The Royal Bank of Scotland Group

Q110 Interim Management Statement

Analyst conference Call

held on Friday 7th May 2010.

Presenters

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

Operator

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

Stephen Hester - *RBS - Group Chief Executive*

Good morning, everyone, and thank you for joining us. As usual, Bruce van Saun is with me. We plan to talk over the results reasonably briskly and leave as much time for questions as possible. I hope you're all aware that, in addition to the very detailed pack with market-leading levels of transparency that we have again produced, summary slides that can be found on our website. We won't go through them page by page but they're there to help you either during or after the meeting. We apologise for starting this earlier than normal but we were trying to avoid an overlap with HSBC who I believe are later so obviously we'll quite understand, as we get towards the end of the call, if some of you need to drop off. In any event, obviously, it's a day when eyes are probably less on us and more on a combination of what's happening in global markets and what's happening in the UK election. So we will hopefully enjoy being dull and boring, which is entirely our ambition for the year.

The introductory summary I would make in respect of our quarterly results is, indeed, that we are doing exactly what we said we would do and across every one of the key aspects of our business and the key targets we've put out, we are on target or in some cases ahead of target for the plan but it is a five-year plan. Our key priorities remain to serve our customers well. The font of all strength of RBS will derive from doing that and I'm pleased to record that all of our core business franchises remain stable and, in many instance, actually growing both in customer numbers and in customer satisfaction.

Restoring the bank to stand-alone strength is a crucial goal. The really big improvements were made last year in balance sheet, in capital and in liquidity, but there is steady improvement to go from now on through the rundown of non-core and other disposals and increasing the quality of our liquidity, which are all on track. And, of course, all of this is being done in order to produce the return profile and quality of earnings that we've targeted in our five-year plan. We are on track to do that, to by so doing, rebuild sustainable value for all our shareholders and allow the new Government plenty of opportunities to recoup taxpayer money through profitable sales of our shares in the coming years. So that's what we're focused on. That's what we're on track to do and I think this quarter, while there are one or two things that went better than usual in this, some of which will unwind in other quarters, simply we would say we're on-track, we're pleased to be there. And with that, let me ask Bruce to take you through the specific numbers.

Bruce Van Saun

Thanks, Stephen. Let me briefly cover some of the group financial highlights and metrics. I'll then comment on our divisional performance before concluding with a few thoughts on our outlook for 2010. RBS Group posted an operating profit of £713 million in Q1 as seasonally strong GBM performance and diminishing losses in non-core contributed to what we describe as a solid quarter. That said, we did post a small attributable loss of £248 million after absorbing integration costs and the expense associated with the APS coverage. Our TNAV was stable as 51-and-a-half pence.

Some of the key trends driving improved performance that we spotlighted during the annual results meeting continued on through the first quarter. First, our NIM increased by nine basis points versus Q4 to 1.92%, driven by strong money market performance in GBM and a full quarter benefit of higher equity capitalisation in non-core following HMT's capital injection in December. While the reported NIM in our retail and commercial businesses was lower sequentially, after adjusting for day variance and one-offs between the quarters, it was up slightly as asset margin favourable trends continued to outweigh compression on liability margins.

Second, our expenses were down about 1% sequentially, even with higher accruals of GBM, with continued progress against our cost programme targets. And third, impairments declined for the third straight quarter, down 14% versus the fourth quarter of '09, led by favourable performance in UK retail, GBM and non-core. The economic environment continues to trend favourably and we avoided any large single name issues in the quarter.

On the balance sheet, we saw continued progress against key objectives. Deposits grew by £11 billion or 3% sequentially and our loan to deposit ratio improved to 131% from 135% in Q4. I should point out that our core loan to deposit ratio improved to 102% during the quarter.

Non-core TPAs declined by £8 billion, roughly in line with our annual plan. We grew our FSA eligible Government bond portfolio by £5 billion to £25 billion and we further improved the duration of our wholesale funding. Our provision balance increased by £1.7 billion or 11% and coverage of REILs increased to 46% from 43%. Non-core was £1.2 billion of this provision build and while REILs were up modestly in the quarter, this was largely focused in Ulster and non-core real estate.

The balance sheet was up a bit due to greater customer activity in GBM as well as FX rate impacts. RWAs were also up for those reasons, as well as the roll-off of ABN relief trades under Basel one, which we had given previous guidance around. Impact was £19 billion. Core tier one was a strong 10.6%, down from 11% given the higher RWAs. Note that the liability management exercise should add 30 basis points to that.

Looking at the divisional performance, GBM was clearly the stand-out performer. Market conditions were favourable through most of the quarter and our flow trading performance in rates, mortgages and credit were all strong. Some of our peers had exceptional quarters. I think this really drives off of differences in business mix and more write-backs and proprietary trading at selective peers.

So we feel like our franchise remains strong and stable; that's the bottom line. Our UK retail and UK corporate businesses continue to post solid results. NIM for each business was hurt a bit from the day variance in Q1 versus Q4 and some changes in treasury cost allocations but the asset margin pricing trends remain favourable. Impairments are falling faster in the retail than corporate division as business and commercial impairments tend to improve with a lag to the turn in the cycle.

We are pleased to see the US retail and commercial business bounce back to a profit in the first quarter. Expanding NIM, good expense control and falling impairments are contributing to the improved results. Insurance also had a better quarter after the big claims reserves we posted in Q4. Now, we would have hit break-even but for the unusually cold weather and associated claims from January/February. That said, there is still work to do on our pricing and claims capabilities and on the cost base. GTS posted another solid quarter, while Wealth continues to be adversely impacted from the low rate environment and intense competition for deposits. Ulster continues to be a trouble spot as credit costs in both core and non-core remain high and the trend in REILs remains poor. As we've said, it'll be a long road back to profitability in this division, dependent on recovery in the Irish economy.

Non-core produced good income levels in the first quarter, with the absence of any material asset write-downs or losses on disposals. Impairments were lower than Q4 as improvement in leveraged credit in the UK and corporate and commercial more than offset higher impairments in commercial real estate, particularly in Ireland.

For the rest of the year we will continue to focus on implementation of our strategic plan. We expect to see the trends in our operating performance continue absent any jolts to the UK and global economy. Our NIM should continue to gently rise and our impairments to gently fall although, as you know, we have significant legacy single name concentration in the credit book that can skew results for quarter to quarter depending on how they fall. GBM tends to be seasonally strong in Q1 and returns to more normal trend line results over the balance of the year. The R and C business should continue to trend positive and the insurance business should continue to improve as the year progresses.

The wild cards in forecasting at the attributable loss level focused on the amount and timing of disposals, along with APS expenses. We would expect only a modest gain on the Sempra transaction overall given the goodwill associated with that business. The retail and business banking sale should close in 2011 so no gain will be booked this year. The merchant services sale should have a reasonably meaningful gain which will be booked in the second half. Note the liability management gain of £1.25 billion should be booked in Q2. £450 million net of tax to the P&L and £800 million direct to equity, given the underlying aspects of the transaction. We were pleased to see that that transaction has been successfully executed in line with our expectations.

On the APS fee, the way to think about that is that the underlying expense should be about £250 million per quarter associated with time decay but the actual amount booked will vary based on the underlying movement in credit spreads. When they tighten, the expense is greater, and vice versa.

So to sum up, we are pleased with our performance in the quarter and we believe that our recovery plan remains on track. With that, let me turn it back to Stephen.

Stephen Hester - *RBS - Group Chief Executive*

Thank you very much, Bruce. Bruce, I think, summed it up. We're on track for the things we said we'd do. Now, of course, it wouldn't be us if we didn't remind you of the cautionary notes because while we expect to do what we said we'd do, it's not a no-brainer. It's not an easy task and in particular there are obviously two external sources of potential volatility that have to be borne in mind by investors, not just in RBS but generally. The world obviously remains a volatile place. We've seen that with the markets overnight, issues of sovereign risk contagion and so on and clearly they have the ability to be disruptive, both in a credit sense and in a trading sense to banks.

Secondarily, I think this is a very big year in terms of the further debates around banking regulation and we can see those happening all around us, whether it is in new taxes or in the potential impact on banks and the economy of various measures on capital, liquidity, the timing of implementation, and so on. And so there remain quite a wide range of outcomes in these areas; both have the time and quantum and impact which will continue to take a lot of attention as the year folds through. But with the exception of, if you like, those external variables that will impact us all, what we are doing is getting on with what we said we'd do; executing to plan, and that's what I hope we can report on each of our coming quarters. So thank you for listening to us and we'd be very happy to take your questions now.

Questions and Answers

Chris Manners - *Morgan Stanley*

Good morning, everyone. Just a couple of questions that I had; which were, firstly, obviously, you know, due to the volatility we've just seen, there's been a big gap out in LIBOR OIS. Just trying to work out, you know, how will, you know, that could impact RBS and what, if you think that, you know, that additional funding cost could, you know, increase the pressure on your net interest margin. And also, just to follow on on the net interest margin, in UK retail, obviously, you know, you're saying, good ability to re-price assets but you are having a negative mix shift towards more secured lending. I mean, do you think that that asset margin is going to be able to increase despite the negative mix shift? Thanks.

Bruce Van Saun

Sure. I guess, on the first question, we're certainly watching the spreads and kind of the market's willingness to lend money to banks. I think, you know, generally speaking, this has been episodic and as we recover from the shock of 2008 we'll go through periods where things look bleak and dire and then they, you know, all of a sudden turn and look better. So I guess it's a little hard to predict right now what that impact is on NIM but given the amount of money that we borrow in the overnight markets, there could be a little bit of a headwind there. I think, you know, when you put it in the context of the amount of money that we're terming out in terms of the wholesale funding and the build-up of a liquidity portfolio, those would still be relatively bigger impacts than that, as long as things stay reasonably under control.

With respect to retail and commercial margins, I would say that, you know, it's a little bit hard to decipher when you look at the sequential progression. Not to get too technical, but there's 92 days in Q4 then there's 90 in Q1 and there'll be 91 in Q2. So you always see a sequential difference. We don't adjust the NIM for the day variance so that largely explains the drop, you know. As you correct for that and a couple of other one offs, we were probably up a basis point or so. I think some of the mix shift that we're seeing in retail, you know, could bring back that asset margin expansion a little bit but net we're still positive. I think that trend will be clear as the year goes on. GBM should probably hold, there'll be some volatility around GBM but the level that they're at in Q1 is a more likely level going forward. Non-core now gets the benefit of the full capital injection that we receive from the Government. So that, until they start really liquidating the portfolio, some of those higher-yielding loans come off, I think that's a reasonable expectation. So the further growth in the NIM would still come from R and C largely, going forward. And I think that trend is intact and you'll be able to still see that.

Jonathan Pierce - *Credit Suisse*

Morning. I've got three quick questions, if that's all right. Firstly, can you give us – it may be in here somewhere but I haven't seen it – can you give us the pre-provision profits of the businesses that are earmarked for disposal in the first quarter of the year or can I just assume it's roughly running at the same sort of rate as last year?

Bruce Van Saun

Yes, on that one I would say, roughly the same, although the merchant services business is usually seasonally a little lighter in the first quarter and that's really the amount of consumer transactions that take place in Q4 is usually more than Q1.

Jonathan Pierce - *Credit Suisse*

Okay, thanks. Second question is whether there's been any margin benefit, particularly in GBM, I guess, in the first part of the year due to the capital raise in the back end of last year?

Bruce Van Saun

If there's been any capital benefit it's pretty marginal. We had ascribed mainly full capitalisation and so when we received the injection, most of, the lion's share of that injection went into non-core.

Jonathan Pierce - *Credit Suisse*

Okay. And then, on the central items number, it's obviously been bouncing around a bit, I guess, because of the hedges and then obviously this quarter the VAT recovery. Ordinarily, would you expect that to be zero?

Bruce Van Saun

Yes. I think it's going to move, you know, plus or minus zero, but if you were forecasting and building your model, I think zero's as good a number as anything.

Jonathan Pierce - *Credit Suisse*

Okay. Can I just finish on a more broader question, which is that if we look outside of GBM and we look outside of the central items number, the pre-provision profits in the core businesses are pretty static – in fact, generally declining over the last five quarters. And maybe Stephen's view on how he intends to get that up from here, I mean, so there's some margin benefit coming through and maybe a bit of cost benefit. But have you been disappointed by the pre-provision profits for the core?

Stephen Hester - *RBS - Group Chief Executive*

No, I think I always said that, number one, we do expect those businesses to be the key driver of growth from here through to 2013 but the starting bit of that would be rather slow. Why do I say that? Well, first of all, there are some headwinds like liability margins contracting, both because we have to pay up for savings, because we have to hold more liquidity, funding costs more, and hedges roll off on our current accounts. So there's those kind of headwinds that are offsetting the asset pricing and there are also headwinds in areas like overdraft charges, and PPIVs and you see that particularly in UK retail. And it was always the case that retail and commercial impairments were likely to recover more slowly than the, if you like, the big company impairments that you'd see in GBM, because those, you know, the smaller companies have less access to rescue rights issues and bond issues and so on. And then the final point is the various important cost programmes we've got obviously taking time to bite in terms of reducing costs.

So I would say that we consider ourselves to be on track in all of our retail and commercial businesses, with the exception that we feel that we're actually a bit ahead of track in the UK and probably behind in Ulster because we think that the credit problems in Ulster will be worse than we thought, although that's obviously a small part of the total. But what I think is true is that the real pop from those businesses requires a more decisive move down in impairments, which will happen, I hope, as the year goes through and into next year, and secondly, interest rates to start rising so that we can recoup some of these liability margin squeezes. And the basis ambition is to keep current asset margins where they are – new business margins, obviously that has to work through the book – and rebuild liability margins to hit our targets. If, for some reason, the world went into a sort of a Japan scenario where interest rates really stayed low for a lot of years, we and all other banks would have a margin problem and would have to go back and start increasing asset margins more, which would delay, if you like, the profitability targeted through that process. But obviously at this stage, you know, inflation seems like it's still around in the world and so on and so forth, so I think it's too early to feel that that interest rate rise won't come, but I think that's the thing to watch.

Bruce Van Saun

I would just add to that, Jonathan, that, you know, we are in the midst of a major change management programme so we have significant investments going into these businesses. And to strengthen Stephen's point, the expenses could be coming down sharper, except we are reinvesting some of the savings into these change management programmes. I think we'll have a much stronger franchise coming out of that that'll help us hit the 2013 targets as we get the payback from some of those investments. Some of those deal with the cost base and some of those also deal with bigger share of wallet, cross-selling with our customers, etc. So, you know, I think we're on the path that we would expect to see and you'll start to see those benefits come through as we get into the 2011-2013 period.

Rohith Chandra-Rajan - *Barclays Capital*

Thank you, Good morning. A couple, if I could, please. Firstly, on GBM, where sort of £2.8 billion of revenues in the first quarter. You talk about being seasonally strong, I guess. You mentioned the sort of flow products and particularly also, I guess, US mortgage trading. Just wondered what you'd seen in terms of performance in April and the extent of the seasonality you expect given, I guess, previous guidance for a run rate of about two billion per quarter, whether that had changed at all given the first quarter performance.

Bruce Van Saun

No. I think so far in the quarter to date we're back on our trend lines, which, I think, would be the expectation, that the first quarter tends to be seasonally strong. I would say, we're now in a very active trading period in the past few days, with what's going on in the markets, and so I think it's too early to call where we end up in the quarter but in terms of April, we're satisfied kind of where April is relative to expectations.

Rohith Chandra-Rajan - *Barclays Capital*

And sorry, just to clarify, when you say back on the trend line, is that trend line two billion per quarter or eight billion per year?

Bruce Van Saun

Yes, I mean, that's the same number so two billion per quarter is the guidance that we've given. Two billion plus is where we would expect to be.

Rohith Chandra-Rajan - *Barclays Capital*

Okay. Thank you. And then just on RWAs, you know, I guess the ABN relief trade roll-off resulting in RWA growth greater than assets; is that something that's done or is there more of that to come as the year progresses and any other movements in RWAs that we should be thinking about?

Bruce Van Saun

Well, that's the bulk of the impact, the net impact that we indicated at the annual results meeting. We said, you know, 15-ish should be the net impact of going to AIRB in ABN and, you know, I think we still have other kinds of progress to make and there could be some timing differences with potentially things going up or down, not exactly paired off but I think net, you've seen the bulk of the impact that we would expect to see for the year. There is… one caveat that we did highlight is, we are working very hard to get all of our models approved, these RBS models, by both the FSA and the DNB, by June 30th, as I said. If we don't have all those models signed off by June 30th, there is a chance we could go back to standardised, which could push the RWAs up by 15 to

20 billion further. We hope that's not the case. We might be able to get some partial implementation on those models but, having said that, we would expect that to be a temporal position if it does occur.

Stephen Hester - *RBS - Group Chief Executive*

The one thing that I would add just going back to GBM revenues. Hopefully you all realise this but, you know, I regard investment banking revenue lines as inherently volatile and when you look at the kind of trading markets that are out there and the shocks, from Greece and so on, to have any sort of comfort in trend lines, I think, would be false. You know, these things can bounce around; down as well as up. And that's just the nature of the beast.

Arturo De-Frias - *Evolution*

Yes, hi. Good morning. A couple of questions also, if I may. First of all, you have already discussed a bit margins answer in a previous question. But I would like to have a bit more detail on how asset margins versus deposit margins are playing, in both UK retail and UK corporate. I mean, of course, interest rates are low and spreads, deposit spreads are under pressure, but the net interest margin is down quarter on quarter, both in UK retail and in UK corporate. And there haven't been substantial changes in interest rates in the previous three or four months so I wonder if there is something else that is putting pressure on these margins. And also, related to this, I mean, taking into account what's going on in the rest of Europe and in the rest of the world, I think it's very unlikely that we are going to see any interest rate increase any time soon. Some people think interest rates are going to start going up. I think that's completely impossible and so from that point of view, what kind of measure would you take? You mentioned trying to raise asset margins but obviously that's not easy in a competitive market like the UK. So what measures could you have in mind to try to stop additional pressure on NIMs on both retail and corporate?

Bruce Van Saun

Okay. Let me just re-emphasise a point I made in the answer to the first question. There is a day variance at work here in retail and commercial, more than either in GBM and non-core because it's really an accrual book. And so if you have to look at the number of days in the quarter and if you say that there were two less days in the first quarter relative to the fourth quarter, that is the cause for the decline between Q4 and Q1. Underlying that, we still have, I think, the conditions that we've referred to that, you know, the mortgage market has less competition from securitisation and some of the entrants to the market that made life difficult in the mortgage area a couple of years past, and so the players, the big players are regaining mortgage market share and are pricing for the higher cost of being in the banking business. That trend is continuing. I think the same thing on the UK corporate side as some of the loans get renewed or new loans get booked at today's spreads and at today's cost of funds. That's widening the margins in the corporate book relative to what's rolling off. And so we did see, you know, continued asset margin expansion in the quarter. We saw, again, to the negative side, continued pressure on deposit margins as the hedges roll off over time. So there's some headwind there. But the net asset margin still exceeded that compression as we've seen in past quarters. I think as the days kind of lengthen in each quarter, we go to a 91 day quarter in Q2 and then 92 in Q3 and Q4, you'll see this trend clean up a little bit, and you still, I think, will see some growth in the retail and commercial margins.

With respect to your second question which was about interest rates and timing of any rise Pardon? Oh, yes, timing of when interest rates move up, I totally agree. I think the global economy is weak. It was unlikely a week ago that interest rates would go up in 2010. It's even more unlikely today as we sit here, so I think our plan and our expectations for 2010 never counted for, never were based on an assumption that interest rates go up in 2010. The growth that we expect in getting to our 2013 targets is predicated on a rising rate environment as we move through 2011 through 2013. And I still think that is a reasonable expectation at this point.

Arturo De-Frias - *Evolution*

Okay, thank you very much. May I, that was my first question which maybe was a bit too long. The second one is an inevitable question on exposures to Southern European countries. Could you give us some detail on what your, both sovereign bonds exposure and lending exposure to Greece, Spain, Portugal etc? Thank you.

Bruce Van Saun

Yes, I think we put some disclosures in this IMS around Greece which is, I think, the topic of the day. There, we said that we had roughly gross exposure of about a billion and a half sterling to Greek sovereign debt and we had accumulated losses on that position through the end of April of about 400 million net of tax. And then in the release, we have a loan table that shows where we have single A or less exposures that are more than a billion, and Greece did not make that table. So I think, overall, our exposure to Greece is moderate and any potential economic impact, I would say, is manageable.

I would put Portugal in, roughly the same it's probably a little less overall than Greece but it is more the Corporates and it's more diversified and there's collateral behind those loans. So I would say Portugal is even less of an issue. Of course, if you get up to Spain and Italy and other southern European countries, you can look at our annual report and we have the exposure details there. I would simply say that at this point we think that those countries are secure, They have a much better starting point than Greece. And they, I think, are taking the steps that they need to take to keep their economies strong. So we are watching those but we are not that concerned at this point

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Arturo De-Frias - *Evolution*

Thank you.

Leigh Goodwin of Citi

Morning gentlemen, two or three quick ones actually. I just wanted to circle back on the NIM question, just really, are we saying that, your previous guidance of an expansion at roughly five basis points per quarter through this year is still on track or should we be expecting something different? That's my first question.

My second question is, there's quite a sort of useful jump in the revenues going on within the UK corporate business, in corporate and commercial lending, and I wonder if you could sort of just tell us a little bit about what's happening there? And finally, just on a point of an earlier question on the trading of mortgages in the US and a very strong performance in the first quarter, I presume some of that was driven by spread compression. I wonder if you can tell us what your thoughts are and the outlook for that going forward.

Bruce Van Saun

Okay. On the first question, yes, I think that the, you know, roughly zero to five basis points would be a reasonable expectation but I just have heavy caveats around that to say that given the complexity of the group and the amount of cross-currents in NIM, it's more of an art than a science to give guidance on NIM. So I think what's happened is, I got badgered into giving a number and now everybody has put it in the bank. So, you know, but I think if you looked at roughly a 190 start point would, you know, five basis points a quarter given the positive bias that we see, still be a reasonable expectation. I think that's probably reasonable. But again, having said that, you know, the GBM number can swing around, the non-core number can swing around and so I wouldn't 100% put that in the bank.

On the UK corporate, there is, let me turn to page 30 here in the analysis. Yes, I think, just generally speaking, we started to see some traction in making some new loans. We actually did hit our lending targets in the month of March so there is starting to be signs of a little pick up in loan demand. Also, the asset margin trend that we referenced, I think is still at play there. So as new facilities come in, they're coming in at today's pricing and that's better than what we were pricing loans three or four years ago when the original facilities were in place. So that would be driving that.

I think in trading mortgages in the US, there clearly was a big demand for yield product and enhanced yield products. So as the world felt a little safer, as the calendar turned into January, there was, you know, heightened demand to kind of move out of cash and buy yield product. And so we saw increasing flows in mortgages. I think it's that simple.

Leigh Goodwin

Yes, so, I mean, is what you're saying is that that sort of basically has run its course and we'll be back on a more normal…

Stephen Hester

No, it hasn't run its course but it will slow down and the rest of the year will be our expectation. So the first quarter will be unusually strong. But certainly we would expect, as with the rest of GBM revenues, the next three quarters to be less stronger than the first.

Leigh Goodwin

Sure. And just follow up on the second question I had on the corporate. I mean, as I say, we've seen this almost one third increase in revenues year on year in the corporate side. Would you say that's going to slow? One would think it would.

Stephen Hester

The big increase in revenues year on year were asset margins and that will slow down because the pace of new business margins moving through the back book will slow as that's accomplished. And obviously we continue to have the headwinds of liability compression hedges moving off. So I think we do see continued progress in corporate NIM but at a much slower pace.

Leigh Goodwin

Okay, thank you.

Michael Helsby - BOAML

Yes, thank you. Morning everyone. I've got just two questions. Firstly, on the insurance business, the claims ratio was 89% in the quarter and I appreciate that's down on where you were in the fourth quarter, but the fourth quarter was extremely high, certainly relative to anything that we've seen since, well, pre the second half of last year. I was wondering if you could give us a little bit more color on what's going on in claims and where you'd expect it to settle. I think pre the second half of last year you'd typically be running in the 70 to 75% range.

And the second question is just following on really from, clearly the markets o/s, with everything that is going on are a lot more jittery. Chris highlighted the fact that LIBOR has just moved out a bit. I think we're all seeing a few more questions coming through on liquidity, and I was just wondering if you could draw out what you think are the key differences of where Royal Bank is today in terms of liquidity and funding versus where it is or where it was pre the crisis. I think that would be very helpful.

Stephen Hester

Let me take the second and ask Bruce to take the first one on insurance. I mean, you know, I think that pre the crisis, there were dramatic changes last year. There were dramatic changes to our capital which puts us at the strongest Core Tier1 of any of our comparative banks. We obviously have the further insurance policy of APS and contingent capital that no-one else has. We've already built our total liquidity reserves to where our 2013 targets are, and the liquid government bond component of that steadily builds up. And as I've said before, what we call our days survival rate, although we don't publish it, is the best that we can remember and our use of central bank facilities have dramatically declined. So on every possible measure and our total consumption of wholesale funding has come down very substantially. So on every possible measure, we are in much better health from a capital and liquidity and confidence standpoint than was the case 18 months ago. And of course, we would responsibly have positioned ourselves, you know, against the risk of volatility around the election period and so on as you might expect. All of that said, as we know, markets can move to extremes so we're not in any way feeling sanguine or saying that there's no circumstance that becomes painful for RBS either in cost or in sort of duration of funding, but I think we feel that the picture is really quite dramatically better than last year. Bruce, you might want to pick up on insurance.

Bruce Van Saun

Well, let me just add a couple points to Stephen's comment, just to put a few numbers behind that. But I would say that we've been cracking on with these structural improvements to the balance sheet and those are embedded, obviously, in our net interest income figures. But for example, the FSA eligible government bond portfolio, we said we were going to go to 20 to 50 over the next four years which would imply seven and a half a year. We did five of that in the first quarter. Our wholesale funding ratio that's beyond a year increased from 50 to 53% so we're running off more of the short money. We issued £8 billion of unguaranteed wholesale funding beyond a year during Q1 so we are certainly taking aggressive steps to continue to improve the balance sheet.

Back to your first question on insurance, you know, I think, the story of last year was this bodily injury claim phenomenon which I think we have, been wrestling with a tiger here. And we had a catch up provision in the fourth quarter. I think that is still at relatively high levels. We have various programs in place to deal with that, including kind of pricing up, including looking at our underwriting practices, our claims management practices, and so we're kind of working on that. But I would say it's fair to say we are wrestling a tiger there. So the sequential improvement was really Q4 was an elevated number and Q1 is still a high number, but it's something that we're hoping to bring under control through time.

The one difference that I would say that there could have been a greater reduction in claims in Q1 was that the weather was particularly bad in the UK in the first quarter. If you think back to the winter, we had very cold weather and snowy weather and so we probably took 75 million of additional weather related claims versus a normal winter, which if you added that back to the 50 loss, we would have had a slight profit in the quarter. So, you know, it's hard for me to give you explicit guidance on claims. I do think, as the year goes by, you'll start to see these various programs we have in place start to bite and you'll start to see the profitability in insurance come back. We still think it's a great business. We have good market share. We have a good new management team and that will manifest itself over time.

Michael Helsby

Okay, thank you.

Peter Toeman - HSBC

Morning. Looking back at last year, the procyclicality added almost £100 billion to RWAs and I wondered if, maybe it's early days yet, you could see procyclicality moving in a more positive direction as credit quality improves. And the second question is, the sort of run-off of the non-core portfolio, I mean, are you, I think you've got a forecast of £143 billion of tangible assets at the end of this year, and are you still confident that the timetable on the run down of assets is going to be met or are you now finding it more difficult to make disposals?

Bruce Van Saun

Okay, on the first question on RWAs, I think it's probably premature to count on gains in procyclicality going the other way. So there was zero impact in Q1 from either way, from procyclicality which is better than it was last year. But I wouldn't expect it to start to contribute to reductions in RWAs.

On your second question, you know, we ran down TPAs in non-core by about eight billion. And we had an adverse FX against that of about four billion, so kind of the gross number in the quarter would have been about 12. We had expected, you know, probably 45-ish for the year, so I think more or less we're running in line. We have some things queued up such as some of the disposal of these Asian banks that are in the process of closing which will facilitate achieving that target. And then we're looking at individual assets and portfolios all the time, and we have a pipeline that we're monitoring. But at this point, I think it's safe to say that we are on track and would expect to, you know, be near that 143 target.

Peter Toeman

Thank you.

Manus Costello - Autonomous

Morning everyone. I had a couple of questions on the core business please. Just looking at the NPL trends in retail and in corporate, in UK retail and corporate this quarter, they actually picked up a little bit in Q1 versus Q4 which had been down on Q3. It's only a small move but I wondered if it's seasonality or if you'd expect that to continue the down trend in Q2.

And secondly, just to come back to this question about revenues, if I look at your core revenues excluding GBM, they were down quarter on quarter. I wondered, on that basis of core revenues ex GBM, would you expect your revenues to increase this year and next year given your interest rate outlook, or should we expect a flat or down outlook ex GBM?

Bruce Van Saun

First off, on the trends in retail and corporate, I don't think those number were meaningful so I would say there's nothing alarming in that at this point. What I would say is I think we're seeing probably a turn in the consumer market a little faster than we are in the business market. I think the business market often kind of moves with a lag and so problems show up a little later after you see the turn in the cycle. So that is one that I'd be watching a little more carefully. But I think on the first one, on retail, I'm not concerned at all at this point. I think the turn is relatively clear.

On the revenues ex GBM, I think, you know, part of the issue here was the day variance in the quarter. I do think, and then there's, some of the points Stephen responded to earlier, such as overdraft fees and some temporal things that we're working through, I think those clear over time and we should start to see the kind of revenue picture improve in retail and commercial.

Stephen Hester

But what's true is that the significant improvements of revenues in retail and commercial require two things: they require, number one, margin expansion which needs liability margins to expand or else another round of asset margin re-pricing, and secondly, they require the ability to grow your balance sheet with some credit demand. And so that's why we've always said that 2010 will see improvement in those businesses but there is more of a hockey stick on revenues in 11, 12 and 13 that will be driven by those two things if they happen. And in the meantime, we're getting our businesses as fit as they can be on investment, on cost, on management, on customer satisfaction, on all these different things and doing enough on revenues to offset the headwinds. But I think it will be, you know, we do need that external help on interest rates and business volumes to really have the R&C revenues move significantly.

Manus Costello

Okay, thank you.

Jon Kirk - Redburn

Morning everyone. Actually, most of my questions have been answered already, thank you, but there was one on the net stable funding ratio which you put at 90% but I think that within that, you're including government provided or government guaranteed funding. And also I think you're excluding loan commitments. If you were to adjust for those two, where would your net stable funding ratio be? And also, are you, with that in mind and I guess the current market conditions are not helpful, but I'm presuming you're still very comfortable, you'll be able to get to 100% by the time you get to the end of 2012.

Bruce Van Saun

I couldn't do that math right now in my head. Maybe on that question on net stable funding ratio you could follow up with Richard O'Connor later in the day. I do think it is worth pointing out that the way we're calculating it, we did continue to be stable in that ratio so we're at 90% second consecutive quarter and, as I indicated to an earlier question, we are kind of cracking on with terming out that wholesale funding and improving the quality of our collateral. So I think you'll see progress as the quarters go by. One thing we certainly want to do in terms of being leaders in transparency is hold ourselves accountable. You can watch the progress that we're making over time.

Jon Kirk

Can I just follow up on that then; what do you consider to be your annual long term funding requirement, including within that stuff that is rolling off as well as incremental long term funding that you'll need to adhere to the new regulation?

Bruce Van Saun

Well, the 2013 targets have, you know, with a one to one loan to deposit ratio overall, which is predicated on non-core running off and the overall group de-levering, when you look at the snapshot of our balance sheet at that point in time, we would have roughly a trillion sterling in footings, we'd have £150 billion of liquidity and we'd have £150 billion of wholesale funding, of short term wholesale funding that would be paired off with that liquidity portfolio.

Jon Kirk

So, sorry, to ask the question again then, what is your sort of annual long term funding requirement beyond a year?

Bruce Van Saun

The amount that we expect to do this year is probably £20billion to £30billion and we did £8billion in the first quarter so we're on track to do what we need to do there.

Jon Kirk

Is that a similar number going beyond this year as well?

Bruce Van Saun

Yes. Yes, I think that's the ballpark number.

Jon Kirk

Okay, thanks.

Stephen Hester

But obviously as non-core runs down, some of that requirement also reduces. I think we've got time, really, for one more before we let you guys go off to listen to HSBC.

Robert Law

Good morning everybody. Can I add two brief questions and one long one please? Firstly, could you comment on your year guidance that you gave at the start of the year which was that you expect to be in loss?

Stephen Hester

I think we haven't changed our guidance with the only caveat that there's a sporting chance that impairments will turn out better than we thought, but there's still some lumpiness. And it's very hard for us to predict the timing and quantum of one off issues like liability management – well, we can predict that, we know that now – but like disposals or GMS. So with those two caveats, which you might think we'd slightly improved our forecast in respect of those, I think we, the forecast would, might be better than before but still in loss.

With strong core profitability which is what matters.

Robert Law

Thank you. Secondly, can you comment on…

Yes, could you comment on the cost flexibility within GBM? It looks like the expense base has been basically pretty stable in absolute terms while the revenue line has moved around.

Stephen Hester

I think you'll find that this is increasingly the case with investment banks because with very large amounts of the compensation now being in deferred format, and therefore amortized over time, once, if you like, three years has passed, substantial amounts of bonus expense are really amortizations of past year grants that don't vary. And so I think the previous ability for investment banks to keep pretty constant comp to revenue ratios quarter to quarter will reduce due to the amortization of past charges. So although I think there'll continue to be very wide volatility of actual bonuses, it won't show, it will be more smooth in its manifestation in the P&L.

Bruce Van Saun

I'd say also to your point, we were down sequentially 1% in expenses. Business services continues to take costs out but that figure incorporates kind of the higher revenues sequentially in GBM, and accordingly a higher accrual. We accrued at a 32% rate in GBM for the first quarter. Last year the accrual rate was 28% in GBM.

Robert Law

And the final question was your views on your capital position. There's been some comment about significant surplus capital potential within the group over the medium term and I wondered if you wanted to comment on that. Obviously there's regulatory uncertainty but if you could comment on progress on that, but also what your view, as an institution is with the amount of capital that you have within the group at this point and over the medium term. Do you think it's appropriate or not?

Stephen Hester

I think that, I would say the following two things: Number one, we are determined to be shareholder friendly in the way we behave throughout. And if we were to ever have the luxury of an inefficient balance sheet, we would want to do something about that. However, I think it would be foolhardy to currently forecast that we will get an inefficient balance sheet with the simple weight and breadth of regulatory proposals that are on the table. And so I think anyone who puts that in their model is taking quite a big risk at this stage of uncertainty.

Robert Law

Thank you.

Stephen Hester

I think we're done for now. Obviously we're available to any follow up questions and calls during the day or in subsequent calls to help you digest this. And again, thank you for listening. Hopefully you will agree with us that we've delivered, again, what we said we'd do and we have our fingers crossed to continue to do that. Thank so much.

Operator

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