've done a good job of reducing Non-Core commercial real estate; it's actually down in the high 30s adjusting further transfer in of the Ulster portfolio mid-year.

And so we've made some good progress, but again there'll be more of that late cycle in 12 and 13 and effectively what the strength of the economy is and where interest rates are will have an impact on whether there's much and how much frictional cost exists in liquidating that tail of the, of that portfolio.

Philip Hampton – *RBS – Chairman*

Good. We'll go right to the very extreme right wing over there.

Arturio De Frias – *Evolution*

Thank you very much. It's Arturio De Frias from Evolution. Two quick questions, both related to your guidance on interest rates on the impact of higher interest rates. You have mentioned £250 million; should I assume that that's Group and, if that's Group, could the impact on Retail, UK Retail, follow similar proportions?

And then the second one is, what about the net impact, i.e. after potential increase in impairments? Could you expect any increase in impairments because of rise in rates? I guess your answer is going to be not much if rates are moderate, but I would be interested in hearing from you what can be the gain between higher revenues and higher impairments in a high rate environment. Thank you.

Bruce – *RBS*

First off, the £250m is a, it is a Group number so it's a composite of different asset sensitivity at the different operating units. The unit that has the greatest asset sensitivity is Citizens, always has been Citizens, and so just given the composition of their balance sheet, the loan to deposit ratio, the investment securities they have on their book, there's their position to benefit from an increase in rate.

UK Retail would probably be second on that pecking order so clearly there'd be a benefit in UK Retail. I think it drops off from there, so most businesses have some benefit but it's not that significant. And then in Group treasury we have some offsetting positions to try and manage the overall at the sensitivity which would work against the centre, if you will, and from an accounting standpoint. So that's how it would play out.

I think, you know, our view is that there'll be a ramp scenario rather than a shock scenario, is the likely forward path of interest rates. Given a ramp scenario you're right to point out I don't think there's a significant impact on borrowers' ability to repay because they're able to make adjustments and absorb those modest increases as they come and hopefully then their incomes are going up at their individuals or their cash flow is going up at their corporates. So at this point we're not calling out an impact on impairments from the projected path of rates which is likely to be gradual.

Philip Hampton – *RBS – Chairman*

Good, okay. There's very high quality questions, right, so whilst they are high quality we will continue.

Bruce – *RBS*

They're raising the bar.

Philip Hampton – *RBS – Chairman*

I'm waiting for the lower quality one to come, absolutely.

Leigh Goodwin – *Citi*

Thank you. Good morning, it's Leigh Goodwin from Citi. Yes, no pressure for the extreme right-wing. Actually a couple of questions, if I might. Just on the UK Corporate, I noticed there was a figure up in impairments and you referred to a number of small, large, small, largish items in the impairment line. I wonder if you could just elaborate on that and give us an idea of whether you expect that to continue?

My second question is on costs and that is that, you know, you're still a little away above the target of 50% cost to income ratio and I know you're through the £2.5 billion programme and, in fact, you've exceeded that. I just wonder whether you have in mind another programme for cost reductions across the Group. Thank you.

Bruce – *RBS*

Sure. Do you want me to take it? Okay. So on UK Corporate, there's nothing alarming in the Q4, you know, number. I think there really is just a couple of one-offs and so when you get into a portfolio that has a bespoke credit profile you can have a lump together in a quarter and then have an absence.

So, you know, Q3 was probably a little on the light side in UK Corporate and Q4 was a little on the heavy side, but if you look at the whole second half it's following a glide path that appears, you know, intact. And I would say going into this year we would still expect a gentle fall in impairments in UK Corporate and so that's our call there.

On costs, we have actually increased the target of the £2.5 to about £3 billion and so we continue to work on ways to become more efficient. Ron Teerlink here in business services is leading a lot of the charge on that, but, you know, I think in an environment where growth is expected to be sluggish, interest rates are likely to stay low and only come up gradually, I think to continue some earnings momentum we do have to continually review the cost base and we're going to crack on with that again in 2011.

Philip Hampton – *RBS – Chairman*

Any question on costs, by the way, is a high quality question. That's taken for granted. Good, okay.

Steve Hayne – *Morgan Stanley*

Thank you. Good morning, it's Steve Hayne from Morgan Stanley. Just a question, I don't want to let a Royal Bank results go past without mentioning commercial real estate. I'm wondering if you can just give a brief outlook on where you see that going, because you mentioned that on the rundown of Non-Core, for example, as one of the areas that it's being a bit slower to come off. And then linked to that, in terms of the new target you've given on the faster Non-Core rundown, which areas, which specific assets do you expect to come off faster? Thank you.

Stephen Hester – *RBS – CEO*

On, well, on commercial real estate I think that our views would be the similar, similar to those that we've expressed in the past, which is with the exception, if you like, of the Irish wildcard where of course, you know, a lot of the pain has been taken, I think our judgement is that the commercial real estate market is not likely to have now big step changes.

And what you're likely to have is, if you like, a market which slowly over quite a number of years works itself through and each year you make a bit of progress, but you're also rolling over loans and doing forgiveness and so on because there isn't a whole lot of point, you know, repossessing things if there's, if the asset market underlying it is, you know, not going to reward you for dumping those assets.

So I think that this is going to be a slow burn, not slower than I thought a year ago, but a slow burn. And, you know, as Bruce has indicated, it's our biggest remaining risk concentration, although a lot of that lies in Ireland, but even outside Ireland and I think that it will be not only the source of continuing impairments, gradually going down but continuing, but again as Bruce indicated, both in 11, 12 and 13 disposal losses to the extent that we dispose of some of those.

So that, you know, I think that's the case, but it does feel to us that the underlying market, while, you know, not radically strengthening, you know, is at least going in a sort of flat positive way on both sides of the Atlantic and in Europe.

Bruce – *RBS*

And on the second part of your question, we have a couple of wheels on slide 30 which shows the size of the reduction by asset class and if you look at that you'll see that the corporate, the markets and the Retail were the three parts of the wheel that moved down most aggressively last year and I think I would expect that to continue.

So that's where there's interest in the assets and the commercial real estate and the SME, it's a very small book, have moved down as well with over 30% reduction from the, since commencement, but I would expect those to lag a little bit relative to the things that we have been able to move.

Philip Hampton – *RBS – Chairman*

Okay. Brilliant questions now. The challenge is yours.

Unidentified male speaker

Thank you. I thought I was going to die of old age actually. On your slide on GBM you talk about the capacity to rebuild returns in the event of regulatory changes and I suppose we're all thinking about Basel 2.5 and Basel 3, but realistically the independent banking commission could impose subsidiriasation on GBM. You could find that you could only fund it from its own balance sheet and not rely on the balance sheet of the parent. I wondered just if you could give us some rough guidance, the extent to which those particular costs might be recoverable from re-engineering the P&L of GBM.

Stephen Hester – *RBS – CEO*

Well, I think that the, there is no doubt that subsidiarisation in any form will be bad for banks and probably won't make them any safer either, but there is just an incredibly wide menu of nuance as to from not very bad to quite bad in terms of destruction of funding synergies, creation of capital inefficiencies, and I think it's just way too soon to know where that pans out.

If you were reading between the tea leaves you might think that, if you like, the focus was more on, if subsidiarisation was more on protection of the most Retail end and small business end of life than isolation of the investment bank. So, you know, that might give some clues as to wherein it lies, but honestly we don't know.

But as, you know, as I said in my outlook statement, I think these regulatory issues are very real and one needs to be, you know, really very cautious about them until we can have some clarity in terms of the impacts they can have. But I don't think we are, particularly on us, but not on anyone.

Philip Hampton – *RBS – Chairman*

Any more? I think we're probably done. Well, I think your questions, if I may say so, matched our rate of progress. Very impressive. It's good to see you know us so well. So thank you very much. We'll see you next time.

Operator

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