The Royal Bank of Scotland Group

Annual results 2012

ANALYSTS PRESENTATION

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280 Bishopsgate London EC2N 4RB

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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 Annual Results announcement published on 28th February 2013.

Presenters

Philip Hampton

The Royal Bank of Scotland – Chairman of the Board of Royal Bank of Scotland Group Plc

Stephen Hester

The Royal Bank of Scotland – Group Chief Executive Officer

Bruce Van Saun

The Royal Bank of Scotland – Group Finance Director

Presentation

Sir Philip Hampton - *Chairman, RBS Board*

Good morning, ladies and gentlemen. I have to say it's morning mainly gentlemen, not many women in the audience. Just before Stephen and Bruce make their presentations, just let me make a few points. I think, although it's in some ways a chastening year, as Stephen says, it's a year of considerable achievement, with our exiting of the APS, full repayment of all the liquidity support, resumption of pref dividends, loan:deposit ratio of 100% and the non-core business down to £57 billion, which just probably puts us in the pack of banks in terms of having assets we don't really want to have.

These are all fantastic achievements on restructuring business, so I think we've made excellent progress in all of those areas. And I think that we are now coming to the end of the really material changes that the Bank needed to make in the wake of the financial crisis. Our objective, as we've said many times and repeating today, is to get the Bank into a shape in terms of safety, soundness, profitability and income stream, to enable the government to start to sell its shares in a stable business, as soon as possible. And if that can be done in 2014 that would be great progress.

It is disappointing that despite all that progress on the balance sheet and getting the business right that we do have this very long list at this particular time, of I think what you would mainly call legacy charges. They're not all legacy charges but I think it's fair to say they are mainly legacy charges. And whilst I think it would be wrong to say that the conduct risk charges there are all behind us, we hope that 2012 will mark the high water mark of those sorts of events.

One final thing, if I may. There's been quite a lot of stuff in the newspapers and other places just recently about some of the changes that we're announcing today in relation to the asset intensity of the Investment Bank and in relation to Citizens. And some questions about ownership of those decisions: is it regulatory push, is it a controlling shareholder or is it the company? I mean, obviously, as a bank in particular, we need to comply with all regulatory requirements but major decisions in public companies have to sit with the Board. That's, apart from anything else, a simple Companies Act legal matter. And I can say that the RBS Board has approved all of the steps we're setting out today, taking into account the interests of all of our shareholders. There's no other compromise that we're making.

So with that I'll hand over to Stephen.

Stephen Hester – *Group Chief Executive*

Thank you, Philip, very much. Thank you very much everyone for coming and giving us the time. Normal format: I'll go through highlights of the results, some of the strategy behind that, and then leave Bruce most of time to go through the numbers. As Philip has mentioned, we are extremely conscious that the future for this company will be bright only if the people to whom you speak, i.e. investors, want to own our shares. They will only want to do that if we do a good job overall as a company and so it's very important to us that the things we do have that end result.

But before getting in to a conventional presentation of our financial results and our strategy I do have this slide, I'm sorry I don't have posters around the room, to talk about what we're doing culturally. But we can't escape it; the banking industry, in addition to putting right risk and physical mistakes, also needs to put right cultural things that we do, as much as any other bank – more than many other banks. And from the very beginning, in 2009, of the restructuring phase of RBS, we have been really clear, we need to rebuild this company as a really good bank. And that actually starts and finishes with serving customers well. That's the lodestar that the best companies in the world consistently reach. We need to consistently reach that and along with that, to make sure that we're doing it in the right way.

You can see these as what we call our Purpose, Vision and Values; it's not where we started, it's not exactly where we are today. It's where we need to get. And to use a phrase which isn't here, because the Comms guys are scared of me putting it up, but we're calling it Thinking Outside the Bank. We need to make sure that our people are thinking of the outside world, thinking of customers, thinking of our impact on everyone in the outside world, and doing it consistently well. And whatever else we do, financially and in appearing to investors or anyone else, our mission will not be successful if we don't live this more successfully than RBS has in the past – and the banking industry has in the past.

Let me move on. You'll have seen the headlines in what we put out and so I won't go through these line by line. But I think we feel that in 2012 we accomplished a lot; that's important because we had a lot that we needed to do. We've still got a lot to do but we do believe, as Philip said, that we are coming much closer to the end of the restructuring phase of RBS than we have been. And that we can see that light in place and that the business beneath it that will be unveiled is in increasingly solid shape, with more work to do. Safety and soundness are terrific and, indeed, one of the ironies of today's results is by far the biggest number, nearly £5 billion – what put us into loss – is the fact that we are the most improved major bank in the world, in terms of credit perceptions in the last year. Which is the market verdict in terms of our fair value own debt charge of the safety and soundness agenda, which has been core to what we've been doing. You'll all see that the operating profits are pretty solid, are restored to a pretty solid level despite an economy that isn't growing, doubling at the Group level, which is a function of non-core losses coming down. All of our non-core targets have been exceeded well, terrific; we are within a year of getting to the place where non-core can start taking a back seat in the company, having done its job close to perfection, I would say.

We have hit key milestones; the Chairman mentioned some of those. Beneath all of this are 33 million customers, we're serving them well; we need to serve them better. But we have not been in any way starving our businesses on the way through the deleveraging. The deleveraging has been, in non-core – our UK business is an example. We lent something like £75 billion last year albeit people paid us back a similar amount of money as well.

The financial highlights: again, I won't dwell on these. They show, I think, our core businesses are now in good and solid shape, not growing, because the economy isn't growing and our customers aren't growing. But in good and solid shape. Some areas where we need to do work, of course, and the Group showing that the weight of charges from cleaning up the Bank, the big progress in that clean up.

Let me just reflect over the four years of the five-year plan, the four years that have now passed. The five-year plan relates only to the restructuring and the rebuilding of the foundations; I hope there'll be a 550-year plan thereafter in terms of this company flourishing. Safety and soundness, we are almost at the point where we think the job is done. It won't be an on-off switch but you can see the main element left, in terms of the financial envelope of RBS, is to get to 10%+ Basel III capital ratios. Obviously in theory we have till 2019 to do that; we expect to be much closer to the end of 2014 in accomplishing that, and Bruce will talk some more about that later. But the record is very strong that we have in this area and I believe we can continue to make it stronger. And, of course, some of the initiatives we've announced today will contribute towards that path.

At the same time as the safety and soundness agenda being prosecuted strongly we needed to get the core, the ongoing bit of RBS, into a shape that even if economies aren't growing, produces reliable cash flow. Right now we're still using that cash flow to pay for the clean up, but it is only a matter of time before it's available for shareholder-friendly usage. And you can see on this chart the build of core profitability – that is despite the shrinkage of the Investment Banking activity. And so the mix of this core profitability, at least in share multiple terms, has improved dramatically and, of course, at 80% Retail and Commercial and 20% or so Markets, I think is in a positive shareholder value mix position relative to some other big banks in Europe that you cover. We've tried to make sure that that's built on a foundation of serving customers well; we know we need to do a better job of it but we're doing a decent job already. And in all of our businesses we have a solid foundation relative to other banks, in terms of the core businesses and how they're performing for their customers. And, of course, the UK economy, which is important because it's our biggest market, it's important because of our shareholding base, I think we are more than holding our own, remaining by far the biggest lender to UK companies, taking share in mortgages as well.

Let me talk a little bit about conduct. I've talked about it in terms of the reputational goals of the Bank earlier on. And, as we know, the clean up from the financial crisis has a financial dimension, it has a reputational dimension that all banks are having to grapple with. And, as I have said before, my earlier quote is up here: it is a difficult but true statement that too often the banking industry I think in the past saw customers as a vehicle for making money rather than the rationale for existence, out of which money comes if you do it well. And that cultural attitude clearly is changing fast. We have three big bills in this regard that we are reporting on: LIBOR, the SME swaps and PPI. Probably coming down the track is a smaller bill but still significant, in money laundering, don't know when. And on LIBOR I would say there is still a couple of shoes to drop in bill terms, once the European Union primarily gets round to this with other banks. We'll also see how many other banks are involved one way or another but there's no doubt that these are wrenching issues for the whole industry, our company. They need to be dealt with in the right way; there's no comfortable way to deal with them. And we will do the best we can to put those efforts behind us and gradually get to the point where the conduct cases are ones that are diminishing in scale.

Forward strategy and outlook: as I've said, I think that we have done a really good job, which is much closer to the end point than ever before. On the safety and soundness agenda, gold standard reached already in loan:deposit – HSBC is the only other UK bank that has managed that. Funding and liquidity in terrific shape, obviously that also means that whilst we have the last bits of rebuilding our capital ratios, we are much less vulnerable to market volatility in the meantime, because we don't need to be out there funding ourselves in wholesale markets, And the funded balance sheet, as everyone knows, is a scale of reduction that no other bank has accomplished.

The business alignment, again I think that we have done by far the biggest bits of the change in scale and scope that was required of our business, and a lot of the divestments and so on. And in government support terms, although the most eye-catching bit will be our share ownership, actually, in financial terms, the £200 billion of liquidity that public authorities around the world advanced us at the height of the crisis, the £300 billion of toxic assets that were insured in APS. Those are out, no claims, no one's suffering, government's getting paid back are a big measure of the way that we have, I think, begun to stand on our own two feet.

What's left to do? Well, of course, in shareholder terms we need to make sure that the core profitability is up just enough, that means a number of our businesses retaining the profits that they've already got at above the cost of capital. It means some of our businesses getting to that level and some of that will require economic recovery, as we see, for example, in Ireland. I'm hopeful that this will be a year of turn in Ireland; Bruce will talk about that more. So we need to do those two things.

All banks need their customers to want to grow in order for them to grow. So in the meantime, until the outside world delivers us a growing economy, we need to work very hard in the detail of our businesses and are doing, to make sure that they are capable of making good money in flat economic times, from serving customers well. And then, in better economic times, being able to take advantage of that. And, of course, most importantly, even if we build, protect and have a high quality top line profit, we need to get through the period where we're using that profit to pay for legacy exposures and we can see the path to doing that, I think.
In business alignment it's always around serving customers well. We have a bit more work to do in non-core; we have a bit more work to do on divestments, not so significant in shareholder terms, a branch divestment, but we have to do it, the remaining shares in Direct Line Group as well. We have been I suppose somewhat in the news in recent weeks and months for our piece the governmental and FPC and regulator concerns around bank capital. In our case, also shareholder issues of one sort or another. And, as Philip has mentioned, we believe that we've reached an accommodation, which is consistent with the concerns of those very important stakeholders but also consistent with the future of this company, in its ability to serve customers well and produce something that shareholders will want to own.

That has two primary components: a further reduction in the capital employed in our Markets business, which will be one of the tools to get the remaining momentum into our capital ratios, that we will execute. I would say that because of the multipliers involved, although clearly our Markets profits will be lower if we're deploying less capital in them and we'll have some hard work to do in terms of expenses and other things, I think that the net shareholder impact of the business mix changes should not be a negative and certainly we are very clear that, as a bank distinguished in particular by its Corporate footprint around the world, we need to have credibility in the Markets business to serve our customers well. Despite the wrenching issues around LIBOR and so on, we have terrific people in this area who do a good job, and we're grateful for that.

The second element of the accommodation related to the Citizens IPO in two years time. We will prepare Citizens for a partial IPO in the US in two years time; there's no great precision to that number and, of course, it's subject to market conditions and so on, so forth. And I think you can think of that in a few different ways. From an FPC concern standpoint, think of it as contingent capital; it's our emergency ripcord, it's a way of getting capital, making that asset more liquid if we need it. I don't think we will need it for that reason in two years time, but it is a way of bolstering contingent capital thought of in that way, and therefore responds to that need of the authorities.

From our point of view, I hope that it will respond to a more positive thing and that is to be able to showcase the value that we believe that we will have restored in that business. You'll have seen that every year in the past four we've increased the profits in that business; they're still not at a level we need them to be. But a combination of profits increasing, the market environment getting better, us retaining the profits that are being made rather than just having them in the bank earning Treasuries: a combination of those three things is making this whole process a positive one for our shareholders. And I think that in roughly two years time, that's roughly the time it takes to prepare these things properly, the business should be capable of that sort of appeal. It's a similar thought process to Santander, if they ever get round to floating part of their UK business. And I think will enable the business to, encourage staff in terms of share ownership anchored in the local community have a currency in the United States for use in addition to showcasing value for our purposes. So I think that this is a move that both is responsive in a contingent sense to the regulator concerns and responsive to a healthy, strong business and a good shareholder case. And that's what we will try to accomplish.

Bruce, as I said, will talk more about our forecast capital ratios but it certainly is our intention to hit both global standards on capital G-SIF, which is 8.5%, and the Vickers standards of 10%, many years ahead of when we are required by those regulations to do so. Clearly whatever we do on the Group and its profitability and its stability and the business mix that sits behind that, the equity story will hang off those things but will hang off some other things. Philip has made the first point I think clearly in his remarks; we do need the government to clear away the dividend blocker or the dividend access shares, as it's otherwise called. There's no need to do that until we're in a position to pay dividends, in profits and in capital terms, so personally I think it's unlikely to be 2013 business. I hope it's 2014 business. Clearly, once that's cleared away we'll want to articulate a dividend policy as quickly as possible, indeed, we'll want to start paying dividends as quickly as possible. And I think those will be our contribution to the case of privatisation which then will lie in the government's hands – partly in the hands also of the stock market and the economy and how that's doing. But that's how we see that playing out.

Our targets haven't changed. Of course, for so long as the economy remains weak and slow, the return on capital and cost:income bits of that will be slower to achieve than we would have otherwise wished. Although, as we've talked about, we're nevertheless making very good progress in achieving all of the other ratios. And we do believe that our business is capable in normal times of hitting all of these targets.

Now, I won't go through the detail of this; we do believe that the RBS that will be left after the restructuring is a company that has the ability to be a high performing company. Yes, in mature markets; yes, with relatively modest growth rates, but one on which people can depend for dividends, for cash flow, for service to its customers and with some coherence. We're not there yet, we've got some important things to do. We can trip up, of course, and people are right to put a discount on that achievement until it's achieved. But that's certainly what we think is possible.

So in conclusion for my bit of this: I do think that the toughest work in recovering RBS is behind us. I'm very conscious that that doesn't mean to say it's all behind us. I think 2013 will be tough economically; in conduct terms we've still got important things to do in capital. And, of course, you know, the external environment, whether in regulatory terms or political terms or whatever, will no doubt remain quarrelsome and intense and so on and so forth. So we are under no illusions as to yet being in the state that we want to be or in an environment that we want to be in. But I think we do take encouragement from what's behind us and we're very clear, the end game for RBS is not about privatisation. It's not about cleaning up the balance sheet. The end game is that this bank is acknowledged by all who depend on it as being a really good bank. Bruce.

Bruce Van Saun – *Group Finance Director*

Thank you, Stephen, and good morning everyone. I'm going to walk you through our financial highlights, challenges and opportunities. So let me start off with our Group performance.

Over the recovery plan period to date we've delivered a meaningful improvement in our operating results. Since 2008 there's been a £12 billion positive swing in Group operating profit, with increasing traction in 2012 as our non-core losses shrank. The £12 billion swing is driven by a roughly £9 billion decline in non-core losses and a £3 billion increase in our core profits.

Looking into the detail of the 2012 Group P&L, 2012 revenues were down £1.9 billion or 7% versus prior year, with core revenues down 4% and non-core declining by almost £1 billion. Offsetting this, however, were lower expenses, which were down by 900 million or 6%, claims which were down by £0.5 billion or 18%, reflecting tighter underwriting standards and better claims management at Direct Line. And impairments, which were down nearly 30%, or £2.2 billion, as NPL trends moderated. The net result is that net operating profit nearly doubled year-over-year, to £3.5 billion.

The below the items charge, excluding OCA, was £4.1 billion, a decrease of £400 million on the year; while including OCA the charge was £8.8 billion. At the pre-tax line we reported a loss of £5.3 billion, largely due to the OCA charge and a goodwill write-down. Our funded balance sheet declined by 11% or over £100 billion, to £870 billion. The asset reduction was driven by non-core, Markets and the International Bank. Core Tier 1 is robust, at 10.3%; that's up 60 basis points this year despite the loss and regulatory uplifts of over £40 billion. Tangible book value per share is 446p, down from 500p on the year, primarily again reflecting the OCA charge.

Our group NIM remained broadly stable. R&C which delivers 96% of the group net interest income had their NIM decline slightly as lower funding costs were more than offset by lower benefits from current account hedging. Market’s NIM increased as their smaller balance sheet drove lower costs of funding and liquidity. Non-core margin continues to decline as higher yielding assets roll off.
Core asset yields were broadly stable in 2012 while the group’s cost of liabilities has been trending favourably due to deposit pricing initiatives.

Strong expense control is the key feature of our recovery plan. In the last five years the Group’s expenses have been managed down by 18%. In fact, Group expenses are down in absolute terms every year of the strategic plan. In 2012 our costs were down 6% year over year. The original cost-saving programme ambition of £2.5 billion has been exceeded by £1.1 billion as benefits now total £3.6 billion. Disposals and restructuring have delivered a further £2.1 billion in saving. However, inflation and our targeted investment programme have raised costs by about £2.6 billion over the period. Now, we’re not done. We are developing plans to further reduce our costs, targeting an impact on 2014. This cost effort will be centred on five key areas which you can see listed here on the slide. This work is getting harder as we pick the low-hanging fruit. However, we’ve scoped these out and we should have more to report at the half-year.

Group impairment trends remain favourable as we saw £2.2 billion decline in 2012 versus last year. Core impairments were down nearly half a billion on 2011 while non-core saw £1.7 billion decline largely due to the Ulster Bank portfolio. In Q4, impairments picked up, driven primarily by top-ups to legacy positions in Ulster non-core. Core impairments were flat on the prior quarter. REILs were down over £1 billion versus a year ago. The group has continued to strengthen its provisioning levels as yearend group provisioning coverage of 52% was up 300 basis points on a year ago. Ulster core and non-core impairments were down £1.4 billion on the year, almost all of that in non-core. Though still high, the impairment ratio, as a percentage of loans, has declined by almost 300 basis points this year. Note that Ulster provisioning levels have improved by 400 basis points in 2012, and NPLs are beginning to flatten on a constant currency basis.

Now let’s look at the so-called below the line items in more detail. 2012 saw a total charge of £8.8 billion, significantly higher than last year. Leading the way was the £4.6 billion charge for own credit adjustment, and as Stephen mentioned, it’s worth remembering is that this charge indicates the debt market’s recognition of our balance sheet progress. At year-end the net OCA left on the balance sheet is now just a small debit of £29 million. Excluding OCA the below the items tallied £4.1 billion, which is a £400 million decrease from 2011. The biggest items were for conduct related redress, restructuring costs and a charge for Direct Line Group goodwill impairment. DLG is now carried at the year-end price of 216p per share. During Q4 we raised the PPI provision by £450 million to £2.2 billion. At year-end we had paid out 59% of that amount. On LIBOR, we had agreed a resolution with US and UK regulators and we took a Q4 charge of nearly £400 million. On swap redress we've taken a provision of £700 million based on work and our pilot study and reflecting the FCA's framework. As we move into 2013 we expect the below the line items to decrease on lower restructuring and conduct costs.

Now let's turn to our core performance. Core operating profit was up 5% year on year, reasonably good given the subdued revenue environment. To deliver this result we tightly managed costs and impairments declined. The core operating profit has averaged £7 billion over the first four years of our recovery plan as R&C profit growth has offset the impact of our smaller markets business. Core ROE for the year was 10%, that's 13% ex-Ulster Bank. Core divisional performance was led by a rebound in markets which delivered £600 million in higher profit and a 10% ROE. And also the US retail and commercial business, which had a £200 million higher profit on the back of lower impairments, had a 9% ROE. The UK businesses generated good returns but earnings were crimped a bit by low rates and a subdued economy. Also noteworthy is that Ulster loss remained stable on the year and also on the quarter. For Q4 our operating profit was up 7% in retail and commercial relative to Q3, while overall core profit was down 7% on Q3 due to the seasonality in markets.

It's worth a deeper look at the progress we're making in several of our businesses. First with Markets, we've made good progress on restructuring the business. Expenses are down 15% from 2010 with 4500 fewer heads in the business. RWAs have been reduced by almost £20 billion to £101 billion despite significant regulatory uplifts. We continue to work hard to mitigate the coming CRD4 impact, particularly around counterparty credit models. As Stephen indicated earlier we will target further reduction in the business to £80 billion RWA target by the end of 2014. This will necessarily mean lower balance sheet usage and a smaller expense base to offset the impact on revenue. We believe that we will be able to do this while maintaining the strength of our key franchises and serving our customers well. We'll provide further details of this plan at our half-year results.

Note that Markets is an integrated part of the RBS group, delivering important products to our R&C franchises. In 2012, we had the baseline resilient ROE of 10% as I mentioned, but if you add the contributions to divisional returns back, markets return would be boosted to 13% for 2012. Looking at it the other way, Markets boosted international banking's ROE by 4% and UK corporates by 2%, and Markets also positively affected Wealth and Ulster returns. Markets is closely connected to our UK corporate customer base, and here you can see across four key products including FX and syndicated lending, Markets has the number one market position as well as excellent client penetration rate. Finally, comparing Markets profit margins to peers, our business ranks a respectable third place.

Another franchise worth a closer look is Citizens which continues to make solid progress in improving its profitability. Citizens has an attractive footprint and good scale, as seen by the top left graphic. The challenge has been to generate better returns, which has been hampered somewhat by the sluggish US economy and low rate environment. That said, we've made steady improvement in profitability with returns getting closer to our cost of equity. Loan buy-ins have been showing promising signs with corporate and commercial balance growth of 21% since 2010. We announced today, as Stephen mentioned, that we'll be taking steps towards a partial IPO for Citizens in a couple of years' time. This technology is the progress that's been made and will provide sufficient runway to get the asset ready for listing at an attractive valuation.

Our ambition for Ulster Bank is for a top tier bank in Ireland with an acceptable level of return. After the clean-up process, the balance sheet will be self-funded with a solid one-to-one loan to deposit ratio. Core's business model, asset portfolio and risk appetite will all be attractive, while non-core assets will be methodically worked out over time. We foresee core ROE approaching 10% by 2016 with a cost to income ratio target of 50%, assuming a favourable economic trajectory. We're investing now in improved systems and products to help drive us to these targets. We remain highly focussed on our customers in Ireland. In the retail bank we have 175 years of history as a foundation. On the corporate side we offer a local presence combined with global expertise.

Non-core had another excellent year. Third party assets were down £36 billion or 40% to £57 billion at the end of the year. Of the £36 billion in asset reduction, £18 billion came from asset sales and £16 billion came from run-off. In the fourth quarter alone, TPAs were reduced by £8 billion. As we enter the final year of the active run-off of non-core, we remain confident in achieving our target of £40 billion. We're targeting about £8 billion of asset sales which is well below the average in the first four plan years of £21 billion. This asset reduction was achieved well within our loss tolerances. Non-core's operating loss was £1.3 billion lower in 2012 than in 2011, at £2.9 billion. The improved performance was driven by a £1.7 billion reduction in impairments and at 27% fall in costs that helped partially offset the £1 billion fall in revenues. The revenue decline reflects the lower asset base and associated frictional disposal costs. The 2012 drop in impairments was driven by the Irish portfolio as the book was heavily provided for in 2011. Note we did take a modest top-up in Q4 in order to be prudent.

Looking forward to 2013, we expect the P&L loss to continue to decline. Lower impairment charges are expected to be partially offset by higher disposal losses. Looking beyond 2013, we expect the non-core rump to consist largely of longer term corporate assets and key area exposures. Our approach from 2014 onward will be to move to a more passive management of these assets while still providing good disclosure to the market. Core divisions will manage their legacy assets while our experts in Global Restructuring Group will continue to actively manage down problem asset. The rump will include good quality credit assets of around £20 billion that run off by 2016. The balance will be made up of stressed assets and long maturity lower yielding assets.

For the next section we'll switch our focus to the balance sheet and risk. The scale and the risk profile of the Group has been transformed to the first four years of our recovery plan. Scanning a few metrics the Group's funded balance sheet has declined by nearly £700 billion or 44%. At the worst point we had 503 corporate exposures above our risk appetite. This now stands at 135. We had CRE growth exposure of £110 billion. Today, that's decreased to £63 billion, well on the way to our target of £50 billion. Finally, daily revenue P&L volatility in markets has been significantly managed down with the 2012 levels 68% lower than at the worst point. While there's still some more work to do the progress has been dramatic. The group has also re-engineered its business mix to be less exposed to investment banking volatility. This should be rewarded through time through both improved credit ratings and equity valuation. Market's TPAs are down 43% since 2008 and RWAs are down by 33%. As mentioned earlier, we plan further shrinkage from here. Now, critical to this execution has been our ability to preserve our offering to our UK and global corporate franchises.

Revisiting our balance sheet metrics' dramatic progress is once again evident. We've now met our group loan to deposit ratio target of 100% one year early. Customer deposits now represent 74% of funding versus 66% last year, and only 51% at the worst point. Our key funding and liquidity metrics have all improved. Our short-term wholesale funding requirement declined to just £42 billion compared to around £300 billion at the worst point. The liquidity pool remains robust, increasing in the last quarter to 350% of short- term wholesale funding and just about covering our total wholesale funding. Our liquidity coverage ratio is already compliant with the recent Basel framework, more than six years ahead of schedule. And we're also compliant with a net stable funding ratio, again well ahead of schedule. One of our challenges though continues to be a build-up of liquidity. We'd like nothing better than to see an uptake in loan growth.

The group continues to maintain a strong capital position with a 2012 core Tier 1 ratio of 10.3%. The exit from the APS scheme in the fourth quarter was a significant milestone which reflects our improved capital strength. The CT1 ratio increased by 60 basis points year over year ex the APS. The key driver was de-leveraging and de-risking which led to a £90 billion gross RWA reduction.

Regulatory RWA uplifts were around £40 billion. RWAs were down around £50 billion on a net basis. This RWA story will continue to play out similarly over 2013 as we work hard to shrink and de-risk in order to mitigate further regulatory uplift.

The market has moved on to focus on fully loaded Basel III capital ratios so it is worth providing some detail. We estimate our 2012 FLB3CT1 ratio – that's a mouthful – at 7.7%. This ratio is projected to improve in 2013 to around 9% to defer the RWA mitigation and further rundown of markets and non-core RWAs. Of our capital deductions, note that we believe our expected loss calculation is on the prudent end and our DTAs offer stored value. For 2014, we project an even stronger FLB3CT1 as we return to profitability.

Let's look at some of our future challenges. We clearly take note of the FTC industry concerns and we're working hard to ensure we're in the right place on these matters. On RWA intensity, we've been through a programme with the FSA that increases our RWA intensity. Combined with Basel changes we believe that the end result is a capital framework that reflects the underlying risk that we're taking. On provisioning we have steadily built our provision coverage ratio to achieve strong coverage ratio of REILs, certainly ahead or in line with peers. We've taken a prudent view in our yearend accounts of an incremental £250 million management overlay in our latent provisioning primarily related to commercial real estate assets in the UK and in Ireland. Our expected loss calculation, as I mentioned, provides further protection using conservative stress LGD assumptions. On conduct related matters we accrued £1.55 billion in Q4. We anticipate come further costs in 2013 so we expect a more manageable level.

With respect to capital more broadly we believe we're on a trajectory to achieve and sustain a robust capital framework. We set our medium term core Tier 1 ratio target of 10% plus. This exceeds both the G-SIF and the ICB ring-fenced bank requirement. With respect to our total capital ratio we target a buffer on top of core Tier 1 of greater than 5% made up of Tier 1 and Tier 2 debt. At the end of this year that buffer was 4.2%. To achieve our aim we require further issuance in 2013 and 2014. Note that there'll be around £4 billion of maturities and amortisation over the same period. Our preference remains for straight LT2 instruments so we are carefully considering the merits of a Co-Co feature. The current government contingent capital facility with a 5% CT1 trigger is providing less value to the group. This terminates at the end of 2014 unless we can negotiate something earlier.

There's been much speculation as to the status of the EC mandated branch disposal process. Key points to note are that the business continues to perform well with a 2012 ROE of 16% and an 84% LDR. Next, there's an encouraging level of interest in the business although execution will be challenging. We're fully engaged in completing the separation of the business including establishing a standalone technology platform. It is likely we'll need an extension to the EC timeline in due course and three's several ways we can go in terms of the transaction, but the baseline case is the creation of a standalone bank.

Let me wrap up. With respect to outlook we offer you the following: group NIM should be stable but gradually up over 2013 given the reductions in wholesale funding costs and extensive deposit funding. Lower hedge income will provide a partial offset. A wild card though is avoiding the build-up of liquidity if loan growth fails to materialise. We project 3% growth outside of the run-off books. But operating expenses costs will remain tightly controlled and you should expect absolute cost reduction at the group level again this year. We expect further improvements in impairment levels over the next two years which again will be led by non-core. Markets performance is, as ever, market dependent. So far Q1's performance is running in line with our expectations behind Q1 a year ago, but ahead of Q4. And we remain confident of hitting the £40 billion non-core TPA target and we do expect the P&L loss will decline again.

To sum up, we feel good about what we've accomplished over 2012, and more broadly, over the first four years of our recovery plan. As Stephen indicated, 2013 is another year focused on risk reduction and paving the road for a brighter future. In 2014, we would like to start a new chapter as a clean, normal bank where we can build capital organically, start to grow the balance sheet and engage in capital management strategies which are positive for our shareholders. It's been a long, hard road but we are getting there. With that, I'll turn it back to Philip for the Q&A.

Questions and Answers

Sir Philip Hampton

Thank you, Stephen, thank you, Bruce. I always think after such a comprehensive presentation there can't possibly be any questions but we know you better. There you go, right in front.

Chintan Joshi – *Nomura*

Good morning. Two separate questions for dividends. The 10% target for 2014, is that how we should think about dividends, so the question is if paying a reasonable, say, 25-30% gets you below 10%, would you do that or you'd resolve to about 10%?

Sir Philip Hampton

We can't answer the question yet because the two gating, the three gating points are number one, we've got to produce some profits to pay a dividend out of, number two, the government has got to find a way to remove the dividend blocker, and number three, the regulator has to approve a dividend strength. I hope that during the course of 2014 we can address all three items and at least be in a position to articulate a dividend policy. That dividend policy will be to start paying dividends as soon as we can but there're a number of things that aren't under our control in that process and so I think, to be more precise than that, is impossible at the moment.

Chintan Joshi – *Nomura*

Just to confirm that 10% is excluding the FPC review and the DAC?

Sir Philip Hampton

Our capital targets of greater than 10% are targets regardless of what lies beneath them. The timing of reaching them is obviously the function of thousands of moving parts and so, and what the dividend blocker will cost to remove, I don't know, so there's some fuzziness around it which is why we're saying dividend policy articulation in 2014, if we have a little window to stick something in as a smidgen towards the end, obviously we'll do that if we can but I don't think we can today be that confident to promise that.

Chintan Joshi – *Nomura*

The second question was on margins. I was a bit surprised to see both asset yields and liability costs trending up in Q4 versus Q3 given the trends that we've seen in the market. I was just wondering how we think about margins from your, I mean particularly around mortgage rates. I mean fixed mortgages are around 3% at the moment, even lower from some banks and we see others at 4%. I mean how do we think about that situation? Is there a chance that SVRs come down on the back of that or do we see asset yields coming down on the back of that?

Bruce Van Saun

Again, we're calling for broadly stable interest projection next year or through this year I should say. Asset yields I think have been reasonably stable. What we're trying to work on is lowering our cost of non-interest bearing liabilities that will partly offset continued erosion in the current account hedges and so I think the dynamic to that, as the year goes by, could be net positive so the NIM could expand as the year goes by fairly slightly. And what I pointed out is the wildcard is how much loan growth do we get. Obviously loans have a better yield than cash building up on a balance sheet so we'll have to see how that plays out.

Chintan Joshi – *Nomura*

So bottom line, asset yields should be stable is what you are saying?

Bruce Van Saun

I think so, yes.

Raul Sinha – *JP Morgan*

Hi, morning, it's Ralph Senna from JP Morgan. If I can have two questions please; firstly, Bruce, could you talk about your cost plan? You've already exceeded your 2.5 billion cost reduction target by 1.1 billion. Where do you think you could top out that over the next two years in terms of an overall cost number? That would be really helpful. And then secondly on the Markets, 30 billion incremental reduction that you've guided today, which part of the Markets business is this coming from and is this coming out of your working capital within the Markets business or is this the fixed capital that supports the Markets operations, so we can get some idea about how much impact there would be to the revenue and the cost line?

Bruce Van Saun

Again, just the first one was what?

Raul Sinha – *JP Morgan*

The first one was on the cost, the £3.6 billion cost saving.

Bruce Van Saun

Yes, the costs are going to be affected by a number of things so again Direct Line Group will be sold off and deconsolidated. The branch business will ultimately be sold off and deconsolidated. So again the group continues to shrink both at a top line and then those cost impacts. On the underlying cost basis we will be taking more cost out of Markets as we work towards that 80 billion plan. We don't have all the details of that but that's you're taking RWAs down another £25 billion and that's going to have a revenue impact. To get to an ROE that works you have to take costs down a fairly meaningful amount so that's part of the challenge that we have to work through. Around the rest of the group we've been very disciplined on cost but I do think there's more to squeeze. In this environment we have to really be ambitious and keep working on that. So I'm giving myself a little wiggle room. We're going to work through those things and put a number out there at the half year but again I'm not satisfied with 3.6. I think we can keep pushing that number higher.

Raul Sinha – *JP Morgan*

The second one was Markets RWA, is that a particular part of the Markets business?

Bruce Van Saun

think we have a broad view as to, but that's a reasonable number where we maintain our position in our key franchises. But then the details about the best way to do that, are there any product line exits, are there any geography exits, obviously those would have a related impact on our international banking business and have to be considered carefully together. We've got Peter and Suneel and John Owen, a bunch of folks really working hard on this and again we'll be having discussions on that with the board probably around March/April timeframe and be able to put all the details of that forth at the half year results.

Stephen Hester

As I said, I think we have to be honest. This is business and we're putting a lot of pressure on, I think it's true, for other businesses like it in the market and there must be some risk to our returns through this process. I think when you look at it at a shareholder aspect, even if the returns show some slippage, ie we're unable to cut costs as fast as revenue, I think it's possible to make a shareholder case for this based on some of the parts and multipliers and quality of earnings so that's our underpin. But I do think we have some risk in this process. We'll execute as well as we can and all I can say is I think the business has done a really terrific job in the last four years of going through dramatic change and producing profits all the way along for us.

Bruce Van Saun

And in particular the numbers that we showed today for them, to have a 10% ROE in a period where they've already taken a good whack at RWAs and dropped a whole bunch of people and narrowed the product focus, to still be competitive and show FICC results that are in line with peers for the year is quite a testimony to the management team.

Raul Sinha – *JP Morgan*

And will you reinvest the capital back into retail and commercial?

Stephen Hester

No, it's reinvested in a higher Basel core tier one ratio. I wish it were invested in something profitable.

Tom Rayner – *Exane, BNP Paribas*

Thank you very much; it's Tom Rayner from Exane, BNP Paribas. Maybe just sticking on that last point, I mean Stephen, I don't want to give the wrong impression with this question because I think the restructuring that you guys have done has been pretty amazing in some ways but if the FPC really needs more contingent capital, surely raising that rather than agreeing to IPO US business would make more sense? And on the Markets, I mean it wasn't that long we all sat through that presentation and I thought it was a very credible sort of presentation of what the optimal size of that business would be and taking all of the revenue and capital into account, and yet we're now talking about another 20 or 30% downsizing. I guess my question is if you're a potential institutional shareholder, how can you be sure that the decisions are being made for economic rather than political reasons?

Stephen Hester

Tom, we tried to, both the Chairman and I tried to address that upfront and of course all companies are subject to a series of pressures and not just ordinary shareholder pressures. We are subject to some particular pressures. We have to have an accommodation with regulators, all banks do, and they're more muscular today than they have been in the past. The Chancellor himself, our majority shareholder, has described how he is being muscular in the majority shareholders' wishes and you can't run a company ignoring your majority shareholders. That would be stupid. What we believe we are doing, have done and can do, we believe, is steer a sensible path through the needs of our customers which come first, the other stakeholders we have and have a company that can be appealing to all shareholders at the end of it. All companies have to pick a path through these things. We have more boulders on that path than many but we think that we're picking a sensible path through it and so I think that's the best answer that we can give to you.

Bruce Van Saun

We'd rather be where we're going than where we are. We think it's a better place to be.

Tom Rayner – *Exane, BNP Paribas*

Thank you.

Michael Helsby – *Bank of America Merrill Lynch*

I'd just like to follow up on that just to make a few things clear if we can. Clearly the FPC highlighted the three things that you put up on your slide and you mentioned that the Citizens IPO, the reduction in risk weighted assets was certainly steered by some of the comments that they've made. Should we read it as being contingent, ie to give them more confidence about your capital path and your capital plan or should we read it as the comments that they've made, there's a deficit, ie your capital ratios are overstated because I think that's what people are really worried about.

Stephen Hester

No, I understand. First, the most important thing is we can't speak for the FSA and we can't speak for, and they can't speak for the FPC and the FPC will meet in March and no-one can know what they will or won't say about the industry. I don't think they are able to say things about individual banks, so every bank will have been in close discussion with the FSA and no banks will know what the FPC will or won't conclude. At no stage have the FSA given us a specific target, ie the FSA did not say here is a capital gap, please fill it. And indeed the FSA has been just as interested in the risks in our balance sheet, how they're provided. Bruce has indicated increasing RWA intensity that we've been doing. So next drove some follow on the scale and provisioning and so on so a lot of the dialogue has been to get people comfortable with how our RWAs are reported, how we're provisioning for loans, how we're provisioning for conduct cases in addition to the naked ratios and the full debt positions regarding this. So we were never given a target, I have no idea if we were given a target whether this exceeds the target or doesn't exceed the target. That hasn't been the nature of the process but it has been a very thorough process. We think the regulator believes we've engaged constructively and appropriately but the regulator themselves are not the FPC and obviously that's still a hurdle for everyone yet to come.

Michael Helsby – *Bank of America Merrill Lynch*

Can I just have a separate question on loan growth?

Bruce Van Saun

Just on that point, I do think we should say it, we did say it but I think we believe our capital position is more than adequate for the business that we're running and we believe in our forward projections that we can continue to deliver and we can deliver very strong capital ratios. So, you know, even without those extra two actions on Markets and Citizens but in the end we've chosen to take these additional actions.

Michael Helsby – *Bank of America Merrill Lynch*

And then just finally, you mentioned I think 3% loan growth at a Group level, that's what you're pencilling in, could you give us a little...

Bruce Van Saun

That's ex the run-off books. That would not be including non-core or the UK commercial real estate rundown.

Michael Helsby – *Bank of America Merrill Lynch*

Could you give us a little bit more colour in terms of where you're seeing that and maybe a bit of colour in terms of how you're seeing the trends at the real grassroots level? I know the Bank of England credit survey suggested that corporate credit demand felt like it was picking up so can you just talk a little bit about what you're seeing?

Bruce Van Saun

So just broadly, a couple of pockets where we expect probably the most loan growth, the mortgage area and UK retail feels like we'll have a good year in terms of growth there. Also in the US, in the corporate and commercial space we've had good loan growth last year and we think that should continue even though competition has increased around, from other banks. But we still think we'll see some growth there. You might want to talk about your key corporates, Stephen?

Stephen Hester

Yes. Just a small thing on mortgages; I think our first quarter will be soft because one of the things we did in December was take most of our mortgage advisers off the road for retraining pursuant to the new FSA standards and so I suspect we'll have a soft first quarter but hopefully a decently positive year as a whole.

On UK business loan growth I guess the thing to look at frankly is GDP for the averages. If GDP isn't growing then people don't want to take on more debt. Some companies do and some don't. So last year we lent something like £60 billion to UK businesses and a similar amount paid us back so our net lending was pretty close to zero ex the run-off from the real estate books that has been talked about. At the moment, Q1, the pattern is the same. If economic strength and confidence grows then first of all companies need to see their order books grow. When they see their order books grow they think okay, let's have a new machine tool or some more inventory or whatever. And so there's never been an economic cycle where lending growth didn't lag economic recovery and business recovery and those are the indicators I would look at if I were you.

Cormac Leech – *Liberum Capital*

I'm quite interested in your liquidity portfolio, £147 billion at the end of the year, unchanged from the third quarter and that's despite a lot of noise from Basel and I think Bank of England and so on about banks potentially holding too much liquidity. Frankly I was a bit surprised you didn't run it down a bit. Is that pressure from debt investors or what's going on there?

Bruce Van Saun

I referred to that a bit, so as we delever we keep getting more cash in the door. The logical thing we'd like to do is put it out the door in more loans but there's not a lot of loan demand. So then we have to say well, gee, the right side of the balance sheet is stable and the left side of the balance sheet is coming down, what do we drive off in terms of the right side of the balance sheet if that cash comes in the door? What we have done is driven down short term wholesale funding, so it started at £300 billion, it's down to £42 billion. Probably half of that is a roll down of term debt that's now under a year maturity and there's really not much you can do with that. And then there's other amounts of short term wholesale funding which are tied to business strategies which make sense. So we're getting down to the nub of short term wholesale funding. There's probably a bit more we can do. Then you say okay, we could, and then we have to look at long term debt. In the first quarter we did so far this year in January a small LME which we retired about £2 billion of long term debt. The problem is we're a victim of our own successes. Our spreads have come in, the prices on that debt have moved well above par, so if we buy in debt at 120, say, of par we have a day one loss, we make the interest back over a period of time. As we're trying to manage the capital position there's a certain appetite that you have for taking day one losses that pay back hopefully within the year, which is why we started this one early in January. But again we don't have an unlimited ability to go out and retire term debt. So then the only other thing to look at is deposits and so in some cases there are deposits that are not as stable, low cost franchise deposits, they're kind of hot money type deposits; you try to drive those off next. We were also captive to hitting our loan to deposit ratio targets so we didn't want to go too fast and too abruptly on that score either. So those are the tensions and things that we have to balance as the year goes by. We're going to get cash continuing to come in, non-core is deleveraging further, Markets is going to shrink further and then what do we do with the money? We have to go to those buckets and those buckets are starting to get tougher.

Cormac Leech – *Liberum Capital*

In terms of the long term shape of the business, you know, two or three years out when you get above your 10% Basel III equity tier one, so debt investors have nothing to question on the capital side and therefore presumably relax on the liquidity side, what do you see as kind of the normalised run rate, say percentage of short term wholesale funding? You're currently at 3.5 times versus your own target of 1.5.

Bruce Van Saun

I think we can bring it down to maybe 120 to 130 once loan demand picks up and that short term wholesale funding can maybe be 40 or something like that. So you could run it at three times and still hit all of your other metrics. I mean it's a crude formula but we have other metrics that, the FSA has a series of three month metric, two week outflow metric, gap two metric but I think you could certainly, if you got that number down another £30 billion you'd still be able to comply with those metrics.

Cormac Leech – *Liberum Capital*

Maybe just a final follow-on, I mean from the outside in it's quite difficult to understand what the delta on your PBT might be if you did that, so simplistically, say it's currently earning, I don't know, a yield of maybe 50 basis points and you put that money to work in low LTV mortgages, presumably you can get two, 2-2.5%, so what might the delta...

Bruce Van Saun

Delta might be 2% I guess but roughly I would say, you know, take 2% of that.

Stephen Hester

And obviously we'd use more capital because liquidity is low risk weighted assets and if you speak of in a loan, it's higher but it's not straight ROE.

Peter Toeman - *HSBC*

The Citizens IPO you described as a source of contingent capital. You then referred to the CoCo from HM Treasury which is of course a source of contingent capital; that might be terminated in 2014 so should we regard those two transactions cancelling each other out or...

Stephen Hester

No, I think the HMT, because it's in capital is essentially worthless given its trigger point and its maturity so that's just, that's not any part of this. The Citizens, there were two reasons for Citizens; part of it was FPC type discussions and part of it is what we think is right for the business and for shareholders in terms of showcasing value in terms of giving liquidity to the assets and in terms of allowing the asset deeper footprint in the United States market. So we see, you know, trying to kill more than one bird with the same stone.

Peter Toeman - *HSBC*

So you won't have to replace that in any way or your thinking is the FPC won't require you to replace that contingent, that eight billion of contingent capital?

Stephen Hester

I don't, there hasn't been a focus on the government contingent capital because everyone knows it runs out in 14 and I don't think anyone believes either we have a need or the government has an inclination to extend capital support for RBS, so that has not been a feature of any of the discussions. The FPC, I do think, has some keenness on contingent capital and that's why Bruce said we remain open on the subject of contingent capital in a sort of conventional sense and in a CoCo sense and we have to see how that develops and we certainly remain open to that issue. So I think that's a separate issue. Maybe I used slightly the wrong phrase for Citizens as to how to think about it but I was just trying to describe to you...

Bruce Van Saun

But the LT2 issuance that I referenced is four billion of maturities and we want to build up a buffer a little bit so we'll probably have to issue five billion, say, over the next three years. That's the underlying post instrument and then the question is would you put a CoCo feature on that or not?

It depends on market conditions and the price etc and what kind of pressure you're getting from regulator etc but those are things for us to consider.

Rohith Chandra-Rajan – *Barclays*

If I could follow up actually just on Citizens, so core Citizens made a 9% ROE this year; I'm just wondering where you think that can go to in the current rate environment. Provisions look maybe a little bit on the low side versus normalised at the moment so I was just wondering what you can do in terms of continued business, changing the business mix or cost efficiency.

Bruce Van Saun

If you look at the trajectory over the last four years we've come from a loss all the way up to, I guess it was 4%, 6%, 7%, 9%. It's going to get harder from here. A lot of that move was, as you're right to point out, on falling cost of credit so provisioning has been favourable there and at this point we might be able to sustain that level through this year but it might actually move up a little bit because as a percentage of loans and advances I think it's down about 20bps which is quite low through the cycle basis. We are certainly working through organic plans to improve pre-provision profit. One of the things has been to shift the business mix away from just more of a kind of mortgage bank with a big home equity portfolio to build out the commercial operation. We've seen 21% loan growth over the last three years on the corporate side and so that portfolio, we used to have maybe a third of the assets in corporate space and that's up to almost a half at this point and so we think that's going to help. And then we can do more cross-selling of various products and services into those corporate customers. We are also looking to have better profiles of our retail customers and get a bigger share of wallet. So there are things on the revenue side as well as, again, on the expense side. People look at the efficiency ratio at Citizens and they say it's high, but is it a revenue problem or a cost problem? It's probably more of a revenue problem I would say because if you look at the expense base as a percentage of assets or other measures it looks actually below the median, but having said that we still will look for opportunities to take more out of expenses. So I think a long winded way of saying there's some improvement that we can do but it's going to get harder from here because we won't get any more boost from credit. We have to get it on the pre-provision profit line, so can we push nine up to ten, can we then push ten to 11? Instead of coming in chunks of 200 basis points I think it's going to be smaller augments from here.

Stephen Hester

I think along with that, from an IPO standpoint, the passage of time not only will help us, probably as Bruce says now, inch up the profit; clearly once the US economy starts growing better there'll be those kinds of gains. We're not relying on those but those will come at one point or another, but also the efficiency of the rest of what's happened in Citizens we can improve, so the remaining bits of non-core in Citizens over the next two years can be largely eliminated. We then have some capital management or capital structure issues to work through with the regulator that will allow more of the core ROE to come to the bottom line. I think when you put all of that together you should have a company that will be competitive with some of the other regional banks in terms of where it could trade, whether those trading multiples expand still further will be, from where they are today, will be I think more of a function of the external environment as we said.

Bruce Van Saun

Yes, I mean the last point I should mention, Stephen jogged my memory, they've also had a relatively asset sensitive position on the balance sheet so higher rates also, when that comes, will be a little turbocharge and boost to the ROE.

Rohith Chandra-Rajan – *Barclays*

That's great. Just on the other area of restructuring, the £80 billion, so the £100 to £80 billion RWAs in the Markets business, the additional reduction in third party assets, does that relate to it?

Bruce Van Saun

I would guess it's, you know, 25 to 35 maybe, something like that.

Stephen Hester

But let's be clear; the reduction is actually more than you've just stated because in the middle we'll have CRD4 so we're having to go from CRD3, 100 and something billion to a CRD4, 80 billion. So as I say this is not shaking for the company as a whole because Markets is now just 20% of the total but it's an important and challenging job of work for our Markets business.

Rohith Chandra-Rajan – *Barclays*

Which sort of links to my final very short question; so thanks very much for the additional Basel III disclosures, really helpful. I just wondered if you could split it, the deductions and the RWAs between core and non-core. So the additional Basel III disclosure, if you're able to split the impact on both deductions and RWA between...

Bruce Van Saun

I don't have it on the top of my head. You can come back to Richard later in the day.

Rohith Chandra-Rajan – *Barclays*

Okay, thanks.

Manus Costello – *Autonomous*

I also wanted to follow up on that interesting and useful Basel III slide because I just wanted clarification for how you calculated your 7.7%. Because if I read the impressively dense footnotes on that slide it looks to me like you've taken the current capital position but the RWAs you've given as our post-management action and assuming that all models are approved. So my question would be what would the 7.7 be if you didn't have those? What would your old RWA number be because most of your peers tend to give it on a spot basis rather than upfront…

Bruce Van Saun

No, I don't think that's right. I mean we looked very carefully at how other people are presenting their numbers and I think we're doing that on a consistent basis. We have, in the models that we assume will be approved upon implementation, I mean we're way down the track on those things. We were preparing those models for approval actually at December 31 2013 were CRD4 to come into place on January 1 of this year so it's just really going through the final stages of having full model approval on those.

Manus Costello – *Autonomous*

So in terms of the management actions that you assume, you don't assume the Markets, the additional Markets reduction that you've announced today but do you assume the Markets reductions that announced in January last year?

Bruce Van Saun

In getting to the 9% and getting to the 10%, those actions, that's how we're getting there. So it's not in the 7.7 but in going to 9% we certainly have further non-core deleveraging, we have the Markets shrink of the first program that we announced last January is in those numbers.

Stephen Hester

I think the kind of management actions that are in are not shrinkage of business; it's adjusting of books for the new calculation of CRD4 so certain things are managed in one way and will have to be managed in another way, so there are important management actions without which there are unintended consequences but then on top of that are what I call real shrink actions which are, as Bruce said, are in the forecast for the increasing capital ratio.

Mike Trippitt – *Numis Securities*

Two questions; just following up on your capital planning, particularly looking forward at the Citizens partial IPO, what are thoughts on the risk of stranded capital in the US particularly with the Turello proposals on creating an intermediate holding company structure? Do you think that there is a risk that you end up with a sort of regulatory turf war between PRA or whatever they're going to be called now and the US regulators?

Stephen Hester

Yes, there's a risk. We've got stranded capital there today and part of the two year timetable is to allow us to negotiate an accommodation with the Federal Reserve to make it a sensible capitalisation strategy. I think that actually having a quoted stock there will make the US regulators more comfortable because they will perceive it as a second source of capital in emergency, ie the public markets rather than just having a foreign parent to call upon. So I hope that we will find that the regulators see it as a positive development in our capital discussions in the same way that in the fourth quarter of last year we did the first, since the crisis, tier two issuance out of Citizens in order to, not because we needed it but to demonstrate to the US regulators that Citizens has sources of capital which in turn should allow us to have a more sensible... So these are things, you're right, that have to be worked through for us and a lot of banks. We're thinking that it's work through-able.

Bruce Van Saun

On the Turello proposal for the holding company, obviously that's in a comment period. The comment period has been extended another month till the end of April. I think on a relative basis we're in reasonable position there having Citizens today. If you combined what we do in the US with Citizens we're in a reasonable position. I think one of the broader things that the US has to grapple with is are they going to apply bank standards to broker dealers? So today for example the US, the foreign broker dealers doing business in the US, when you do a leverage calculation they're able to back out the amount of reverse repo they have invested in treasuries from the leverage calculation. It's a very safe asset. The current proposal that Turello put out doesn't do that which would cause potentially shrinkage of balance sheets for the foreign broker dealers which has a second order consequence of hurting liquidity in the government market, and the last time I checked the US is still going to borrow a lot of money for a long time and that's not a good thing. So those are the kind of comments that are going to go back in to say be careful of unintended consequences. If you do things like this you may just find people shrink and pack up and not provide as much liquidity to that marketplace. The other thing is really on the liquidity test for the banks so that's why you need a deposit base if they are very strict on the liquidity side, and I think you may see some weakening on the liquidity side. Otherwise you might see people like Deutsche Bank and Barclays have to go out and buy a thrift just to meet the liquidity standards, right? So I think there's still a lot to play out on that but I do think there is the potential for some issues to arise but, again, having Citizens we're in reasonably good shape on a relative basis.

Mike Trippitt – *Numis Securities*

Thanks. Just a quick question; I just want to clarify the comment about the government addressing the dividend block. Do you mean the terms of the DAC?

Stephen Hester

Yes, that's what I call the dividend block, otherwise nicely called the dividend access share.

Mike Trippitt – *Numis Securities*

But isn't that immovable? I mean you've either got, either the share has got to trade at a certain level or you've got to buy...

Stephen Hester

... or we have to reach an accommodation, or they have to reach an accommodation with us, we have to reach it with them and the EU has to agree it. There's some sort of buy-back.

Bruce Van Saun

There's a potential to pay them some money to eliminate the DAS and have the B shares convert back into A shares and then we get back to a nice clean capital structure. So I think that day is coming down the road when it's closer to when it looks like we can put a dividend in place. And there is much an interested party in that because it'll reflect positively on the share price which they have a lot of stock to sell so again that will be an interesting negotiation.

Mike Trippitt – *Numis Securities*

And the payment will reflect the fact that these Bs have been available, have been part of your capital structure. Is that how it works or...?

Stephen Hester

There isn't a formula so it will be by negotiation.

Sir Philip Hampton

One of the laws of results presentations is that as time passes the importance of the questions has to increase, so who's going to go next?

Sandy Chen – *Cenkos Securities*

No pressure. Yes, just two questions and not, well to ask the umpteenth question on capital and risk weighted assets. Looking at the risk weighted asset movements from 2012 there were about £37 billion of Market movements. I've seen that that was spreads coming back in and bringing down the level of RWAs and then £44 billion of model related uplift in terms of RWAs and another forecast, ten to £12 billion under fully loaded Basel III, so a longwinded way of saying how do you get from the 7.7% of fully loaded Basel III core tier one end of 2012 to, say, an expected 9% given...

Bruce Van Saun

We had to cross a number of dimensions. Clearly the gross RWA number is going to come down as non-core shrinks and Markets shrinks so there's an element of that. I think as we work off legacy credit assets, the gap between our EL and our provision, that number will come down as well. There are some other things in counterparty credit and other things that we'll be mitigating over the course of the year that also will contribute so it's really across the balance sheet. We're not projecting to make a huge amount of profit next year so we really have to work the balance sheet to go from the 7.7 up to the nine. Once we get to 2014 we'd expect to start making money again. A lot of that ride from nine to ten would come on the back of profit and then using up DTA. So one of the things, people look at the 7.7 and they say oh, that's a little light. But you have to recognise we think there are two important elements of that. We are in a work in process, so we are running down non-core and we're not done so that, note that, A. And then B, some of the deductions, the EL we think we're on a conservative footing, maybe we can take less conservatism down the road, we'll have to see, but we certainly have a shrinking portfolio of legacy assets that should help that number in an absolute sense. And the other thing is DTA, so DTAs are deducted but they're actually a store of value. I mean we won't be paying those cash taxes down the road and so something that deducts from that ratio actually helps us in two ways; it'll eliminate and therefore the ratio will go up naturally but then we'll also have, you know, better after tax cash flow because we won't be paying taxes.

Sandy Chen – *Cenkos Securities*

And then a follow up question, I mean related to pulling the Citizens ripcord at some point if necessary, to be I guess cheeky and not to, well I mean Sanko is far too small to be pitching for the business but has a share demerger of UK retail and commercial banking been considered?

Stephen Hester

When you see a good market you'll probably be able to see us sell our branch business, you'll be able to see Lloyds sell their branch business, you'll be able to see Santander do a floatation, then you'll know there's a great market for these things. Right now I haven't seen that great market but, you know, what we are doing first and foremost is not financial engineering; it's trying to build a really good business. I hope we'll be alive to financial engineering whenever that adds value but in my experience most of the time what adds value is just making a business better.

Andrew Coombs – *Citi*

I have two questions please. Just first I want to return to the Markets business and particular Greenwich Capital. It's clearly a high return business; it's still almost $180 billion of assets and nearly $70 billion of RWAs and similarly has less interconnectivity with the rest of your group compared to perhaps the rest of the Markets business. So I guess my question is has Greenwich Capital come up in discussion with the FPC or with your largest shareholder and what do you see as the future for that business?

Stephen Hester

I think this is the wrong, you know, there is no investment banking business that I know of that doesn't technically have a broker dealer in the US because you have to, it's US regulation. But that doesn't mean, you know, we also have broker dealers in Hong Kong and Japan. There are all sorts of different regulatory legal structures. The businesses run blind to those. We don't have a business called Greenwich Capital. We have a legal entity that's a broker dealer. We also operate out of the branch in the United States so I think it's wrong to think of these things as separate chunks. Once upon a time there was; there isn't today. But we are of course alive to all the dimensions of our business. I don't really think of it in legal entity terms. We think about all of the ways to create value but what I do know is that if you want to be in the rates business to tell your customers oh, we can do your sterling business and we can't do anything in euros and dollars, it would be a pretty short conversation and our corporate business would end up looking like Lloyds and Santander not like the one we have today. And so these are interrelated although we have to balance the issues and release capital in the way we talked about.

Andrew Coombs – *Citi*

Just the second question, I wanted to address the number of media reports lately discussing a potential resurrection of the government policy to offer a share handout to the general public. I'm just wondering what you think is the likely reality of that emerging and any logistical obstacles to that.

Sir Philip Hampton

I think the logistical obstacles are colossal. I think some wag wrote an article about the AGM being held in the O2 or Wembley Stadium or something and transmitted to all the other football stadiums all over the country. If the government were to decide on this plan we would have to probably fall into line and help them to deliver it but I suspect they won't is my guess.

Stephen Hester

I don't have a view. The sooner we are privatised the better for the taxpayer and the better for us so the method is less important than the goal I think.

Jason Napier – *Deutsche Bank*

Just two please if I may. This week one of your US competitors put a number to the impact of regulatory change on Markets revenues and it works out at 10%, 11% of FICC and rates is the most affected business losing about a fifth of the top line. I appreciate you're not ready to share the detail on the risk weighted asset reduction and the new plan for Markets but I just wonder on a business as was basis whether you had a sense as to what proportion of the top line in Markets was at risk from post-rate clearing and transparency of that sort of nature.

Stephen Hester

We don't have a number but you're absolutely right; investment banking business, the trading business, not ours but as an industry, is under ROE pressure and that pressure has got some years left to unfold and everyone is trying to figure out how to deal with it.

Jason Napier – *Deutsche Bank*

If you look at it another way you're taking more than 20% of RWAs out of the business, they're saying 10% of top line goes away, you clearly don't want people thinking this is an additive story so at least part of what you're doing is in reaction to regulatory change. That's a reasonable...

Stephen Hester

Yes. It's very clear we strategically felt that our company would be more valuable if it had a different business balance and that was a top down view but it was also a bottom up view. And the investment banking business everywhere has been hit by regulatory change and by market trends. No-one's paying commissions or anything like that. In the UK there is special pressure coming up around ringfencing and so that's why it is both something that our majority shareholder wanted but it is something that in all shareholders' interests we think was right to reshape the company from a shareholder value standpoint because in a ringfenced world the scale of investment bank that we had before would not be viable in my opinion. And if it was viable it wouldn't be the best shareholder outcome. Obviously every different bank has got to deal with their own situations but we are hopeful that we can have an investment bank that is strong, vibrant and serves our customers well but within the context of the group that we have a group that has the best shareholder value balance and coherent to its type and geography of business. That's what we're aiming at. Of course the regulatory sands shift and the market sands shift and so that's why the precision of landing point, I've said for some years now, is not yet visible. But when Markets activities were 60% of the capital employed of this company it would be a drama what the result of those uncertainties was. When you're talking about 20% of the capital of the company then you could afford to have some, if you like, some uncertainties without it being ruinous from a shareholder value and that's why I think that, you know, at the moment there's all sorts of noise, restructuring and so on around us and everyone else but when people concentrate on business mixes and business models in calmer different times that we will find that our change in business mix is something that allows the sum to be worth, something that's attractive to shareholders.

Sir Philip Hampton

And the other point I would add is we need to achieve stability. We've had an awful lot of change in our business, dramatic change. We don't want to come back to you in a year or two years time and say it's going to be different again so this should be it. Okay, one more question.

Jason Napier – *Deutsche Bank*

Can I just follow up with one more, just one? Thank you. And I'm sorry if I'm being unusually dense here but I appreciate that we don't know what the FPC will say until they've met and decide what to say but in your prepared comments where you said that RBS had reached an accommodation with authorities and there are steps that are coming out of that that look like Citizens and Markets and so on, is that to imply that having been through the process of looking at the three issues that the IPO and the Markets reduction has effectively the blessing of the FSA this month or to the FPC once it becomes the PRA? When you say you reached an accommodation, what does that actually mean in practice?

Stephen Hester

It really is not my place to speak for the FSA and I think, I don't want to get into hot water for doing so. As I said, I don't think anyone can speak for the FPC. We have worked very closely with the regulator on the regulator's concerns. We believe that we, our plans address the regulator's concerns. We believe we're not being irresponsible in saying that but do we have a certificate of evidence? No.

Jason Napier – *Deutsche Bank*

Thank you.

Sir Philip Hampton

Okay, good, one more question.

Ed Firth - *Macquarie*

I'll be quick. I was just trying to square your comments with the fact that you say you want to stimulate loan demand but you expect asset pricing to remain static this year. I mean surely traditionally the way to stimulate loan demand is to reduce asset pricing?

Stephen Hester

Let me explain this to you a little bit because actually the funding for lending scheme, which is out there and which we're an enthusiastic and prominent participant, is an experiment and we'll see how it goes because the funding for lending scheme in essence reduces loan pricing, so our loan pricing has come down as a result of that, everyone's has but the cost of funds came down which is why the margin was overall manageable. Although the funding for lending scheme I think is an important tool, so far our observation is that it has brought forward refinancing as opposed to strong incremental loan demand. And the simple way of thinking about this is most businesses have internal rate of return holes for new capital projects of double digit somewhere, ten, 15, 20%. Our average interest rate to small businesses is under 4% and to businesses as a whole it's a lot lower. So the price elasticity of demand, for business lending anyway, is very low when interest rates are this low. And the much more important factor in demand for lending is confidence and use of the money and confidence that people can pay it back and so on and so forth. There is a bit more price sensitivity in the mortgage market because people think much more in terms of mortgage payments as a percent of take home pay, although even there the FSA requires us, in making any mortgage lending, to assume interest rates will pop back up to higher levels and so who we can lend to, there are limits to what we can do. But that's why we are a bit more optimistic about mortgage demand than we are about business demand in the immediate term because there's a bit more price elasticity there. But either way what we need is growth and that means competitiveness and so on and so forth and it is never an economic cycle that loan growth frontruns the recovery of economic confidence and other growth and you've seen that in the US and other markets.

Sir Philip Hampton

Okay, thank you all very much. Stephen and I will now go back to a day with the media talking about bonuses. Thank you.
