Re-building Standalone Strength

Stephen Hester, Group Chief Executive

26 February 2009

The 3-5 Year Journey to Standalone Strength

- Restructure as premier financial institution, anchored in the UK while serving individual and institutional customers here and globally
- Rebuild attractive shareholder value for all and enable UK Government to sell down its shareholding profitably
- Be leaders in our markets – effective and disciplined in our management
- Re-commit the entire organisation to delivering for our customers

Our primary task is to rebuild standalone strength and value

Building Blocks Necessary for Recovery

Recapitalisation & Government funding support	✓
Management and Board changes	✓
Analysis and Presentation of 'the problems'	✓
New Strategy – roadmap to unite people and resources	***Today***
Asset Protection Scheme – improve protection against extreme loss during strategy execution	***Today***
Severity of downturn "manageable"	***Tbd***

What now – Execution!

Today

The strategy we announce today will:

- Shift ~20% of funded assets to Non-Core Division for disposal/run down
- Cut more than £2.5bn out of the cost base
- Benefit from the Government Asset Protection Scheme

- Radically restructure GBM, taking out 45% of capital employed
- Deliver substantive change in all businesses
- Centre on UK with tighter, more focused global operations
- Target retail and commercial exit outside UK, Ireland and US

- Drive major changes to management, processes and culture

Country exits subject to consultation with works councils, regulators and social partners

Action to Date

- Major decisions on Strategy made ☑
- Deleveraging and reducing wholesale funding begun ☑
- New RWA and asset growth constrained ☑
- Comprehensive cost reduction underway ☑
- Restructured compensation ☑
- Fuller suite of management tools deployed ☑
- Introduced new disciplines on risk concentrations and processes ☑
- Restructured and simplified management ☑

2008 Results

Our results for 2008 were bad:

- Net attributable losses before goodwill of £7.9bn
- £16.2bn write-down of goodwill paid on prior acquisitions

- This masks the inherent strengths of RBS’ businesses and strong or resilient performances by most of the Bank
- The global economic downturn will test us again in 2009
- All our efforts are now focussed on the path to recovery

The Past – issues to address

Leverage

ABN AMRO acquisition

Strategy

Risk controls

Profit focus

Management & processes

Strategic Plan

RBS

Top Down Tests

- **Regain standalone AA ratings category** – lower leverage, less reliance on unsecured wholesale funding, stronger businesses
- **15%+ return on tangible equity (ROE)** – necessary to cover cost of capital
- **More stable business mix** – cease proprietary activity, focus on customer flows, risk management & less leverage

Tests for each Business

- Top tier competitive position in enduring customer franchise
- 15%+ ROE in normal markets
- Proportionate use of balance sheet, risk & funding
- Capable of organic growth – but “market limited”
- Connected to the Group – customers, products, people

Strategic Plan

Non-Core and Core split

Non-Core

- Non-Core division to be separately managed and wound down within the existing legal structures of the Group

Core

- UK Retail
- UK Corporate & Commercial
- Wealth
- Ulster
- Citizens
- Insurance
- GBM
- GTS

- All other businesses have been through root and branch strategic review: no sacred cows
- Many will be significantly restructured
- All subject to cost programme
- All have tight RWA targets

A ‘self help’ programme given weakness of disposal markets

Non-Core

- Non-strategic assets
- Stressed assets
- Includes portfolios, assets and businesses
- Vast majority from GBM
- Retail and commercial businesses continental Europe and Asia
- Other Retail & Commercial Non-Core

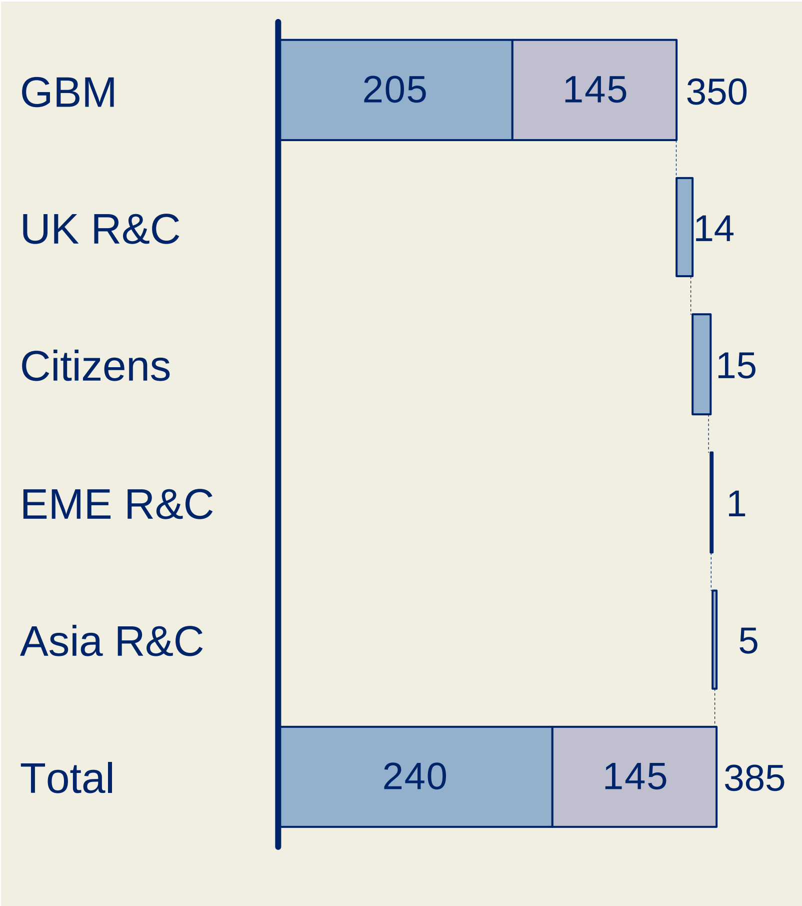
2008 financials

- ~£240bn assets (+~£145bn derivative positions)
- ~£155bn RWA
- ~£3.9bn revenues
- ~£1.1bn direct expenses
- ~£3.2bn impairment losses
- ~£9.2bn credit market and other trading asset write-downs

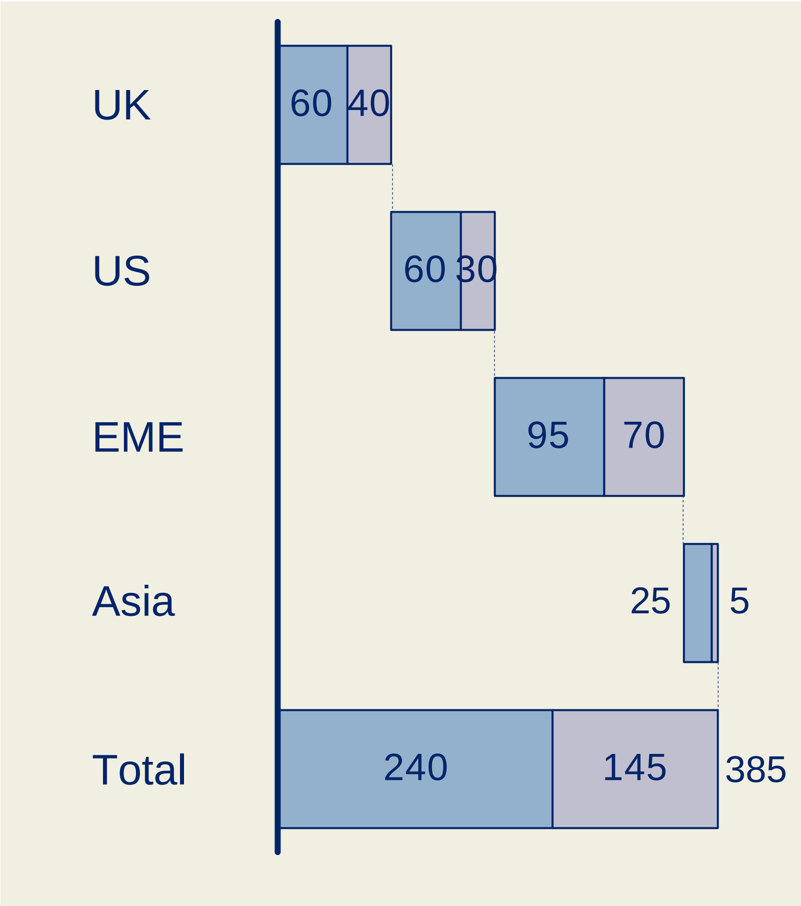
- Separately managed, reporting line to CEO
- Matrix support from donor Divisions
- Run-off over 3-5 years as fast as is consistent with value and risk

Non-Core

Non-Core Assets by Division, 2008 £bn



Non-Core Assets by Region, 2008 £bn



Third Party Assets excluding derivatives MTM   Derivatives MTM

GBM geographic split based on client view

Global Banking & Markets

Re-size and re-focus GBM

Retention Rationale

- Restructured and de-risked business will deliver steady and significant profits
- Can maintain top tier customer businesses
- Natural complement to corporate businesses
- No viable market exit opportunity

Planned actions

- £350bn in assets to non-core:
  - Exit balance sheet heavy, niche segments
  - Focus on major financial centres, scale back presence elsewhere
  - Exit illiquid products/proprietary trading
- New risk management disciplines and substantial operating cost reductions

Goals

- 20%+ ROE
- £150bn RWA (45% lower than today)
- Business limited to liquid customer franchises with top tier competitive position
- Major re-balancing of funding requirement

Global Banking & Markets

Split between Core and Non-Core

Core		Non-Core
Core businesses	**Restructured core businesses**	**Non-Core assets and businesses**
Essential to our clients *Resilient origination and distribution markets*	*Re-sized market opportunity* *Reduced RBS capacity*	*Distressed asset prices and "closed" markets* *Non strategic to RBS, including some highly valuable businesses*
FX and options Rates Money markets Commodities Cash equities DCM ECM Restructuring and advisory	ABS Trading Flow Credit Trading Equity derivatives Equity financing Prime ABS origination Corporate and FI lending	Structured credit trading Illiquid proprietary trading Structured derivatives Asset management Non-conforming ABS origination Real estate lending Leveraged finance lending Project finance lending Asset finance
~£153bn RWA		**~£126bn RWA**

GBM & GTS International Network

Streamlined footprint, while maintaining global proposition

Primary countries

- Australia, China, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Netherlands, Russia, Singapore, Spain, Sweden, UAE, UK, US

Refocused countries

- Austria, Belgium, Brazil, Canada, Czech Republic, Denmark, Finland, Greece, Indonesia, Korea, Luxembourg, Malaysia, Mexico, Norway, Poland, Qatar, South Africa, Switzerland, Taiwan, Thailand, Turkey

Explore new ownership

- Argentina, Bahrain, Chile, Colombia, Egypt, Kazakhstan, New Zealand, Pakistan, Philippines, Portugal, Romania, Slovakia, Uzbekistan, Venezuela, Vietnam

Subject to consultation with works councils, regulators and social partners

Citizens

Focus on retail and commercial customer relationships in core footprint

Retention Rationale

- Strong franchise and attractive portfolio in core markets
- Meets the Group strategic tests over cycle
- Improves Group funding ratios
- Improves Group geographic balance and opportunities
- Sale would be destructive of value and capital

Planned actions

- Exit most activities outside core "footprint"
- Cost restructuring in order to re-invest in the core franchise (incl technology and marketing spend)
- Improved cross-sell to in-footprint customers
- Resize risk portfolios
- Revitalise retail (sales, technology, deposits)

Goals

- Top 5 in the markets we serve
- Disciplined use of balance sheet:
  - 1:1 ratio loans/deposits
  - Retain below average risk profile
- 15%+ ROE
- Greater organic growth
- Increase connectivity with rest of Group

UK and Wealth

	UK Retail	UK Corporate & Commercial	Wealth
Key Actions	■ Reduce costs: Online, lean, automation ■ Segment service by value ■ Invest in systems and sales	■ Manage portfolio stress ■ Reduce cost base, tailor cost to serve to value ■ Invest in systems and service	■ Consolidate UK and international ■ Grow RM base, enhance productivity ■ Investment in platform
Goals	■ ROE 15%+ ■ Funding growing faster than assets ■ Customer service leadership ■ Lending commitments	■ ROE 15%+ ■ Work off risk concentrations ■ Stronger credit, portfolio management processes ■ Deposit growth ■ Lending commitments	■ Maintain high ROE ■ Continued AuM growth ■ Sustain UK market leadership

Other businesses

	Ulster Bank	Insurance	GTS
Key actions	▪ Re-balance assets/ liabilities ▪ Pro-actively manage risk ▪ Increase and diversify deposit base ▪ Move to single brand ▪ Significant cost restructuring	▪ Re-invigorate top line growth by investing efficiencies ▪ Strengthen multi-channel distribution	▪ Maximize value of global capabilities ▪ Rightsize the global network (incl. country exits) ▪ Maintain service levels ▪ Slimmed down operating model
Goals	▪ 15%+ ROE ▪ Improved loan:deposit ratio ▪ Risk concentration reduced ▪ Franchises maintained	▪ 20%+ ROE ▪ Extend lead ▪ Lowest cost operations ▪ Strong UK commercial lines	▪ Maintain high ROE ▪ Europe as core base ▪ Leading SEPA bank ▪ Explore in-organic options

Management disciplines and culture

Financial discipline

- Improved controls and costs/capital fully allocated to Divisions
- Focus on funding balance
- Disciplined RWA usage in the core (value not volume)
- Focus on returns (and setting of return targets) not just profits
- Total balance sheet size controlled and liquidity surprises avoided

Risk management disciplines

- Reduced single name, sector & country concentration limits
- Earnings volatility/ impairments managed down
- Strengthened risk function role
- Drive business performance through focus on returns and strategy
- New reporting systems increase transparency

Underpinned by new management processes and incentives

Expenses

Maximising efficiency crucial to restoring shareholder value

- Deliver greater than £2.5bn (16%) efficiency cost savings by 2011 versus 2008, at constant exchange rates
- This includes the remaining £0.5bn already promised from ABN AMRO integration not reflected in 2008
- The greatest savings arise in GBM and Manufacturing
- Restructuring charges likely over next 3 years: 1.5 - 1.75 year payback targeted
- The programme does not include effect of inflation, incentive pay movements, or cost reductions arising from business exits or the impact of new projects (if any)

The Asset Protection Scheme

RBS objectives

Secure asset insurance that protects and enhances capital strength and outlook, thereby

- Enhancing financial strength and stability for customers and depositors
- Reducing risk to shareholders
- Allowing greater support for UK customers via increased lending
- Facilitating Non-Core run-off plan, leaving Core Bank more free to restructure and progress

The Asset Protection Scheme

Overview

- RBS has the opportunity to "insure" the following portfolios:
  - £225bn third party assets and £44bn undrawn commitments
  - £33bn derivative counterparty risk exposures
  - Total pool of £302bn, RWAs ~£160bn
- Insured assets would be:
  - 53% placed in non-core division
  - 47% part of ongoing businesses. Rationale for latter to "make room" for new UK lending commitments
- More detail and recommendation to shareholders to follow in the coming weeks

The Asset Protection Scheme

Core elements of the scheme	Description
RWA relief	■ Estimated at £144bn at 31 Dec 2008 (Reflecting 90/10 risk sharing on second loss)
Percentage of first loss borne by RBS on pool	■ 6%
Split of second loss	■ 90% to HMT / 10% to RBS
Fee paid	■ 2% of gross pool to be amortised over 7 years

- £6.5bn fee would be "paid" up front via issue to HMT of B shares, a Core Tier 1 capital instrument defined as ordinary shares with preferential rights in respect of dividends

- Additional £13bn of capital would be issued to HMT as part of APS agreement with a further £6bn available thereafter at RBS' option

Pro forma financial impact 31 Dec 2008

	Pre	Post
RWAs	£578bn	£434bn
Core Tier 1 capital	£41bn	£54bn
Core Tier 1 ratio	7.0%	12.4%

- Post APS Core Tier 1 impacted by issuance of £19.5bn B shares, offset by the £6bn deduction of first loss exposure (50% of first loss, capped at 8% of RWAs)
- Over time book value attributable to Ordinary Shareholders eroded by fee amortisation, the cost of the B shares and potential losses on insured assets
- RBS would also be required to give up the tax shelter from any part of future UK losses prior to returning to profitability

UK lending commitments

Entry into the APS would also involve RBS committing to:

- £25bn increase in net lending commitments in 2009 (vs current plan)
- Further £25bn increase provisionally targeted in 2010
- Commitment for each year divided
  - £9bn mortgages
  - £16bn SME and corporate
- Lending subject to commercial pricing, credit decisions and risk limits

Challenges at Hand

- Executing "business as usual" is a challenge for all banks in the current economic environment
- The quantum and urgency of change required at RBS to recover its standalone strength is a major additional challenge
- Market pessimism, illiquidity, strained funding markets and industry de-leveraging make "short cuts" unviable
- Need to retain and motivate our people and rebuild external confidence
- Market environment very uncertain – credit costs are rising, risk of further write-downs

Building Blocks Necessary for Recovery

Recapitalisation & Government funding support	✓
Management and Board changes	✓
Analysis and Presentation of 'the problems'	✓
New Strategy – roadmap to unite people and resources	***Today***
Asset Protection Scheme – improve protection against extreme loss during strategy execution	***Today***
Severity of downturn "manageable"	***Tbd***

What now – Execution!