

ROYAL BANK OF SCOTLAND GROUP PLC  
Form 20-F  
April 30, 2014

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 20-F

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2013  
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc  
(Exact name of Registrant as specified in its charter)

United Kingdom  
(Jurisdiction of incorporation)

RBS Gogarburn, PO Box 1000, Edinburgh EH12 1HQ, United Kingdom  
(Address of principal executive offices)

Aileen Taylor, Group Secretary, Tel: +44 (0) 131 626 4099, Fax: +44 (0) 131 626 3081

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ  
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)



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Securities registered or to be registered pursuant to Section 12(b) of the Act:

| Title of each class  | Name of each exchange on which registered           |
|--|---|
| American Depositary Shares, each representing 2 ordinary shares, nominal value £1 per share  | New York Stock Exchange<br>New York Stock Exchange* |
| Ordinary shares, nominal value £1 per share<br>American Depositary Shares Series F, H, L, M, N, P, Q, R, S, T and U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, M, N, P, Q, R, S, T and U respectively | New York Stock Exchange                             |
| 3.250% Senior Notes due 2014   | New York Stock Exchange                             |
| 3.950% Senior Notes due 2015   | New York Stock Exchange                             |
| 4.875% Senior Notes due 2015   | New York Stock Exchange                             |
| 2.550% Senior Notes due 2015   | New York Stock Exchange                             |
| 4.375% Senior Notes due 2016   | New York Stock Exchange                             |
| Floating Rate Senior Note due 2017   | New York Stock Exchange                             |
| 1.875% Senior Notes due 2017   | New York Stock Exchange                             |
| 5.625% Senior Notes due 2020   | New York Stock Exchange                             |
| 6.125% Senior Notes due 2021   | New York Stock Exchange                             |
| 6.125% Subordinated Tier 2 Notes due 2022  | New York Stock Exchange                             |
| 6.000% Subordinated Tier 2 Notes due 2023  | New York Stock Exchange                             |
| 6.100% Subordinated Tier 2 Notes due 2023<br>Structured Hybrid Equity Linked Securities (SHIELDS) due January 16 2014 linked to the S&P 500 Index  | New York Stock Exchange<br>NYSE MKT                 |
| Leveraged CPI Linked Securities due January 13, 2020   | NYSE MKT  |
| RBS US Large Cap Trendpilot™ Exchange Traded Notes due December 7, 2040  | NYSE Arca   |
| RBS US Mid Cap Trendpilot™ Exchange Traded Notes due January 25, 2041  | NYSE Arca   |
| RBS Gold Trendpilot™ Exchange Traded Notes due February 15, 2041   | NYSE Arca   |
| RBS Oil Trendpilot™ Exchange Traded Notes due September 13, 2041   | NYSE Arca   |
| RBS Global Big Pharma Exchange Traded Notes due October 25, 2041   | NYSE Arca   |
| RBS NASDAQ-100® Trendpilot™ Exchange Traded Notes due December 13, 2041  | NYSE Arca   |
| RBS China Trendpilot™ Exchange Traded Notes due April 18, 2042   | NYSE Arca   |
| RBS US Large Cap Alternator Exchange Traded Notes™ due September 5, 2042   | NYSE Arca   |
| RBS Rogers Enhanced Commodity Index Exchange Traded Notes due October 29, 2042   | NYSE Arca   |
| RBS Rogers Enhanced Agriculture Exchange Traded Notes due October 29, 2042   | NYSE Arca   |
| RBS Rogers Enhanced Energy Exchange Traded Notes due October 29, 2042  | NYSE Arca   |

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RBS Rogers Enhanced Precious Metals Exchange Traded  
Notes due October 29, 2042  
RBS Rogers Enhanced Industrial Metals Exchange Traded  
Notes due October 29, 2042

NYSE Arca

NYSE Arca

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\* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares pursuant to the requirements of the Securities and Exchange Commission.

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Securities registered or to be registered pursuant to Section 12(g) of the Act:  
None

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:  
None

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2013, the close of the period covered by the annual report:

| (Title of each class)   | (Number of outstanding shares) |
|---|--------------------------------|
| Ordinary shares of £1 each                                      | 6,203,022,294                  |
| B Shares  | 51,000,000,000                 |
| Dividend Access Share   | 1                              |
| 11% cumulative preference shares                                | 500,000                        |
| 5½% cumulative preference shares                                | 400,000                        |
| Non-cumulative dollar preference shares, Series F, H and L to U | 209,609,154                    |
| Non-cumulative convertible dollar preference shares, Series 1   | 64,772                         |
| Non-cumulative euro preference shares, Series 1 to 3            | 2,044,418                      |
| Non-cumulative convertible sterling preference shares, Series 1 | 14,866                         |
| Non-cumulative sterling preference shares, Series 1             | 54,442                         |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes     No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes     No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes     No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-Accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  
 International Financial Reporting Standards as issued by the International Accounting Standards Board  
 Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

## SEC Form 20-F cross reference guide

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#### Presentation of information

In this document, and unless specified otherwise, the term ‘company’ or ‘RBSG’ means The Royal Bank of Scotland Group plc, ‘RBS’, ‘RBS Group’ or the ‘Group’ means the company and its subsidiaries, ‘the Royal Bank’ or ‘RBS plc’ means The Royal Bank of Scotland plc and ‘NatWest’ means National Westminster Bank Plc.

The company publishes its financial statements in pounds sterling (£ or ‘sterling’). The abbreviations ‘£m’ and ‘£bn’ represent millions and thousands of millions of pounds sterling, respectively, and references to ‘pence’ represent pence in the United Kingdom (‘UK’). Reference to ‘dollars’ or ‘\$’ are to United States of America (‘US’) dollars. The abbreviations ‘\$m’ and ‘\$bn’ represent millions and thousands of millions of dollars, respectively, and references to ‘cents’ represent cents in the US. The abbreviation ‘€’ represents the ‘euro’, the European single currency, and the abbreviations ‘€m’ and ‘€bn’ represent millions and thousands of millions of euros, respectively.

The geographic analysis in the Business Review, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have generally been compiled on the basis of location of office - UK and overseas – unless indicated otherwise. ‘UK’ in this context includes transactions conducted through the offices in the UK which service international banking transactions.

The results, assets and liabilities of individual business units are classified as trading or non-trading based on their predominant activity. Although this method may result in some non-trading activity being classified as trading, and vice versa, the Group believes that any resulting misclassification is not material.

#### International Financial Reporting Standards

As required by the Companies Act 2006 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (together ‘IFRS’). They also comply with IFRS as issued by the IASB.

#### Non-GAAP financial information

The directors manage the Group’s performance by class of business, before certain reconciling items, as is presented in the segmental analysis on pages 478 to 485 (the “managed basis”). Discussion of the Group’s performance focuses on the managed basis as the Group believes that such measures allow a more meaningful analysis of the Group’s financial condition and the results of its operations. These measures are non-GAAP financial measures. A body of generally accepted accounting principles such as IFRS is commonly referred to as ‘GAAP’. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Reconciliations of these non-GAAP measures are presented throughout this document or in the segmental analysis on pages 478 to 485. These non-GAAP financial measures are not a substitute for GAAP measures. Furthermore, RBS has divided its operations into “Core” and “Non-Core”. Certain measures disclosed in this document for Core operations and used by RBS management are non-GAAP financial measures as they represent a combination of all reportable segments with the exception of Non-Core. In addition, RBS has further divided parts of the Core business into “Retail & Commercial” consisting of the UK Retail, UK Corporate, Wealth, International Banking, Ulster Bank and US Retail & Commercial divisions. This is a non-GAAP financial measure. Furthermore, RBS has presented certain measures “excluding RBS Capital resolution (RCR)” which are deemed non-GAAP measures. Lastly, the Basel III net stable funding ratio, fully loaded Basel III ratio, liquidity coverage ratio, stressed outflow coverage and further metrics included in the Risk and balance sheet management section of this document represent non-GAAP financial measures given they are metrics that are not yet required to be disclosed by a government, governmental authority or self-regulatory organisation.



## Forward-looking statements

Certain sections in this document contain 'forward-looking statements' as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'believe', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited to: the Group's restructuring and new strategic plans, divestments, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), return on equity (ROE), profitability, cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; discretionary coupon and dividend payments; implementation of legislation of ring-fencing and bail-in measures; sustainability targets; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; and the Group's exposure to political risks, including the referendum on Scottish independence, credit rating risk and to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: global economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the simplification of the Group's structure, the divestment of Citizens Financial Group and the exiting of assets in RBS Capital Resolution as well as the disposal of certain other assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislation and regulation in the

United Kingdom (UK), the European Union (EU) and the United States (US); the implementation of key legislation and regulation including the UK Financial Services (Banking Reform Act) 2013 and the proposed EU Recovery and Resolution Directive; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of LIBOR and other interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group's operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the Group; reputational risk; the conversion of the B Shares

in accordance with their terms; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

#### Recent developments

##### Completion of sale of remaining interest in Direct Line Insurance Group (DLG)

Further to the announcement on 26 February 2014, RBS completed the sale of its remaining interest of 423.2 million ordinary shares in DLG on 27 February 2014 at a price of £2.63 pence per share, raising gross proceeds of £1,113 million.

RBS has now sold all its ordinary shares in DLG except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to DLG management.

The sale marks the completion of RBS's EC-mandated disposal of its interest in DLG.

##### Board change

On 27 February 2014, RBS announced that Philip Scott, a non-executive Director, will step down from the Board by 31 October 2014.

On 7 March 2014, RBS announced the appointment of Morten Friis as a non-executive Director with effect from 10 April 2014.

Also on 7 March 2014, RBS announced that Anthony Di Iorio, a non-executive director, would step down from the Board on 26 March 2014.

On 4 April 2014, RBS announced that Ewen Stevenson had been appointed as an executive director and RBS Chief Financial Officer with effect from 19 May 2014.

##### Dividend Access Share and revised State Aid terms

The Company announced on 9 April 2014 that it had entered into an agreement ('DAS Retirement Agreement') with Her Majesty's Treasury ('HMT') to provide for the future retirement of the Dividend Access Share ('DAS') subject to the approval by the Company's independent shareholders. The DAS Retirement Agreement sets out the process for removal of the DAS - a key element of the Government's 2009 capital injection into the Company and the associated European Commission approval of the State Aid package for the bank. Among other benefits, the retirement of the DAS will in future allow the Board of the Company to state more clearly a dividend policy to existing and potential investors.

The DAS was an important factor in the EC's assessment of the State aid RBS received and was part of the basis for its approval of that support in 2009. It was therefore necessary for the proposal for the eventual retirement of the DAS to be notified to the EC by HMT and this was done by HMT.

The EC concluded that the new arrangements for the eventual retirement of the DAS did not constitute new State aid and approved the changes to the Company's restructuring plan in its State Aid Amendment Decision of 9 April 2014. In addition, this decision included two further key commitments made by HMT to the EC as follows:

- The deadline for the Company's divestment of the Williams & Glyn business (by initial public offering, whole business sale or tendering procedure for its entire interest) has been extended. In the expected event of divestment by IPO, the Company must carry out this IPO before 31 December 2016 and complete the disposal of its entire interest in the Williams & Glyn business by 31 December 2017.
- Citizens Financial Group, Inc. ('Citizens') will be disposed of by 31 December 2016, with an automatic 12 month extension if market metrics indicate that an IPO or subsequent tranches of disposal cannot be completed in an orderly fashion or at a fair value. On 1 November 2013, RBS announced that it would accelerate the divestment of Citizens with a partial IPO and that it planned to fully divest the business by the end of 2016. The obligation under the State Aid Amendment Decision to dispose of Citizens is therefore in line with the Company's planned and publicly stated divestment timetable and already reflected in its capital and strategic planning.

The Company has entered into a Revised State Aid Commitment Deed under which it undertakes to do all acts and things necessary to ensure that HMT is able to comply with the revised State aid commitments made by HMT to the EC. HMT's obligations to the EC and the Company's commitments under the Revised State Aid Commitment Deed will remain in effect even if the DAS Retirement Agreement is not approved by independent shareholders.

#### Tomlinson Report

As discussed in more detail on page 470, in response to the Tomlinson Report, the Bank instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report. Clifford Chance published its report on 17 April 2014 and concluded that there was no evidence to support the principal allegation. The Group continues to cooperate fully with the ongoing FCA investigation.

#### Card Protection Plan Limited

As discussed on page 470, the FCA announced on 22 August 2013 that Card Protection Plan Limited (CPP) and 13 banks and credit card issuers, including the Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. The compensation scheme has now been approved by the requisite number of customers and by the High Court of England and Wales. CPP has written to affected policyholders to ask those who believe they have been mis-sold to submit their claims. Claims that have been submitted to date are currently being processed. Save for exceptional cases, all claims must be submitted before 31 August 2014. The Group has made appropriate levels of provision based on its estimate of ultimate exposure.

#### SME banking market study

As discussed on page 472, the OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. Following a consultation on the scope of the market study, the OFT published an update paper on 27 September 2013 setting out its proposed scope. On 11 March 2014, the OFT set out some competition concerns on SME banking but also announced that its successor body, the CMA, would continue the review. On the same day, the CMA indicated that it expected to come to a provisional decision on whether or not to refer SME banking to a more detailed phase 2 investigation by Summer 2014.

#### Cap on variable remuneration

The fourth EU Capital Requirements Directive (CRD IV), implemented for banks in the UK by the Prudential Regulatory Authority, imposes a 1:1 cap on variable remuneration in relation to salary; however with shareholder approval it is possible to award variable remuneration up to 200% of fixed pay (i.e. a 2:1 cap).

All of our major competitors have indicated that they will seek approval from their shareholders to introduce a 2:1 cap and the Board believes the best commercial solution for RBS would be to have the flexibility on variable

compensation which is now emerging as the sector norm. This would also allow RBS to maintain the maximum amount of compensation that could be subject to performance conditions including claw back for conduct issues that may emerge in future.

On 24 April UKFI informed the board that it would vote against any resolution which proposes a 2:1 ratio. In these circumstances, the Board expects that such a resolution would fail and will therefore not be brought to the Annual General Meeting. HM Treasury has commented that it considers an increase to the cap on variable remuneration cannot be justified whilst RBS has yet to complete its restructuring and remains a majority publicly-owned bank, and notes that as a result of its pay policy RBS will remain a 'back-marker' in its overall remuneration compared to other banks.

The Board acknowledges that this outcome creates a commercial and prudential risk which it must try to mitigate within the framework of a 1:1 fixed to variable compensation ratio.

#### Moody's Investors Service

On 13 March 2014, Moody's closed a second ratings review, first initiated on 12 February 2014 on RBS Group by lowering the credit ratings of RBSG and certain subsidiaries by one notch. The long term ratings of RBSG was lowered to 'Baa2' from 'Baa1' whilst the long term ratings of RBS plc and National Westminster Bank Plc were lowered to 'Baa1' from 'A3'. Short term ratings were affirmed as unchanged. Post the review, the ratings outlook assigned was negative.

The ratings of Ulster Bank Ltd and Ulster Bank Ireland Ltd's were impacted by the rating action on the RBS Group. Moody's lowered its long term and short term ratings of these entities by 1-notch to 'Baa3' (long term)/'P-3' (short term) from 'Baa2'/'P-2'. A negative outlook was assigned to ratings, in line with the outlook on the RBS Group.

The long term ratings of subsidiaries, RBS Citizens National Association and Citizens Bank of Pennsylvania were not impacted by the rating action on the RBS Group and long term ratings of these entities were affirmed as unchanged by Moody's. Ratings are on a negative outlook.

#### Standard & Poor's

There have been no significant rating actions on RBS Group plc and its subsidiaries by Standard & Poor's. However, on 23 April 2014 they published a report setting out their views on potential risks for banks and key considerations for rating banks in an independent Scotland.



## 2013 Financial Results

RBS reports a pre-tax loss for 2013 of £8,243 million, including regulatory and redress provisions of £3,844 million, and impairments and other losses of £4,823 million related to the establishment of RBS Capital Resolution (RCR).

Excluding the impact of the creation of RCR, RBS operating profit on a managed basis was £2,520 million, down 15% from 2012:

RBS has, on 27 February 2014, updated on its comprehensive business review, aimed at transforming the bank (see page 10).

## 2013 Financial Results

Third party assets were reduced by £130 billion over the course of 2013, with Markets down £72 billion and Non-Core down £29 billion. In the five years since the end of 2008, the funded balance sheet has been reduced by £487 billion and total assets by £1,191 billion.

The Core Tier 1 ratio was 10.9% at 31 December 2013. On a fully loaded Basel III basis, the Common Equity Tier 1 ratio was 8.6%. The impact of the regulatory and redress provisions booked in Q4 2013 was already reflected in our future capital plan, and RBS continues to target a fully loaded Basel III Common Equity Tier 1 ratio of c.11% by the end of 2015 and 12% or above by the end of 2016.

Continued improvement in credit quality, particularly in the UK Retail and Non- Core portfolios, saw risk elements in lending fall by 4%. Reflecting the increased impairments associated with the creation of RCR, provision coverage increased from 52% at end 2012 to 64% at end 2013.

RBS remains highly liquid, with short-term wholesale funding down £10 billion to £32 billion at the end of 2013, covered more than four times by a £146 billion liquidity portfolio.

### Building a bank that is trusted by its customers

RBS has announced a refreshed strategic direction with the ambition of building a bank that earns its customers' trust by serving them better than any other bank.

RBS will be structured around the needs of its customers, with seven existing operating divisions realigned into three businesses: Personal & Business Banking, Commercial & Private Banking and Corporate & Institutional Banking.

Ulster Bank in Northern Ireland will benefit from a closer integration with our personal, business and commercial banking franchises in Great Britain. We are continuing to explore further opportunities in the Republic of Ireland with a view to being a challenger to the systemic banks.

To position RBS to deliver a sustainable overall return on tangible equity of 12% plus in the long term, we must achieve a significant reduction in costs and complexity.

This simplification is intended to deliver significant improvements to services delivered to our customers while at the same time helping to bring our cost base down from £13.3 billion in 2013 to £8 billion in the medium term (1).

Future performance will be reported against customer and financial measures. Further details are set out on page 12.

### Operating results

RBS recorded an operating loss of £8,243 million. On a managed basis RBS recorded an operating profit of £2,520 million excluding the impact of the creation of RCR which reduced income by £333 million and increased impairments by £4,490 million. Including these RCR-related impairment and other losses of £4,823 million(2), RBS recorded an operating loss of £2,303 million on a managed basis.

Total income increased by £1,816 million to £19,757 million primarily reflecting a lower accounting charge in relation to own credit adjustments; with expenses up 9% to £19,568 million. On a managed basis Group income, excluding the RCR impact of £333 million was down 10% to £19,775 million, principally reflecting a £1,161 million reduction in Markets income, with expenses down 4% to £13,313 million.

Retail & Commercial (R&C) operating profit was £2,693 million compared with £4,238 million in 2012. Excluding £1,385 million of impairments and other losses related to the creation of RCR, operating profit was down 4% to £4,078 million, with lower income in UK Corporate and International Banking offsetting improved impairments in Ulster Bank and UK Retail.

Markets operating profit was £620 million compared with £1,509 million in 2012. Excluding £18 million of impairments related to the creation of RCR, operating profit was down 58% to £638 million, reflecting its smaller balance sheet and reduced risk levels.

Non-Core losses were £5,527 million compared with £2,879 million in 2012. Excluding £3,420 million of impairments and other losses related to the creation of RCR, operating loss was down 27% to £2,107 million, with the cost base falling in line with run-off.

Loss attributable to shareholders was £8,995 million, reflecting the charges relating to the creation of RCR and legacy conduct litigation and redress, the write-down of goodwill and other intangible assets and deferred tax assets.

Notes:

- (1) Includes the impact of business exits such as Citizens Financial Group and Williams & Glyn; bank levy; restructuring costs; and, from 2015, the EU resolution fund charge.
- (2) During the year the Group recognised £4,823 million of impairment and other losses related to the establishment of RCR. This comprises impairment losses of £4,490 million (of which £173 million relate to core Ulster Bank assets which were not transferred to RCR but are subject to the same strategy) and £333 million reduction in income reflecting asset valuation adjustments.

## 2013 Financial Results

### Delivering our capital plan

To deliver our capital plan RBS has formed the Capital Resolution Group (CRG), which is made up of four pillars: exiting the assets in RCR, delivering the IPOs for both Citizens and Williams & Glyn, and optimising the bank's group-wide shipping business.

RCR was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate run-down of these exposures to free up capital for the bank. The revised strategy to run down high risk loans faster led to an increased impairment charge. When originally announced, RCR assets were projected to be £38 billion at the end of 2013, but accelerated disposals and increased impairments have reduced this total to £29 billion. Further details about RCR are set out on page 158.

During the course of 2013 RBS sold two tranches of its remaining shares in Direct Line Insurance Group, realising gross proceeds of £1,137 million. At 31 December 2013, RBS held 28.5% of Direct Line Insurance Group. On 26 February 2014, RBS announced that it had entered into a placing agreement to complete the sale of its residual interest (except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to Direct Line Group management). Accordingly, on settlement of the placing, the Group will have completed the disposal as required by the European Commission.

On 27 November 2013, RBS announced the sale of its remaining economic interest in the WorldPay global payments business. A gain on sale of £159 million was recognised in Q4 2013.

On 1 November 2013, RBS announced plans to accelerate the divestment of Citizens, its US banking subsidiary. Preparations for a partial initial public offering (IPO) in 2014 remain on track, and the bank intends to fully divest the business by the end of 2016.

Following the conclusion of a £600 million pre- IPO investment by a consortium of investors led by global financial services specialists Corsair Capital and Centerbridge Partners, and including the Church Commissioners for England and RIT Capital Partners plc, the Williams & Glyn business (formerly known as "Project Rainbow") has made good progress towards its IPO.

Discussions with the UK Government over the retirement of the Dividend Access Share (DAS) are well advanced. A successful restructuring of the DAS will represent a significant step towards the normalisation of RBS's capital structure.

On 16 December 2013, RBS cancelled its £8 billion Contingent Capital Facility with HM Treasury.

### Legacy conduct issues

As announced in a trading update on 27 January 2014, RBS has provided £1,910 million in Q4 2013 covering claims and conduct-related matters primarily relating to mortgage-backed and other securities litigation. Regulatory and litigation provisions for the full year amounted to £2,394 million.

An additional £465 million provision for Payment Protection Insurance (PPI) redress and related costs was booked in Q4 2013, making a total of £900 million for the full year 2013. Out of a cumulative PPI provision of £3.1 billion, £2.2 billion had been utilised by 31 December 2013. The remaining £0.9 billion provision covers approximately 12 months at current levels of redress and administrative expenses.

A further £500 million provision was made in Q4 2013 for interest rate hedging products redress and administration costs, reflecting higher volumes, higher anticipated redress payments and recalibration of our methodology based on more recent trends. The total charge for the full year was £550 million making a total of £1.25 billion of which £0.2 billion had been utilised by 31 December 2013.

## 2013 Financial Results

Over time, with steady focus and disciplined delivery, the new RBS will emerge. The businesses we operate will be highly effective and relentless in their pursuit of delivering service that makes us number one for customers.

### Serving our customers

Investment of £700 million has been committed over the next 3-5 years to build the best retail and commercial bank in the UK. Investment in digital channels continued, with 50% of eligible customers now banking online or on mobile.

Mortgage balance growth was affected in H1 2013 by advisor training, but application volumes recovered during the second half, helped by RBS's lead in launching the second phase of the Help to Buy scheme. Gross new lending in 2013 was £14.3 billion, up 3% from 2012. This represented an 8% market share, slightly in excess of RBS's share of mortgage stock.

UK Corporate will implement all the recommendations of the independent review of its lending standards and practices led by Sir Andrew Large.

Support for SME customers during 2013 included pro-active 'Statements of Appetite' sent to over 12,000 customers, resulting in more than £5.9 billion of new loan offers.

SME demand for credit has picked up over the course of the year, with new and increased lending sanctioned in 2013, up 6% from the prior year to £9.9 billion. SMEs drew down £6.4 billion of new loans in 2013, up 2% from 2012. However, businesses' cash generation remained strong, with SME current account balances up 13% from the end of 2012. Many customers increased their loan repayments and reduced overdraft utilisation, which dropped to 37% at the end of 2013 compared with 42% a year earlier.

Among larger businesses, £12.9 billion of new facilities were made available to new and existing clients. RBS also helped UK companies, universities and housing associations to raise £24.7 billion through bond issues in 2013.

RBS repaid all its borrowings from the Bank of England Funding for Lending Scheme (FLS) in 2013 but continues to participate fully in the scheme. In the period since launch to 31 December 2013, RBS allocated more than £4.7 billion of new FLS-related lending to business customers, with discounts targeted at SMEs and mid-sized manufacturers. We intend to remain in the scheme throughout 2014 (subject to no further changes in the scheme rules).

Total net lending flows reported within the scope of the FLS scheme were minus £2,295 million in Q4 2013, with net lending of plus £349 million to households and minus £2,645 million to private sector non-financial corporations, of which minus £671 million was to SMEs.

## Our purpose and values

We are here to serve our customers. From the end of 2008 we have drastically changed as a business – our balance sheet has reduced by £1,191 billion, our capital ratios strengthened, our conduct and risk management framework overhauled. As a result, we are smaller, safer and stronger with a clearer focus. However, there was a clear need to unite the bank behind a single purpose and common set of values.

Our purpose:                Serve customers well.

Our vision:                We want to be trusted, respected and valued by our customers, shareholders and communities.

Our future is not about us, it is about our customers. We needed to ensure that this ran through the bank – from boardroom to branch. We spent time with colleagues across the bank debating what should be at the core of our ambition to build a bank known for its consistent, high quality customer service. We agreed on a single, simple purpose – to serve customers well. We want to be trusted, respected and valued by our customers, shareholders and communities. To do this we have put a common set of values at the heart of how we do business. Our values are not new, but capture what we do when we are at our best.

Our values:

Serving customers

We exist to serve customers.

We earn their trust by focusing on their needs and delivering excellent service.

Working together

We care for each other and work best as one team.

We bring the best of ourselves to work and support one another to realise our potential.

Doing the right thing

We do the right thing.

We take risk seriously and manage it prudently.

We prize fairness and diversity and exercise judgement with thought and integrity.

Thinking long term

We know we succeed only when our customers and communities succeed.

We do business in an open, direct and sustainable way.

All this comes together in Our Code.

## Our purpose and values

We have a programme of change in place that embeds a working culture which celebrates challenge when business decisions or behaviours are not in line with our values. We have engaged our employees to stimulate ideas and change that ultimately results in material improvements to the customer experience.

At the beginning of 2013, a personalised letter launching the new purpose and values was signed by the members of our Executive Committee and sent to all of our employees. Employees were invited to engage in an open debate online to discuss the new values – 25,000 joined that conversation.

Regional leadership workshops were designed to build understanding and engagement for more than 3,000 of our leaders. Those leaders then engaged locally to help their people understand how the purpose and values were relevant to their business area. By September, 66% of staff had been involved in a conversation with their leader, and 93% of those have a better understanding of the relevance to their part of the business.

We made fundamental, lasting changes to the way we do business by re-writing our code of conduct and policy framework. Our Code was an important milestone in our focus on the customer and our values. Our Code included a new decision making tool – the YES Check.

It is a simple guide to help employees check whether they are making the right decision in line with our purpose and values. Mapped back to regulatory principles, the YES Check was another important recognition that the decisions we take everyday impact our customers and our communities.

We have continued to professionalise our customer facing staff, committing to accredit them against professional standards by the end of 2014.

We also changed the way we recognise the best behaviours in the bank. We launched Our Values Awards for all our employees and nominations were submitted of examples where people were living the values and serving customers well.

New Leadership Standards were developed to align them directly with our values. These standards support Our Code and provide us with a clear view of what is expected from leaders and is being built into how we recruit, develop and reward them.

We have made progress but we need to continue to have a rigorous focus on how to serve customers well, and work to fully embed our values in everything we do. Our employees believe in the goals of RBS and already 1 in 2 people have seen a change in how their team works.



## Our business model and strategy

The RBS business model is that of a UK-focused retail and commercial bank. Our market leading customer franchises in the UK serving personal, business and corporate customers in the RBS strategy. Our wholesale banking operations in the corporate and institutional business enhance and complement the proposition to our commercial customers.

Our major source of income in our retail and commercial banking businesses is net interest income. This is the difference between the income we earn from the loans and advances we have made to our personal, corporate and institutional customers and on our surplus funds and the interest we pay on deposits placed with us by our customers and our debt securities we have issued. We also earn fees from financial services and other products we provide to our customers as well as rental income from assets we lease to our customers.

Our Markets business earns income from client driven trading activities particularly Rates, Currencies, Asset-Backed Products and Credit.

Our leading customer franchises serve 24 million customers globally, of which more than 70% are in the UK. We aim to provide them with a comprehensive range of products, delivered through a number of channels, which are increasingly digital.

We do business in competitive markets but we have strong franchises and good growth opportunities, and we aim to target our investment to maximise these opportunities.

Over the period 2009-2013, the RBS strategic approach has focused first and foremost on rebuilding financial resilience:

- reducing total assets, principally through the run-off of the Non-Core;
- reducing risk concentrations;
- reducing dependence on short-term wholesale funding while achieving a deposit-led funding model; and
- reducing balance sheet leverage.

This emphasis was necessary in order to correct historical weaknesses and to set RBS on a sound footing, but it left us falling short in our ability to build long-term shareholder value on the foundation of serving our customers and meeting more of their financial needs.

In 2013 we have refocused our Markets and International Banking businesses to deliver a targeted wholesale banking proposition to UK corporates and global financial institutions.

### Strategic review

On 1 November 2013 RBS announced a full review of its customer-facing businesses, its IT and operations, and its organisational and decision-making structures. As a result of this review, we have announced a refreshed strategic direction with the ambition of building a bank that earns its customers' trust by serving them better than any other bank.

### Business structure

RBS will be structured to deliver this ambition by organising itself around the needs of its customers, so as to combine customer groups with similar needs into business units able to deliver co-ordinated services. The seven existing operating divisions will be realigned into three businesses:

- Personal & Business Banking will serve UK personal and affluent customers together with small businesses (generally reporting up to £2 million turnover), with more business bankers moving back into branches.

- Commercial & Private Banking will serve commercial and mid-corporate customers and high net worth individuals, deepening relationships with commercial clients operating overseas through its market leading trade and foreign exchange services, while connecting our private banking brands more effectively to successful business owners and entrepreneurs.

## Our business model and strategy

|  | Personal &<br>Business Banking | Commercial &<br>Private Banking | Corporate &<br>Institutional Banking |
|--|--------------------------------|---------------------------------|--------------------------------------|
| CEO  | Les Matheson                   | Alison Rose                     | Donald Workman                       |
| RWAs profile (%) <sup>(1)</sup>                | ~35%                           | ~30%                            | ~35%                                 |
| Operating profit profile<br>(%) <sup>(1)</sup> | ~50%                           | ~30%                            | ~20%                                 |
| Target RoE <sup>(1)</sup>                      | 15%+                           | 15%+                            | ~10% <sup>(2)</sup>                  |

## Notes:

- (1) All business targets refer to steady state performance 2018 - 2020.
- (2) 7-8% medium-term.
- (3) This table contains forecasts with significant contingencies. Please refer to “Forward Looking Statements” and “Risk Factors”.

Corporate & Institutional Banking will serve our corporate and institutional clients primarily in the UK and Western Europe, as well as those US and Asian multinationals with substantial trade and investment links in the region, with debt financing, risk management and trade services, focusing on core product capabilities that are of most relevance to our clients.

Ulster Bank in Northern Ireland will benefit from a closer integration with our personal, business and commercial franchises in Great Britain, while continuing to operate under the Ulster Bank brand. We are continuing to review our business in the Republic of Ireland with a view to being a challenger to the systemic banks in Ireland.

The reorganised bank will be a UK-focused retail and corporate bank with an international footprint to drive its corporate business. It will be managed as one bank, with one strategy.

Each of the three businesses is built on franchises that have the potential to be the number one bank for their respective customer groups. Each is designed to:

- Serve customer needs better than the existing operating divisions.
- Help eliminate duplication of costs in front and back offices.
- Position RBS to deliver a sustainable overall return on tangible equity of 12% plus in the long term.

A more detailed review of component business lines continues within each business, and further updates will be provided over the course of the year.

## Addressing costs and returns

Key to achieving this is a significant reduction in RBS’s costs and complexity. Transforming the bank to deliver this involves rationalising and simplifying systems, based on a target architecture with improved resilience.

## Examples of these measures include:

- The number of technology platforms we use will be reduced by over 50%.
- We will move from 50 core banking systems to around 10.

- From 80 payment systems currently maintained we will move to approximately 10.
- Our property portfolio will be reduced from 25 million square feet to 18 million square feet, including significant reductions in central London.
- We will maintain a similar level of investment spending but directed at customer facing process improvements, instead of maintaining inefficient legacy infrastructure.

This simplification is intended to deliver significant improvements to services delivered to our customers but at the same time serves as the cornerstone of a programme designed to bring our cost base down from £13.3 billion in 2013 to £8 billion in the medium term, including the impact of business exits such as Citizens Financial Group and Williams & Glyn, the bank levy, restructuring costs and, from 2015, the EU resolution fund charge. This plan will take RBS towards a cost:income ratio of around 55%, moving towards 50% in the longer term. Bringing our cost base back into alignment with the reduced scale of our business underpins our potential to deliver improved returns in future years.

The costs to achieve this plan will total approximately £5 billion over 2014 to 2017; of this approximately £1 billion has already been committed to previous plans related primarily to Citizens, Williams & Glyn and the previous restructuring announced for Markets. Approximately £0.6 billion relates to the costs of achieving asset reductions and realisations in Markets as we reshape this business over the next three to five years.

## Our business model and strategy

|                  | Measure                          | 2013                     | Medium term               | Long term  |
|------------------|----------------------------------|--------------------------|---------------------------|--|
| Customer         | Service(1)<br>Trust              | <25% of businesses at #1 |                           | All businesses at #1<br>#1 trusted bank in<br>the UK             |
| People           | Great place to work              |                          |                           | Engagement index $\geq$<br>Global Financial<br>Services norm (2) |
| Efficiency       | Cost:income ratio<br>Costs       | 73%(3)<br>£13.3 billion  | ~55%(3)<br>~£8 billion(3) | ~50%(3)  |
| Returns          | Return on tangible<br>equity(4)  | Negative                 | ~9-11%                    | 12%+   |
| Capital strength | Common Equity Tier 1<br>ratio(5) | 8.6%                     | $\geq$ 12%                | $\geq$ 12%   |
|                  | Leverage ratio(5)                | 3.5%                     | 3.5-4%                    | $\geq$ 4%  |

## Notes:

- (1) Measured by Net Promoter Score, with the exception of Corporate & Institutional Banking, which will use customer satisfaction. NPS nets the percentage of “promoters” (loyal enthusiasts of the company) and the percentage of “detractors” (unhappy customers) to give a measure of customer advocacy.
- (2) Global Financial Services norm currently stands at 82%.
- (3) Including bank levy, restructuring charges and, from 2015, the EU resolution fund charge.
- (4) Calculated with tangible equity based on CET1 ratio of 12%.
- (5) Fully loaded Basel III.
- (6) This table contains forecasts with significant contingencies. Please refer to “Forward Looking Statements” and “Risk Factors”.

## Delivery of 2009-2013 Strategic Plan

In 2009 RBS set out a five year strategic plan aimed at restoring RBS to standalone strength.

The plan was built on four business objectives:

- To base RBS on enduring customer franchises, with each business capable of generating a sustainable return in excess of its cost of capital
  - To deliver the RBS strategy from a stable risk profile and balance sheet, with each banking business self-funding (100% loan:deposit ratio)
  - To deliver an attractive blend of profitability, stability and sustainable growth from the chosen business mix
- Management hallmarks to include an open, investor-friendly approach; discipline and proven execution effectiveness; strong risk management; and central focus on serving our customers well.

We set out key measures and have consistently reported on our progress against these over the course of the five year plan. Progress against the risk measures has been strong, with all targets exceeded, in some cases by very large margins. Progress against value drivers, however, has not lived up to our expectations at the time the plan was established, with deterioration in both return on equity and cost:income ratio.



RBS at a glance

“We must become a company that knows what it means to obsess about our customers. This is a fundamental challenge that will involve the whole organisation.”

RBS is rooted in the UK, serving personal, business and institutional customers in the UK and many other countries. Our businesses are strong players in the markets in which we choose to compete. The businesses are stronger together than apart, to the benefit of customers and shareholders.

RBS is now safer and the day when we will be able to offer shareholders a decent return is closer. But making RBS a really good bank demands more. That is why we are still investing more effort in all of our businesses to serve customers well.

## RBS at a glance

### UK Retail

#### Customer story

##### Mobile nation

With over one billion logins since its launch, the RBS mobile banking app helps customers access their money while on the move.

##### Over £30 million transferred every day

At the swipe of a smartphone customers can check their balance, move money, view their transaction history, pay a contact or even take cash out without a debit card. With over £30 million transferred every day, it's actually the bank's busiest branch: over a 30 day period, we had around 78 million logins which is equal to each customer visiting a physical branch around 30 times a month.

By contrast, people tend to visit an actual branch less than once a month.

| Performance highlights     | 2013 | 2012 |
|----------------------------|------|------|
| Return on equity (%)       | 26.3 | 24.4 |
| Cost:income ratio (%)      | 54   | 51   |
| Loan:deposit ratio (%)     | 97   | 97   |
| Risk-weighted assets (£bn) | 43.9 | 44.8 |

We offer a comprehensive range of banking products and related financial services to the personal market. We serve customers through the RBS and NatWest networks of branches and ATMs, and also through telephone and digital channels.

#### Performance overview

- Operating profit increased 3% from £1,891 million to £1,943 million, driven by a decline in impairment losses.
- Mortgage balance growth was affected in H1 2013 by advisor training but recovered during H2 2013.
- Customer deposits increased by 7%, above UK market average.
- Net interest margin held steady, despite tightening margins on new mortgages. Lower income was earned on current account balances, but savings margins improved.

#### Building a better bank that serves customers well

In March 2013 UK Retail announced its strategy to become a simpler and more customer focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Investment in digital channels continued, with half of all eligible customers now banking online or on mobile. Although branch counter transactions have fallen 30% since 2010 a programme to refurbish our branches has begun.



## RBS at a glance

## UK Corporate

Chris Sullivan  
Chief Executive

Customer story  
Stormy weather

The UK suffered from terrible weather at the end of 2013, which caused serious damage and destruction. Adverse weather can have a dramatic effect on a business – loss of property and stock, failing systems, supply chain failures and halted trading – pushing them into financial difficulty, impacting employees and local communities. To help ease the pressure for businesses who have been directly or indirectly affected, we launched a £250 million UK Storm Business Fund. Interest-free loans can be provided for three months to viable and eligible businesses, whether or not they are existing customers (maximum of £250k per loan). Short-term, interest-free financing can be provided to cover, for example, cost of repairs and replacement stock while businesses wait for insurance claims to be paid.

| Performance highlights     | 2013 | 2012 |
|----------------------------|------|------|
| Return on equity (%)       | 7.9  | 14.5 |
| Cost:income ratio (%)      | 50   | 44   |
| Loan:deposit ratio (%)     | 80   | 82   |
| Risk-weighted assets (£bn) | 86.1 | 86.3 |

We are a leading provider of banking, finance and risk management services to the corporate and SME (small and medium-sized enterprise) sector in the United Kingdom. We offer a full range of banking products and related financial services.

## Performance overview

- Operating profit was down 41% at £1,060 million. Excluding £410 million impairments related to the creation of RCR, operating profit was down 18%.
- Impairments included an additional £410 million related to the creation of RCR. Excluding this, impairments were 7% lower than in 2012.
- Excluding the impact of increased impairment losses related to the creation of RCR, return on equity was 11%.
- Net interest income fell in a lower interest rate environment.
- Continued run-off of property and shipping outweighed growth in other sectors, leaving loan balances down 5%.

## Building a better bank that serves customers well

To reinforce its commitment to supporting the UK economy, RBS appointed Sir Andrew Large to lead an independent review of its lending standards and practices. UK Corporate has undertaken to implement all the Independent Lending Review's recommendations and is adopting a revised strategy to accomplish this. Support for SME customers included proactive "Statements of Appetite" sent to over 12,000 customers, resulting in approximately £6 billion of new loan offers.

## RBS at a glance

### Wealth

Rory Tapner  
Chief Executive

### Customer story

#### Network connection

Every entrepreneur knows the power of networking to build connections and contacts. Taking that network to the next level takes time and effort, things which are often in short supply.

Coutts were able to bring the right people to the table

However, Coutts' focus on adding value to every relationship can also help bring the right people together. When one client was looking to diversify into renewables and food security in the Middle East, Coutts were able to bring the right people to the table, providing a catalyst for the client's growth opportunities and showing the value of our inter-connected world.

| Performance highlights     | 2013 | 2012 |
|----------------------------|------|------|
| Return on equity (%)       | 12.0 | 13.1 |
| Cost:income ratio (%)      | 77   | 75   |
| Loan:deposit ratio (%)     | 45   | 44   |
| Risk-weighted assets (£bn) | 12.0 | 12.3 |

We provide private banking and investment services in the UK through Coutts & Co and Adam & Company; offshore banking through RBS International, NatWest Offshore and Isle of Man Bank; and international private banking through Coutts & Co Ltd.

### Performance overview

- Operating profit was 9% lower at £221 million.
- Income was 7% lower, with net interest income declining over the year, reflecting tighter deposit spreads. Deposit margins improved in the fourth quarter following a repricing initiative.
- Assets under management rose 3%, but total client assets and liabilities managed by the division declined by 2% following the repricing initiative.
- Expenses were 4% lower, partly reflecting reduced headcount and tight discretionary cost management.

### Building a better bank that serves customers well

2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review. Clients welcomed Coutts' new fully compliant advice led model, where advisers must achieve the more stringent Level 6 rating, in excess of the Level 4 minimum required by the Financial Conduct Authority. Work continued to streamline client-facing processes and drive increased technology benefits.

## RBS at a glance

### International Banking

John Owen  
Chief Executive

### Customer story Straight ahead

TomTom's navigation and location systems are used by customers in over 35 countries. To comply with finance regulations, they had to implement a standard format for payments across the Single Euro Payments Area.

Used by customers in over 35 countries

They also wanted to use this as an opportunity to make payments more efficient and reduce risk. They worked closely with RBS to make a number of changes to their internal processes and thanks to meticulous planning and communication, the changes were successful. TomTom now has one, single payment process for suppliers across the world.

| Performance highlights     | 2013 | 2012 |
|----------------------------|------|------|
| Return on equity (%)       | 3.9  | 9.1  |
| Cost:income ratio (%)      | 73   | 66   |
| Loan:deposit ratio (%)     | 91   | 91   |
| Risk-weighted assets (£bn) | 49.0 | 51.9 |

We offer a core banking proposition to multinational corporates and financial institutions by providing debt financing, risk management and transaction services. We work with clients to find the best product mix to execute their strategy.

### Performance overview

- Operating profit decreased by 53% to £279 million, with cash management income depressed by the decline in LIBOR interest rates. Excluding impairments of £52 million related to the creation of RCR, operating profit was down 44%.
- Expenses were reduced by 5%, as International Banking kept costs under tight control and achieved timely run-off of discontinued businesses.
- Customer deposits declined by 15% in line with a change in Group funding strategy.

### Building a better bank that serves customers well

With business conditions still challenging as themes of low interest rates and margin compression continue, International Banking remained focused on cost discipline throughout 2013. The division continued to strengthen its balance sheet, reducing risk-weighted assets by 6%, despite the introduction of more severe credit risk models. RBS received a number of awards for trade finance and cash management services.

## RBS at a glance

## Ulster Bank

Jim Brown  
Chief Executive

Customer story  
Home run

Demand for affordable housing is extremely high across the UK and Apex, one of Northern Ireland's largest housing associations, is working hard to help meet this need. Apex employs 570 people and has over 4,000 units under management, including general needs housing, supported housing, sheltered housing and registered care.

## 1,000 brand-new social and affordable homes

A £10 million loan from Ulster Bank will help Apex deliver around 1,000 brand new social and affordable homes, creating much-needed new homes as well as hundreds of construction jobs.

| Performance highlights     | 2013   | 2012   |
|----------------------------|--------|--------|
| Return on equity (%)       | (32.4) | (21.8) |
| Cost:income ratio (%)      | 64     | 62     |
| Loan:deposit ratio (%)     | 120    | 130    |
| Risk-weighted assets (£bn) | 30.7   | 36.1   |

We are a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. We provide a comprehensive range of financial services through our Retail Markets and Corporate Markets divisions.

## Performance overview

- Operating loss for 2013 was £1,457 million, including increased impairment losses of £892 million relating to the creation of RCR. Excluding the impact of the creation of RCR, operating loss improved by £494 million or 48%.
- Impairment losses improved significantly, excluding the RCR impact, with a 64% reduction in losses in the mortgage portfolio.
- Retail and SME deposit balances increased by 2%, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.

## Building a better bank that serves customers well

The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers.

## RBS at a glance

### US Retail & Commercial

Bruce Van Saun  
Chief Executive, RBS Citizens and  
Head of RBS Americas

### Customer story

#### System success

The system helped create a much better customer experience. Cheques and documents can now be scanned at the teller window, with transactions being balanced there and then in front of the customer. That means fewer errors and corrections as well as helping to reduce fraud.

#### Helped create a much better customer experience

BIC supports our goal of becoming our customers' primary banking partner through greater convenience, more privacy and fewer errors. Now we have a truly functional tool that delivers efficiency and security for our customers.

| Performance highlights     | 2013 | 2012 |
|----------------------------|------|------|
| Return on equity (%)       | 7.2  | 8.9  |
| Cost:income ratio (%)      | 73   | 71   |
| Loan:deposit ratio (%)     | 91   | 86   |
| Risk-weighted assets (£bn) | 56.1 | 56.5 |

We provide financial services primarily in the Northeastern, Mid-Atlantic and Midwest United States through the Citizens Bank, Charter One and RBS Citizens brands. We are engaged in retail and corporate banking activities.

### Performance overview

- Operating profit of \$1,012 million was down 15%, with low short-term interest rates continuing to limit net interest margin expansion while rising long-term rates slowed mortgage refinance volumes.
- Average loans and advances were flat, with commercial loan growth of 5% partly offset by run-off of long-term fixed rate consumer products.
- Impairment losses increased by \$99 million to \$244 million.

### Building a better bank that serves customers well

On 1 November 2013 RBS announced plans to accelerate the initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. It is expected that by the end of 2016 RBSCFG will be a standalone regional bank, wholly owned by public shareholders. RBSCFG commenced a number of actions in 2013 aimed at improving financial performance, driving profitable growth by focusing on the customer and delivering a differentiated experience.

## RBS at a glance

## Markets

Peter Neilson Co-CEO

Suneel Kamrani Co-CEO

## Customer story

## Weighing anchor

Peel Ports Group, one of the UK's biggest port operators, handles over 65 million tonnes of cargo a year. An RBS backed refinancing programme has enabled the development of Liverpool2, the new deep sea container terminal in the Port of Liverpool, costing in excess of £300 million.

The benefit of this investment is hugely positive.

As one of their most important sites, this investment in growth will assist the UK's shipping industry to remain globally competitive as well as acting as a catalyst for future development. It's believed Liverpool2 will help create around 5,000 jobs in Merseyside, including additional apprenticeships – a great boost for the local economy.

| Performance highlights     | 2013 | 2012  |
|----------------------------|------|-------|
| Return on equity (%)       | 5.0  | 9.6   |
| Cost:income ratio (%)      | 79   | 66    |
| Risk-weighted assets (£bn) | 64.5 | 101.3 |

We provide financing, risk management and advisory services to RBS corporate and institutional clients.

## Performance overview

- Operating profit fell by £889 million, 59% to £620 million with income falling by 26%, partly offset by significant cost reductions. The de-risking of Markets resulted in a 36% reduction in risk-weighted assets.
- Currencies income increased but returns from the Rates business were subdued.
- Costs fell by 11%, reflecting a reduction in headcount of 1,000 evenly split between front and back office – and tightly controlled discretionary expenses.
- Third party assets were reduced by £72 billion (down 25%) and risk-weighted assets by £37 billion (down 36%).

## Building a better bank that serves customers well

In 2013, Markets launched and executed a strategy aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths. The division met or exceeded all internal targets for reducing controllable costs, risk-weighted assets and the balance sheet, while meeting revenue and income expectations. Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment with client activity limited by uncertainty over monetary policy in the US.

## RBS at a glance

### Non-Core

Rory Cullinan  
Chief Executive

Established in 2009 as the principal vehicle of risk reduction. At inception it had £258 billion of Third party assets and £171 billion of risk weighted assets. Non-Core reduced these assets in a capital efficient manner and at a pace the bank could afford.

### Performance overview

- Third party assets declined by £29 billion, or 51% reflecting run-off, disposals and impairments.
- Risk-weighted assets were down £31 billion, driven by disposals and run-off.
- Operating loss of £5,527 million was £2,648 million higher than in 2012, predominantly due to £3,118 million of 2013 impairments related to the creation of RCR.

### Building a better bank that serves customers well

Non-Core has successfully achieved and surpassed its five year strategic plan target set in 2009, reducing third party assets by 89% from an initial £258 billion. By the end of 2013 Non-Core represented c.4% of RBS's funded balance sheet, compared with 21% when the division was created. While the new RCR is similar in size to Non-Core, the assets have been selected on a different criteria and are not directly comparable.

## Business Services

Simon McNamara  
Group Chief Administrative Officer

In Business Services we keep RBS running, supporting our customers 24 hours a day, 365 days a year. We put money in the ATMs, keep the bank's technology systems operating, help to keep our customers safe from fraud, process billions of pounds worth of payments across the world, and provide call centre and online services to customers.

We work across four business areas: Technology Services, Group Operations, Corporate Services and Strategy & Architecture. Together we connect colleagues and customers, providing the tools and services that help us to serve our customers when and where they need us.

- We issued two million time-saving contactless cards in 2013 allowing customers to make quick and easy payments for everyday items under £20 in less than a second.
- Through our Simplifying Customer Life initiative 4,500 ideas have been submitted improving over four million customer interactions each year.
- We have delivered almost 50 Cyber Crime and Fraud Prevention seminars to more than 2,500 RBS customers, non-customers and RBS Relationship Managers worldwide.
- Over two million customers log on to online or mobile banking every day.

- Since 2010, when we launched our mobile app, we have had more than a billion log-ons.
- Our energy initiatives have resulted in an 18% reduction in energy consumption in our flagship buildings during 2013.
- We introduced a funds transfer option on our ATMs, which allows customers to move funds between their accounts.
- IT incidents in recent years have caused inconvenience to our customers. To reduce the impact of any technology outages on our customers, we are investing over £750 million in a three-year period to improve the resilience of our systems, becoming safer and more secure.



## Governance at a glance

Board and committee activity increased significantly in 2013, with a number of key strategic issues taking centre stage, and Board committees continued to play a crucial role in our governance framework, undertaking their complex work comprehensively and effectively supporting the work of the Board.

Conduct and culture have been key areas of focus throughout the year and our 2013 results reflect the impact that conduct related matters continue to have on financial and operating performance. The Board fully supports our new values, which were launched in 2013 and focus on serving customers, working together, doing the right thing and thinking long term. It is vital that the Board continues to set the tone from the top to drive essential cultural change and that our governance framework continues to evolve to support this and our key strategic changes. These will be key priorities for the Board and its Committees in 2014.

Philip Hampton  
Chairman of the Board of directors

### Our Board

The Board has 11 directors comprising the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director. Biographies for each director and details of which Board Committees they are members of can be found in the Corporate governance report on pages 42 to 45.

There were a number of changes to the Board's composition during 2013, details of which can be found in the Chairman's Statement on pages 24 and 25 and in the Corporate governance report on page 48.

The Board is the main decision-making forum for the company. It is collectively responsible for the long-term success of the company and is accountable to shareholders for financial and operational performance.

The Board has overall responsibility for the following areas:

- the establishment of strategy and consideration of strategic challenges;
- the management of the business and affairs of the Group;
- ensuring that risk is managed effectively through the approval and monitoring of risk appetite;
- considering stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations;
- the allocation and raising of capital; and
- the preparation and approval of the RBS annual report and accounts.

We conducted an internal evaluation of the effectiveness of the Board and its committees in 2013, led by the Group Secretary. The evaluation has concluded that the Board is operating effectively but has identified some areas for improvement which we will focus on during 2014.

Our Board committees  
Group Audit Committee

Assists the Board in discharging its responsibilities for monitoring the integrity of the financial statements of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group and the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit.

For more detail of the operation of the committee please refer to the full committee report on pages 55 to 60.

#### Board Risk Committee

Provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's compliance with approved risk appetite and oversees the operation of the Group Policy Framework.

For more detail of the operation of the committee please refer to the full committee report on pages 61 to 66.

#### Group Performance and Remuneration Committee

Responsible for overseeing performance and the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on the remuneration of executive directors.

For more detail of the operation of the committee please refer to the full committee report on pages 69 to 93.

Governance at a glance

Board of directors and Executive Committee

Board

| Chairman       | Executive directors           | Non-executive directors   |
|----------------|-------------------------------|---|
| Philip Hampton | Ross McEwan<br>Nathan Bostock | Sandy Crombie<br>Alison Davis<br>Tony Di Iorio<br>Robert Gillespie<br>Penny Hughes<br>Brendan Nelson<br>Baroness Noakes<br>Philip Scott |

Secretary and Head of Corporate Governance  
Aileen Taylor

Executive Committee\*

|                |   |
|----------------|---|
| Ross McEwan    | Group Chief Executive   |
| Nathan Bostock | Group Finance Director  |
| Rory Cullinan  | Chief Executive, RBS Capital Resolution Group                               |
| Suneel Kamlani | Co-Chief Executive, Markets   |
| Les Matheson   | Chief Executive, UK Retail  |
| Simon McNamara | Group Chief Administration Officer  |
| Jon Pain       | Group Head of Conduct & Regulatory Affairs                                  |
| David Stephen  | Group Chief Risk Officer  |
| Chris Sullivan | Chief Executive, Corporate Banking  |
| Bruce Van Saun | Chief Executive, RBS Citizens Financial Group, Inc and Head of RBS Americas |

\* As at the date of signing of the Annual Report and Accounts.

Group Nominations Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

For more detail of the operation of the committee please refer to the full committee report on pages 53 and 54.

Group Sustainability Committee

Responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

For more detail of the operation of the committee please refer to the full committee report on pages 67 and 68.

Executive Committee

Supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations and considers risk strategy, policy and management.

RBS Capital Resolution (RCR) Board Oversight Committee

Provides oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

UK Corporate Governance Code

This is the first year that we are reporting under the new narrative reporting requirements which include the new Strategic Report and changes in remuneration reporting. Throughout the year ended 31 December 2013, the company has complied with all of the provisions of the UK Corporate Governance Code except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. The company considers that this is a matter which should rightly be reserved for the Board. Our statement of compliance with the UK Corporate Governance Code (the "Code") is set out on page 96.

Chairman's statement

Chairman's statement

Philip Hampton  
Chairman

"We are confident that the actions announced will deliver a customer focused bank."

Five years ago RBS embarked on a strategic restructuring designed to correct the aspects of its business that made it particularly vulnerable to the financial crisis of 2008. The execution of that restructuring has transformed the financial position of the bank: we have reduced our balance sheet by more than £1 trillion, repaid hundreds of billions of Government funding support and removed the imminent threat that our size, risk and complexity posed to the UK economy. In 2013 we took further steps to resolve our remaining legacy balance sheet issues by announcing the creation of RCR, with the aim of accelerating the removal of these legacy assets and releasing the capital they are still tying up.

We have also taken very substantial charges for a variety of conduct-related issues, including LIBOR, PPI, interest rate swaps and RMBS litigation. Almost all of these costs for RCR and conduct issues can properly be described as legacy costs, arising from events and actions in the run-up to the financial crisis.

As our 2013 results make clear, however, restoring the strength of the bank's balance sheet was only one part of the job. In June the Board announced that Stephen Hester, who had led our financial restructuring since 2008 very effectively, would be stepping down as Group Chief Executive. We selected Ross McEwan to re-energise the task of building a bank that earns its customers' trust, improves operating efficiency and can move down the path back to full private ownership. The Board and I want to thank Stephen Hester for his dedication to RBS and to congratulate him on his success in putting the bank on to a sound footing.

There have been a number of other changes to the Board's composition during the year. Bruce Van Saun took up his new role as Chairman and Chief Executive of RBS Citizens Financial Group, Inc. on 1 October 2013 and has stepped down from the Board having done an excellent job as our Group Finance Director. He was succeeded by Nathan Bostock, who has since confirmed his resignation; his leaving date has not yet been agreed and the search for his replacement is under way.

Two of our non-executive directors, Joe MacHale and Art Ryan, also retired from the Board in 2013 and Philip Scott will step down from the Board by 31 October 2014. I thank them all for the hard work and wisdom they have brought as directors. In December 2013, we also welcomed Robert Gillespie as a new non-executive director. I would like to take this opportunity to express my appreciation to all of my fellow directors for their commitment and readiness to deal with the unusual challenges of a government-controlled listed company.

Ross McEwan is bringing a fresh perspective to RBS's challenges, and that perspective is now bearing fruit in the results of the strategic review that we are setting out. The Board believes that this was the right time for this review, so as to ensure that we target our future efforts firmly towards serving our customers, shareholders and wider stakeholders in the best possible way.

Regrettably, last year brought further reminders that many of our customers and stakeholders do not trust us to do so. In response to persistent criticism of our performance in lending to SMEs the Board commissioned an independent review by Sir Andrew Large; we expect to adopt all of his recommendations.



### Chairman's statement

We also faced accusations that our Global Restructuring Group had been culpable of “systematic and institutional” behaviour in artificially distressing otherwise viable businesses. No evidence has been provided for that allegation but it has, nevertheless, done serious damage to RBS's reputation. That is why we instructed the law firm Clifford Chance to conduct an independent review. This is an area where all banks routinely make difficult judgments, and indeed the banking sector has been criticised for excessive forbearance in recent years, charged with supporting unviable “zombie” companies for too long.

Issues like this continue to underscore the important role played by culture and values in enabling us to become the trusted bank we aspire to be. The Board fully supports the new values we launched in 2013, and it is vital that we continue to set the tone from the top in the coming year to drive essential cultural change.

On many of these issues we have engaged closely with HM Treasury (HMT) through UK Financial Investments, which manages HMT's shareholding, and with our two main regulators, the Prudential Regulation Authority and the Financial Conduct Authority. Over the course of the year they have all proposed actions for consideration by the Board.

Ross McEwan has spoken of the need to reset our relationship with HMT and our main regulators. I hope and believe that we have made good progress in this direction. There is a desire on all sides that our relationship with the Government in its role as controlling shareholder should be primarily managed by UKFI on a commercial, arm's length basis. I want to make it clear, however, that the path we have set and decisions we have taken reflect the Board's view of what is in the interests of all RBS's shareholders and other stakeholders.

We are monitoring the debate on Scottish independence but, as I and my colleagues have said many times, we are politically neutral. We don't support political parties or political movements. We will respond to whatever voters decide and governments agree.

Clearly there are issues we are looking at – currency, the application of financial regulation, lender of last resort, credit ratings – which could affect us. But there is real uncertainty about how any of these matters would be settled in the event of a Yes vote and the outcome would depend on negotiations between the two governments. Indeed, there could be a prolonged period of uncertainty over each of the issues so it really is impossible to quantify with any precision what the effects of each might be right now.

We are confident that the actions announced will deliver a customer-focused bank with undoubted capital strength, the potential for attractive returns and an ability to recommence dividends over the medium term.

Philip Hampton  
Chairman  
26 February 2014

Chief Executive's review

Chief Executive's review

Ross McEwan  
Chief Executive

“Our focus will be determined by where our customers need us, and where we can serve their needs better than anyone else.”

Since 2009 RBS has cleaned up the world's largest bank balance sheet by removing more than £1 trillion in assets. This was a remarkable achievement, born of absolute necessity, but delivered with exceptional skill.

These skills now need to be deployed on a task of equal magnitude: creating a step-change in the customer service and financial performance of RBS. The hardest part of our financial restructuring is now complete, and we now need to use our strengths and capabilities to make RBS an example for everything that should be right with banking.

Since taking up post in October, I have listened extensively to our customers and our staff. It is clear to me that people have not given up on us. Our customers tell me we have good people with good intentions. But they also tell me they are frustrated by the way we work.

The potential for RBS is tangible, we have points of brilliance, but these are masked by a heavily damaged reputation, very high cost base and a structure that reflects the bank we are leaving behind, not the one we will become.

We hold many excellent market leading positions across the bank and, despite the distractions of our recovery, there are areas where we have started to excel for our customers. But this remains an inconsistent picture and the returns in our strongest businesses can often be diluted by weaker parts of the franchise, the price of past misconduct and an uncompetitive cost base.

We are clear on our purpose as a bank: to serve customers well, but we are yet to operate in a way that means we can really deliver on this. Delivering on our purpose will mean running the bank differently.

To meet more of our customers' needs we must earn more of their trust. This starts with improving the things that matter most to customers, and then rewarding their loyalty. There are too few rewards for customer loyalty in banking and we need to change this. Loyal and rewarded customers are the basis for the higher quality earnings we intend to deliver.

Change won't happen overnight, but we are clear where we can improve and our progress will be evident quarter-by-quarter. We have already started calling out the barriers to our ambition.



## Chief Executive's review

The opportunity cost of our current approach is clear. We have an 18% share of the GB main current account market but less than half our customers have a mortgage with us. The same is true in different forms across all our businesses and paints a clear picture of untapped potential. I know this frustrates our people, all of whom want to prove the worth of this bank through better service to customers.

The lack of connectivity for customers is a by-product of our own complexity. Too many customers are forced to bank around us; adapting their behaviour to fit with our processes. It's frustrating for them and value destructive for us.

Our customers rightly demand that we are competitive, in every setting and in every sector. We currently carry the cost base of a global financial services group when in fact we are increasingly a UK-based bank. Our operating model means our customers and shareholders end up paying for parts of the business that cost too much and deliver too little in their interests.

This needs to change.

RBS needs a strategy that will address the weakness in our performance for customers, so that we can provide acceptable returns to our shareholders. The business review I have conducted has revealed our key challenges, but it has also given us a clear path to improve the bank.

On every dimension our opportunity to improve the relative and absolute performance of the bank is significant. It is my job to make sure our strategy for customers translates into value for our shareholders.

## 2013 FINANCIAL PERFORMANCE

This bank has had an extraordinary five years. Cleaning up a £2.2 trillion balance sheet whilst addressing the many failings of the past has carried a very heavy cost, which shows in our results.

Even by recent standards, 2013 was a difficult year. Regulatory fines, wide-ranging customer complaints, technology problems and public questioning of our integrity all weighed heavily, and bring into sharp focus the job we have at hand.

For the full year, we reported a pre-tax loss of £8.2 billion. The loss includes £3.8 billion of legacy litigation, conduct and regulatory costs and £4.8 billion of impairments and other losses relating to the establishment of RBS Capital Resolution (RCR).

Looking at underlying performance, total income was down £2.3 billion for the year, primarily reflecting lower revenues from the re-sized Markets business while costs were only down £0.5 billion – pushing the cost:income ratio towards the worse end of our peer group at 67%.

Returns varied across our businesses, but only UK Retail and Wealth delivered returns above the cost of equity. That said, the bank continued to make progress despite our financial performance.

Our business milestones included completing the run-down of another £29 billion of Non-Core assets - ahead of plan and taking the total reduction since Non-Core was established to £230 billion - setting up the RCR unit and reducing risk-weighted assets, and hence our risk profile, by £66 billion, on a fully loaded Basel III basis.

We also cancelled the £8 billion Contingent Capital Facility with HM Treasury, reduced our stake in Direct Line Group to 28.5% - in line with our commitment to the EC - and we are in advanced discussions to restructure the

Dividend Access share.

It is clear that the underlying performance over the last year underlines the need for us to shift the emphasis from restoring the balance sheet to recharging our performance.

#### WHY WE MUST CHANGE

Capital: The capital plan we announced in November outlined a number of concrete actions to place the bank on a sure footing. Among them, the creation of RCR and the flotation of Citizens Financial Group will allow us to target a Common Equity Tier 1 capital position of 12% or greater by the end of 2016.

The capital plan has been designed to allow us to focus without distraction on improving our operating performance.

We will do what it takes to reach and maintain a prudent capital position.

Cost and Complexity: There was a necessary complexity to running an organisation with a £2.2 trillion balance sheet, as ours was five years ago, but this need has reduced as we have scaled the bank dramatically down over recent years. We now need to simplify our structure and cost base to match.

## Chief Executive's review

RBS remains a complex bank. We can be hard to do business with, costly to operate, and complicated to work in. We have seven customer-facing divisions as well as RCR and central functions, many of which are duplicated across divisions. Across this we have hundreds of internal committees. These are costly barriers to interaction between our people and with our customers, meaning we lose out too many times on the opportunity to serve them with more products and services.

This complexity shows in our cost:income ratio, which reaches 73% when fully loaded to include the bank levy and restructuring costs. Reducing costs and divesting businesses in the bank will inevitably result in reduced staff levels. We do not yet have detailed plans for implementation and as always we will deal with such matters sensitively, talking to our staff before communicating any such changes.

**Trust and Reputation:** Behaviour and performance influence the perception of worth. RBS carries huge reputational discount due to the extent of bad headlines the bank attracts. This carries through into our customer and investor interaction and can only be solved by a sustained improvement in the quality of our earnings and meaningful change in the way we deal with customers.

Our customers like and trust the people they deal with, but not the bank itself. We can change this by moving more of the appropriate decision making and process management closer to the people who deal with customers.

**Performance:** Great companies know that quality service goes hand-in-hand with disciplined management; they chase down costs intelligently so they can invest more for their customers. They prioritise and invest with relentless focus on the areas that deliver the strongest, most sustainable returns.

RBS has earned credibility for the execution of our financial restructuring. The same discipline and focus is now needed on our day-to-day operating performance to better deliver for the customer. The costs that subdue our performance need to be intelligently removed and redirected towards activities that enhance our earnings.

## OUR NEW STRATEGY

We now have a strategy to deliver a sustainable bank with a clear ambition: we want to be number one for customer service, trust and advocacy, in every one of our chosen business areas by 2020.

Our ambition aims to deliver a bank that is more trusted than others in the UK. We will earn the trust of customers by serving them better than any other bank.

Quality service leads to repeat business and customer advocacy. Repeat business and higher advocacy leads to sustainable income. We won't compromise on this logic.

The bank will be structured to deliver this ambition by organising around the needs of our customers.

We will collapse seven operating divisions into three customer businesses that can understand our customers' needs and provide appropriate, consistent services far better than we can across current silos.

Our support functions will be smaller, more expert and dedicated to helping the businesses succeed for customers. We will run highly disciplined and well managed conduct and risk functions to maintain safety and soundness.

This will be a highly effective bank and in the medium term we will aim to deliver a cost:income ratio (including bank levy, restructuring charges and, from 2015, the EU resolution fund charge) of around 55%, falling in the long term to

around 50%.

The frontline of this bank is where we'll stand out. Accountable, trusted professionals will staff the perimeter of the bank and drive it forward. They will be supported by simple, effective processes on a sound technology platform.

Only 30% of our people today deal directly with the customer. By 2017 more than half will deal directly with the customer and all our people will be measured against our success in improving customer advocacy.

Our focus will be determined by where our customers need us, and where we can serve their needs better than anyone else.

The UK is our home market and our strongest market. It is also our biggest advantage. Our corporate customer trade flows mean we need a strong European and US presence, so this is where we will be. Our UK clients rely on inward investment, so we'll retain a presence in Asia.

Our three customer businesses will cover Personal & Business Banking, Commercial & Private Banking, and Corporate & Institutional Banking. Across the businesses we will have one management team, working to one joined-up plan.

### Chief Executive's review

The businesses will be built on franchises that can be number one for customers. We have a family of brands across the bank and will use these to deliver on our ambition.

Not every business in our current structure will be best placed to deliver on our strategy. Technology investment will enable some to improve service at a rate that outpaces the market, but others will not.

For those activities where we can't see a clear path to being number one, we will review on the basis of 'fix, close or dispose'. These will become clear as each of our three businesses defines its new customer franchises over the coming months.

The three businesses of the go-forward bank have been designed against a number of goals. Firstly, they will better serve customer needs than the existing operating divisions. Secondly, they will help eradicate duplication of cost in both the front and back office. Thirdly, they will position us to deliver a sustainable return on equity in each business.

### UPDATE ON CAPITAL PLAN

We announced in November that we will target a fully loaded Basel III Common Equity Tier 1 ratio of 12% or greater by the end of 2016 which will principally be delivered through the Capital Resolution Group.

Ahead of the results, we announced that we would take an additional £2.9 billion of charges for litigation and conduct related matters. While these charges were in our future capital plan, provisions were recognised in 2013 and reduced our fully loaded Basel III Common Equity Tier 1 ratio to 8.6% at the end of 2013.

So how do we get to our 12% 2016 target? This will primarily be due to the successful run-down of RCR and the IPO of Citizens, as well as further targeted risk-weighted asset reduction, which will continue to be the main drivers of our plan to deliver our 12% target by the end of 2016.

**Citizens Financial Group:** The cornerstone of the capital plan is the IPO of Citizens Financial Group in the United States. We have appointed advisers and this is on schedule for later this year.

**RCR:** The creation of RCR from 1 January 2014 originally identified £38 billion of third party assets that were highly capital intensive. This represented 5% of our funded balance sheet but used up 20% of our capital.

Mainly as a result of the increased impairments we have taken and significantly higher levels of disposals in Non-Core than had been forecast, the opening balance is £29 billion of third party assets and £65 billion of risk-weighted asset equivalents (RWAE). This reduction in assets has also resulted in a corresponding decrease in the bank's funding requirements.

**UK branch divestment:** To meet our EC-mandated branch divestment, the Williams & Glyn brand will return to the high street via an IPO over the coming years. To achieve this we signed a deal with a consortium of investors led by Corsair Capital and Centerbridge Partners in September 2013. The business will require separation from RBS and this process is well under way.

**Ulster Bank:** The thinking behind every aspect of our new strategy applies to our business in the island of Ireland.

Consumers and businesses across the island of Ireland deserve a better banking service. To achieve this, however, we must change the way we currently organise our business in the Irish market place. We took the first major step at the end of 2013 when we announced our intention to remove £9 billion of the worst credit risks from the Ulster Bank

balance sheet. Our second step is focused on improving customer experience and shareholder return.

As outlined in November, we are reviewing our business to make it viable and sustainable into the future. In this regard we are accelerating our strategy for the bank to improve service to our customers, reduce costs and simplify our operating model.

Our bank in Northern Ireland will benefit from a closer integration with our personal and business franchises in the rest of the United Kingdom. There are meaningful synergies in terms of investment, costs and customer experience from doing this. It is essential if we are to provide a more appealing and compelling service to our customers in Northern Ireland under the Ulster Bank brand.

In the Republic of Ireland we will continue to explore further opportunities to transform our business. We have a range of options but we are now clear on the goal; we will build on our position to be a compelling challenger bank to the domestic pillar banks.

Our customers in the island of Ireland need to know that we are committed to providing them with a great everyday banking service. We will finalise our plans in the coming months – but this is about a change in business strategy not a withdrawal from the market.

These moves are designed to position the bank to do more for our customers and consequently reward our shareholders for their patience.

## Chief Executive's review

### MEASURES THAT MATTER

We will only succeed in delivering our goals if everyone who works in the bank is clear on the measures that matter. It is too easy to be distracted by measures that flatter progress on things that ultimately don't count towards our ambition.

The measures we use must have credibility with customers and the wider public if we are to regain trust. And they must focus the bank relentlessly on improving returns for shareholders. It is abundantly clear to me that we need to reward our existing shareholders for their patience and attract new ones based on our potential and performance.

#### Measure 1: Customer

We will target the best Net Promoter Score in the market in the long term in each of our chosen business areas. The most trusted bank in the UK in the long term.

#### Measure 2: Efficiency

We will aim to deliver a cost:income ratio (including bank levy, restructuring charges and, from 2015, the EU resolution fund charge) of approximately 55% in the medium term, falling in the long term to around 50%. On the same basis, we target a reduction in our costs to approximately £8 billion in the medium term.

#### Measure 3: Returns

Our overall targeted return on tangible equity (RoTE) will be approximately 9-11% in the medium term. Our long-term RoTE target is 12% plus.

#### Measure 4: Capital strength

We will target a CET1 capital ratio, on a fully loaded Basel III basis, of 12% or greater by the end of 2016. Our targeted leverage ratio, on the same basis, will be 3.5-4% in the medium term and 4% or above in the long term.

These simple measures mean we will strike a permanent balance between the needs of our stakeholders.

### HOW WE'LL DO BUSINESS

The scale of the challenge we have faced over the last few years taught us a simple fundamental lesson: you cannot succeed at your customers' expense. This is why last year we agreed a very simple purpose for the bank: to serve customers well.

Our future is not about us, it's about our customers. These words greet our employees as they walk into our offices every day. They have come to represent a shorthand for what went wrong, but also what we need to get right.

Although we remain in the shadow of our past conduct failings, we have a clear and universal set of values that bind the bank together.

#### Serving customers

We exist to serve customers. We earn their trust by focusing on their needs and delivering excellent service.

#### Working together

We care for each other and work best as one team. We bring the best of ourselves to work and support one another to realise our potential.

#### Doing the right thing

We do the right thing. We take risk seriously and manage it prudently. We prize fairness and diversity and exercise judgement with thought and integrity.

Thinking long term

We know we succeed only when our customers and communities succeed. We do business in an open, direct and sustainable way.

These values are the basis for how we lead, how we reward, how we make decisions and how we treat our customers and each other. They are not yet etched in stone, but become stronger the more they are tested. They are core to us succeeding as a bank.



Chief Executive's review

CONCLUSION:

RBS isn't just any bank. Few, if any, comparisons do justice to the scale of the turnaround that RBS required.

We've got to a point of safety and soundness through a steady focus and patient determination. There will be more things from our past that come back to haunt us, but they will be fewer in number.

Over time, with steady focus and disciplined delivery, the new RBS will emerge. The businesses we operate will be highly effective and relentless in their pursuit of delivering service that makes us number one for customers.

We will be simple to do business with, free from distractions and supported by a strong capital base.

The outcome will be a bank that is truly trusted by customers.

Ross McEwan  
Chief Executive  
26 February 2014

## Economic and monetary environment

It has been noted before that when economies are emerging from recessions rooted in high levels of debt and stresses in the financial system, growth is slower than in the typical recovery. That was the experience again in 2013 in the major markets in which RBS operates.

In the UK, performance improved. Total economic activity, as measured by gross domestic product (GDP), grew by 1.9% compared with growth of 0.3% in 2012. At the start of the year, expectations had been for an increase of only 1.0%. Consumption led the way, despite falling real wages. There were more people in work and households drew down savings to fund spending.

Unemployment fell, from around 7.9% at the start of the year towards 7.0% at its end.

Housing market activity accelerated sharply, prompted in part by measures to encourage house purchases such as Help to Buy. According to the Halifax house price index, the average price of a house in the UK increased by 5.8% during the year. Other indices reported stronger price growth. Prices look to have risen in all parts of the UK but inflation was strongest in London, where prices rose by more than 10%.

Inflation ended the year at the 2.0% target having averaged 2.6% for the year as a whole. The Bank of England continued its ultra-loose monetary policy stance. The Bank Rate remained at 0.5%, although market rates increased towards the end of the year on expectations of tighter monetary policy in the United States. There were no additions to the stock of assets purchased through the quantitative easing programme. In August 2013, the Monetary Policy Committee began offering 'forward guidance' on its intentions. It said that it will not consider changing the Bank Rate or the stock of assets purchased until the unemployment rate reaches 7.0%, unless inflation threatens to take off or there are concerns about financial stability.

The Funding for Lending Scheme was adjusted during the course of the year to enhance the incentives for banks to lend to small firms and later to withdraw that support for lending to individuals. The Bank of England's Credit Conditions Survey suggested that the supply of credit had expanded towards the end of the year.

In the face of considerable fiscal austerity and continuing disputes about the public finances, which led to a government shutdown in the autumn, GDP growth in the United States was 1.9% compared with 2.8% in 2012. There was encouraging news on the job market, where unemployment had fallen to 6.7% in December 2013, although part of the fall was accounted for by people leaving the job market rather than finding work. The housing market again performed strongly, with prices up 14% in the year to November.

In December, the Federal Reserve took the first formal steps towards tightening monetary policy. It announced that it would reduce the amount of assets purchased under its quantitative easing programme by \$10 billion each month, with the programme likely to be ended in the second half of 2014. It maintained its guidance that the Fed Funds Target Rate would remain at 0.25% until the unemployment rate reaches 6.5%.

Ireland was able in early 2014 to exit the adjustment programme it had agreed with the European Central Bank, the European Commission and the International Monetary Fund. However, GDP contracted by 0.7% in the four quarters to Q3 2013. The export sector continued to benefit from the boost to competitiveness delivered by falling real wages, although export performance also reflected the decision of companies with limited local activity to domicile in Ireland. For Ireland, gross national product (GNP) is a better measure of the performance of Ireland's domestic economy and people's material well-being. It reflects the income residents receive rather than the value of the incomes generated in the country, an important distinction where there is a large foreign owned sector that remits profits overseas. GNP increased by 2.7%.

Unemployment averaged 13.2% and finished the year at 12.4%. House prices rose by 6.4%, the first year-on-year increase since 2007. However, rises were confined to Dublin, where prices increased by 16%. Outside the capital, prices fell slightly. Nationally, prices ended the year 45% below their 2007 level.

Entering 2013, the greatest economic concern was how problems related to sovereign debt in the euro zone would be managed. With the exception of Cyprus, there were none of the episodes of concern that had marked previous years. Markets were generally convinced that the European Central Bank would indeed 'do what it takes' to sustain the single currency. Further steps were taken towards a banking union. Nevertheless, the region's economy remained weak. Unemployment averaged 12.1%, a record, and inflation fell to 0.8% at the end of the year.

## Risk overview

Financial strength and resilience are at the heart of our Strategic Plan.

### Key themes of 2013

#### Safety and soundness

The Group continued to pursue its safety and soundness agenda during 2013, with Non-Core's assets falling to £28 billion and Markets repositioning its business, both resulting in risk reduction and lower RWAs.

Whilst the continued deleveraging led to a significant reduction in RWAs, this was more than offset by the impact of the regulatory and redress provisions and increased impairment losses reflecting the establishment of RCR. Our Core Tier 1 capital ratio improved over the year, increasing from 10.3% to 10.9%. The fully loaded Basel III Common Equity Tier 1 ratio also improved in the year to 8.6%.

The Group's liquidity position continued to strengthen and at the end of the year, the liquidity portfolio of £146 billion was more than four times greater than its short-term wholesale funding of £32 billion. The loan:deposit ratio continued to improve and was 94% at the end of the year.

Loan impairment charges were £8.4 billion during 2013 of which £4.5 billion related to the creation of RCR. Underlying impairment losses fell by £1.4 billion and provisions coverage of risk elements in lending increased to 64%, up from 52% a year ago. The Group continued to reduce risk concentrations, notably in commercial real estate. Exposure to eurozone periphery countries also continued to fall, down by 11% to £53 billion at the end of the year. Of this, 70% related to Ireland. The Group still has significant credit risk exposures in absolute terms with credit risk RWAs at £313 billion, following a 16% reduction in the year.

The Group's exposure to market risk continued to fall, with average trading VaR declining to £79 million from £97 million. Market risk RWAs at £30 billion are now less than half their end 2010 level of £80 billion.

Conduct risk is one of the most significant issues facing the bank, and the Group continued to suffer from legacy conduct issues during 2013, notably in relation to PPI, Interest Rate Hedging Products and mortgage-backed and other securities litigation. During the year, the Group focused on embedding good conduct at the heart of its business, working to complete the development of its conduct risk framework and promoting staff understanding of conduct issues. It also worked to enhance its assessment of operational risk to identify important vulnerabilities.

### Strategic review

The Group launched a strategic review in the fourth quarter of 2013 to reshape the business to deliver superior customer service. This involved a wide-ranging review of core activities, resulting in the formulation of a plan to address the business challenges of the next five years. While the Group believes the resulting strategy is appropriate, risks remain; the strategy may prove inadequate or the Group may be unable to execute it successfully. Its successful execution, despite increasing regulatory demands and scrutiny as well as a challenging economic environment, is key to the future success of the Group.

To deliver its capital plan, RBS has formed Capital Resolution Group (CRG), which comprises four pillars: exiting the assets in RCR, delivering the IPOs of both Citizens Financial Group and Williams & Glyn, and optimising the bank's group-wide shipping business. RCR was set up from 1 January 2014 and will manage a pool of funded assets (£29 billion) with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate the run-down of these exposures to free up capital for the Group. The Group continues to target a fully loaded Basel III Common Equity Tier 1 ratio of approximately 11% by the end of 2015 and 12% or above by the end

of 2016. The timely run-down of RCR and the successful divestment of Citizens Financial Group, in particular, are cornerstones of this capital strategy.

Top and emerging risk scenarios

RBS identifies and monitors its top and emerging risk scenarios. A number attracted particular attention from senior management during 2013, which are discussed below.

Further information on these and other risks see pages 174 to 176.

## Risk overview

### Macroeconomic risks

- Increased impairments arising from defaults in sectors to which RBS has concentrated exposures, particularly commercial real estate and shipping. Optimisation of the Group's shipping and a significant proportion of commercial real estate portfolios is part of CRG strategy.
- Increased impairments arising from a more severe-than-expected economic downturn. RBS developed business plans to take into account the possibility of slow economic growth and implemented strategies, such as cost reductions, to reduce its earnings vulnerability.
- An increase in RBS obligations to support pension schemes. The trustee is responsible for the investment of the main scheme's assets, which are held separately from the assets of RBS.

### Conduct, regulatory and legal risks

- Increased conduct costs and reputational damage arising from a failure to achieve fair customer outcomes. In order to address this risk, during the year RBS continued to embed good conduct at the heart of the business to ensure fair outcomes for customers.
- Increased costs and reputational damage arising from a failure to demonstrate compliance with existing regulatory requirements regarding conduct, particularly with respect to mis-selling. Although more work needs to be done to mitigate this risk, RBS has simplified some products and stopped offering others. Where appropriate, it has compensated purchasers of some products and services, such as payment protection insurance and certain interest rate hedging products.
- Losses or reputational damage arising from litigation. RBS defends claims against it to the best of its ability and co-operates fully with various governmental and regulatory authorities.

### Risks related to the Group's operations

- Increased losses arising from cyber attacks. The Group has participated in an industry-wide cyber attack simulation. It has also initiated a program to improve controls over user access, taken steps to rationalise its websites, put anti-virus protection in place and educated staff on information protection.
- Increased losses arising from the failure of information technology systems. RBS has launched a major program to improve resilience, enhanced back-up systems and created a 'shadow bank' capable of providing basic services in the event of need.
- Increased costs arising from a failure to execute successfully major projects. RBS is working to implement change in line with its plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.
- Increased costs due to an inability to recruit or retain suitable staff. RBS has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses.

### Political risks

- The Group and the Royal Bank, its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of such referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the Group is subject.
- Were Scotland to become independent, it may also affect Scotland's status in the EU.
- The occurrence of any of the impacts above could significantly impact the Group's costs and would have a material adverse effect on the Group's business, financial condition, results of operations and prospects.

### The integral role of risk management

Risk management is essential to making RBS safe and sustainable, and is an activity performed throughout all of RBS operations. A strong culture of risk management and control will provide the foundation for improving performance and deliver future success.

A more detailed discussion of developments in 2013 can be found in the 'Risk and balance sheet management' section on pages 182 to 186.

## Sustainability

“The success of a bank depends on two things. A strong financial position; and a reputation for great customer service based on a deep connectivity with the society the bank supports, and is in turn supported by.”

Ross McEwan  
Chief Executive

Sustainability at RBS means building our future on long term thinking that focuses on our customers and supporting the communities in which they live. We are committed to being open and transparent regarding the challenges faced by our business, so our stakeholders can see what we are doing to become a more sustainable bank. You can read more about the issues raised here, as well as about our wider sustainability agenda, at [rbs.com/sustainable](http://rbs.com/sustainable).

## Governance

The sustainability programme at RBS is built on a robust governance framework that provides direction on our sustainability objectives. The Group Sustainability Committee (the “Committee”) is a Committee of the Board and comprises three independent non-executive directors. The Committee is chaired by our Senior Independent Director, Sandy Crombie, and attended by senior representatives from the customer facing divisions as well as Human Resources, Sustainability, Risk Management, Communications, Legal, Strategy and Corporate Services. The Chairman of the board also regularly attends the meetings. The work of the Committee is essential to ensuring that our approach to issues is managed effectively and debated at the appropriate level.

The Committee has overseen a number of important developments within the company since it was established in 2009. For more information on the work of the Committee in 2013, see the report of the Chair of the Committee on page 67.

## Stakeholder engagement

Operating in a sustainable manner is about managing our business in a way that takes account of the impact of our activities on our stakeholders. As such, we work with a number of stakeholder groups to understand their views of our organisation, to help shape the way we do business. As a large company we have many stakeholders and we engage with them in a variety of ways, from focus groups to meetings to online forums. These interactions inform decision making and ultimately improve our company. More detail about our stakeholder engagement is available at [rbs.com/sustainable](http://rbs.com/sustainable).

As part of our wider stakeholder engagement programme, the Committee runs its own programme of structured stakeholder engagement sessions. In 2013, the Committee took part in seven of these stakeholder sessions, open forums where advocacy groups can discuss key areas of concern with the most senior decision-makers in RBS.

We will continue to host these sessions to ensure that we understand our stakeholders’ priorities. For more detailed information on these sessions see our sustainability pages on [rbs.com](http://rbs.com).

## External commitments

RBS is a signatory to a number of voluntary sustainability commitments and standards. We understand that implementing commitments is an ongoing process, and we are continuously working to integrate these into how we run our business. We are a member of the Equator Principle (EP) Association Steering Committee. The EPs are a voluntary set of standards adopted by banks for determining, assessing and managing social and environmental responsibilities in project financing. We will not provide project finance where the borrower will not, or cannot, comply with these principles of socially responsible investment.





## Sustainability

We have been members of the United Nations Global Compact (UNGC) since 2003, the leading platform for the development, implementation and disclosure of responsible policies and practices in the areas of: human rights, labour, environment and anti-corruption.

Each year RBS receives ratings for its environmental and social performance by external indices. RBS has been included in the Dow Jones Sustainability World Index (DJSI) every year since its launch in 1999, achieving our best ever score in 2013. The Index ranks companies' corporate sustainability performance, based on analysis of economic, environmental and social issues like corporate governance, risk management, branding and climate change.

The CDP is an independent, investor-driven organisation which facilitates the measurement and disclosure of Green House Gas (GHG) Emissions for 2,500 organisations in over 60 countries. In 2013 RBS received a disclosure score of 88% and a performance score B.

The FTSE4Good Index Series measures the performance of companies that meet globally recognised corporate responsibility standards. RBS has been included in the FTSE4Good since it was launched 10 years ago.

### Transparency and disclosure

We are committed to being open and transparent in our reporting of material issues facing our company. Here we present data on our GHG emissions, diversity data, as well as an update on our approach to managing Human Rights issues. To find more sustainability data read our latest Sustainability Report, available at [rbs.com/sustainable](http://rbs.com/sustainable).

### Managing our impact on the environment

We aim to be recognised as a leader among large global financial institutions in managing our own environmental impacts and developing financial services that support sustainable development.

The activities of RBS and those of our clients can present a number of Environmental, Social and Ethical (ESE) risks and it is our responsibility to manage these risks. We have a robust ESE policy framework, with sector specific policies relating to high risk sectors including oil and gas, mining and metals and forestry.

We are reducing the environmental impact of our operations, led by our 2011 Environment Targets that cover our use of energy, water, waste, paper and CO2 emissions from business travel. In order to ensure our targets continue to be stretching, we have re-examined the baseline on which they are set and adjusted for the decrease in headcount the company has experienced since they were set.

For a full breakdown of our direct environmental impacts, as well as the basis of reporting for the data below, please visit our sustainability pages on [rbs.com](http://rbs.com).

### Environmental impacts table

## Sustainability

### RBS in the Community

We run a number of targeted programmes focused on providing support to the communities where we operate. In addition to this, we have a well established employee volunteering and giving programme in RBS. As well as matching employee donations and fundraising, we also support volunteering during work time. For more information on our community investment please visit [rbs.com/sustainable](http://rbs.com/sustainable).

### Diversity at RBS

We believe it is important that everyone in RBS feels valued and supported. We appreciate the unique perspective and skills that individual staff can bring to the business. Inclusion is more important to RBS than it's ever been. Through 2013, we've taken time to refresh our focus, step back and think about how we support all our colleagues to reach their full potential and better serve our customers. This is delivering a more 'joined up' approach to influencing key organisational processes and practices, achieving better balance and sustainable development. We've continued to progress diversity and inclusion initiatives (including Sexual Orientation, Disability, Race and Gender). Our inclusion policy standard applies to all employees, in every part of the business, in every part of the world and is published online. The strategy for diversity and inclusion sits with the Board and Executive Committee.

As at 31 December 2013, of our global population of 118,079 employees, 54,370 (46%) were male and 63,709 (54%) female. We had 1,071 senior managers (of which 915 (85%) were male and 156 (15%) were female), which encompasses our executive employee population and individuals who are directors of our subsidiaries. The Company's Board of Directors has 11 members, comprising eight male and three female directors.

### Our approach to Human Rights

We recognise our corporate responsibility to respect and uphold human rights, regularly review our policies and procedures to ensure that we avoid infringing on the human rights of others, both in our own operations and throughout our sphere of influence.

In 2013, we contributed to the Thun discussion paper on the implications of UN Guiding Principles 16-21 for banks and are committed to the implementation of the Guiding Principles within our operations.

We have adopted and contributed to a number of internationally accepted codes, notably the Equator Principles and the UN Global Compact, which specifically address the management of human rights issues. The RBS Group Code of Conduct sets out the standards we expect our people to work to, including a clear commitment to respecting human rights. We listen to our people in a variety of ways, including through an annual employee survey, enabling our people to raise issues regarding their working environment. We also have in place an independent whistleblowing facility for employees to raise concerns, without fear of adverse consequence.

Our Sustainable Procurement Code sets out our expectations of the companies that we work with. It clearly states that our suppliers should not engage in breaches of human rights or labour rights, or in discrimination. We are also committed to equal opportunities for suppliers, and we recognise that diversity strengthens our supply chain.

Our ESE risk policies include sector-specific human rights risk screenings and are regularly reviewed and updated to ensure best practice. We conduct due diligence on clients relating to human rights standards, and expect our clients to share our commitment to respecting human rights within their operations.



Governance report

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## Letter from the Chairman

Dear Shareholder,

I am pleased to introduce our Corporate governance report, which sets out in some detail how our Board and committees have risen to the challenges of another demanding year.

Board and committee activity increased significantly in 2013, with a number of key strategic issues taking centre stage. In late 2013, the Board agreed a number of actions to accelerate the building of our capital strength and enhance our strategic focus on our core UK businesses and international corporate business. This included the outcomes of the Good Bank/Bad Bank review and the subsequent creation of RBS Capital Resolution (RCR). We also launched a full review of our businesses, focused on the needs of our customers, improving our operations and IT systems, and simplifying our organisational and decision-making structures. Over the last five years, we have made substantial progress in restoring our safety and soundness. Building on that important work, the Board felt the timing was right for this review in order to target our future efforts firmly on how we can best serve the needs of our customers, shareholders and wider stakeholders.

Conduct and culture have been key areas of focus throughout the year and our 2013 results reflect the impact that conduct related matters continue to have on financial and operating performance. The Board fully supports our new values, which were launched in 2013 and focus on serving customers, working together, doing the right thing and thinking long term. It is vital that the Board continues to set the tone from the top to drive essential cultural change and that our governance framework continues to evolve to support this and our key strategic changes. These will be key priorities for the Board and its committees in 2014.

### Board committees

Board committees continued to play a crucial role in our governance framework during 2013, undertaking their complex work comprehensively and effectively supporting the work of the Board.

The Group Audit Committee has monitored progress on various regulatory investigations and has overseen the remediation of culture and control issues in the Markets division. The Group Audit Committee has also supported the Board in making its assessment that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, in accordance with new provisions in the UK Corporate Governance Code.

The Board Risk Committee has continued to oversee the remediation activity following the major IT incident in 2012 and is also providing oversight of the investigations underway in response to various allegations made by Mr Tomlinson, customer and adviser to the Department of Business, Innovation and Skills.

With the launch of our new values and programme of cultural change, the Group Performance and Remuneration Committee has played a vital role in ensuring that our remuneration policy supports the desired behaviours. Remuneration decisions are considered in the context of performance on a range of issues, including customer service, and reward behaviours and outcomes that are aligned with our values.

The Group Sustainability Committee has provided oversight of the introduction and embedding of our new values, including the launch of a new code of conduct for our people, and continued its innovative programme aimed at understanding and engaging more effectively with key stakeholders.

Finally, we have established a new committee to provide board level oversight of RCR.

#### Board changes

There were a number of changes to the Board's composition during 2013. Stephen Hester stepped down as Group Chief Executive having served for over five years on the Board. Stephen's achievements in stabilising the Group during a particularly turbulent period in its history were considerable, and the Board is immensely grateful for Stephen's outstanding leadership and dedication throughout his tenure. Following an extensive internal and external search, Stephen was succeeded by Ross McEwan on 1 October 2013 and Ross now has his sights firmly set on building a bank focused on our customers and shareholders. Also on 1 October 2013, Bruce Van Saun took up his new role as Chairman and Chief Executive of RBS Citizens Financial Group, Inc and has stepped down from the Board. Bruce's contribution was, again, outstanding. He has been succeeded as Group Finance Director by Nathan Bostock. Nathan has since confirmed his resignation although his leaving date has not yet been agreed and the search for his replacement is underway.

Two of our non-executive directors also retired from the Board in 2013. Joe MacHale stood down in May, having served on the Board for nearly nine years. Joe made a substantial contribution to the Board and the committees he served on, providing valuable continuity throughout a challenging period, and on behalf of the Board I would like to express our sincere thanks for his hard work and commitment. Art Ryan also retired in September after more than five years on the Board. The knowledge, wisdom and experience Art brought to the Board and the Group Performance and Remuneration Committee in particular, were greatly appreciated. Art remains on the board of RBS Citizens Financial Group, Inc.

## Letter from the Chairman

In December 2013 we welcomed Robert Gillespie as a new non-executive director and I am delighted to say that the Board is already benefitting from Robert's skills and experience. We are also announcing alongside our 2013 results some further Board and committee changes to ensure that we will continue to have an appropriate balance of skills, experience, independence and knowledge. Philip Scott will step down from the Board by 31 October 2014 and I would like to thank Philip for the significant contribution he has made to the Board and the committees he has served on and especially for his strong leadership of the Board Risk Committee during a particularly challenging period for RBS. Baroness Noakes will succeed Philip Scott as Chairman of the Board Risk Committee with effect from 1 April 2014. Following the 2014 Annual General Meeting, Penny Hughes will become Chair of the Group Sustainability Committee replacing Sandy Crombie and Sandy will become Chairman of the Group Performance and Remuneration Committee. I would like to thank both Penny and Sandy for their outstanding commitment and dedication whilst chairing the Group Performance and Remuneration Committee and Group Sustainability Committee respectively.

### Board effectiveness

This year, we conducted an internal evaluation of the effectiveness of the Board and its committees, led by the Group Secretary. The evaluation has concluded that the Board is operating effectively but has identified some areas for improvement which we will focus on during 2014.

The Board also received support from the Group Secretary in a number of other areas related to board effectiveness such as Board process and information flows, continuing professional development and induction for new directors.

### Corporate governance

This is the first year that we are required to report under the new narrative reporting requirements, which include the new Strategic report and changes in remuneration reporting. Our statement of compliance with the UK Corporate Governance Code (the "Code") is set out on page 94.

Finally, as we reflect on another challenging year, I would like to conclude this letter by recording my sincere thanks towards my fellow Board members. Being a director of RBS requires extensive time and commitment, and the readiness to deal with the unusual challenges of a government controlled listed company. I remain extremely grateful for their continued support and dedication in working towards the recovery of RBS.

Philip Hampton  
Chairman of the Board of directors  
26 February 2014



## Our governance structure

### Group Board and Board committee structure

#### Group Board

The main decision making forum at Group level, setting the strategic direction of the Group and ensuring that the Group manages risk effectively. The Board is accountable to shareholders for financial and operational performance.

#### Group Audit Committee

Assists the Board in discharging its responsibilities for monitoring the integrity of the financial statements of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group and the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit.

#### Board Risk Committee

Provides oversight and advice to the Board on current and potential future risk exposures of the Group and future risk strategy. It reviews the Group's compliance with approved risk appetite and oversees the operation of the Group Policy Framework.

#### Group Performance and Remuneration Committee

Responsible for overseeing performance and the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on the remuneration of executive directors.

#### Group Nominations Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

#### Group Sustainability Committee

Responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

#### Executive Committee

Supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations and considers risk strategy, policy and risk management.

#### RBS Capital Resolution Board Oversight Committee

Provides oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

## Our Board

Membership of the Group's principal Board Committees has been revised since 27 February 2014:

Group Audit Committee (effective 1 April 2014)

Brendan Nelson (Chair), Baroness Noakes, Philip Scott, Sandy Crombie and Morten Friis (from 10 April 2014).

Board Risk Committee (effective 1 April 2014)

Baroness Noakes (Chair), Brendan Nelson, Philip Scott, Penny Hughes, Robert Gillespie and Morten Friis (from 10 April 2014).

Group Performance and Remuneration Committee (effective following the Group's AGM on 25 June 2014)

Sandy Crombie (Chair), Alison Davis and Robert Gillespie.

RCR Board Oversight Committee (effective 1 April 2014)

Baroness Noakes (Chair), Philip Hampton, Sandy Crombie, Brendan Nelson.

Group Sustainability Committee (effective following the Group's AGM on 25 June 2014)

Penny Hughes (Chair), Alison Davis and Robert Gillespie.

## Chairman

Philip Hampton (age 60)

Date of appointment: 19 January 2009  
(Board)

3 February 2009

(Chairman)

Experience: Previously chairman of J Sainsbury plc and group finance director at Lloyds TSB Group, BT Group plc, BG Group plc, British Gas and British Steel plc, an executive director of Lazard's and a non-executive director of RMC Group plc and Belgacom SA. He is also a former chairman of UK Financial Investments Limited, which manages the UK Government's shareholdings in banks.

External appointment(s):

- Non-executive director, chairman of the remuneration committee and member of the audit committee of Anglo American plc and senior independent director with effect from April 2014.

Committee membership(s)

- Group Nominations Committee (Chair)
- RCR Board Oversight Committee

## Executive directors

Group Chief Executive

Ross McEwan (age 56)

Date of appointment: 1 October 2013

External appointment(s):

None

Experience: Has more than 25 years experience in the finance, insurance and investment industries. He joined RBS in August 2012 as Chief

Committee membership(s)

- Executive Committee

Executive Officer for UK Retail, having previously been Group Executive for Retail Banking Services and Executive General Manager responsible for the branch network, contact centres and third party mortgage brokers at Commonwealth Bank of Australia, Managing Director of stockbroking business First NZ Capital Securities, and Chief Executive of National Mutual Life Association of Australasia Ltd/AXA New Zealand Ltd.

Group Finance Director

Nathan Bostock (age 53)  
Date of appointment: 1 October 2013.  
Nathan Bostock has since confirmed his resignation although his leaving date is still to be agreed.

External appointment(s):  
None

Committee membership(s)  
· Executive Committee

Experience: Joined RBS in 2009 as Head of Restructuring and Risk and Group Chief Risk Officer. Prior to this, he spent eight years with Abbey National plc (now Santander UK), latterly as Chief Financial Officer, ten years with RBS in a number of roles, including Chief Operating Officer of Treasury and Capital Markets and Group Risk Director and seven years with Chase Manhattan Bank in a variety of areas and functions. He is a chartered accountant and holds a BSc (Hons) in Mathematics.

Our Board

Independent non-executive directors

Sandy Crombie (age 65)

Date of appointment: 1 June 2009

Experience: Previously group chief executive of Standard Life plc. He was also previously a director of the Association of British Insurers, a member of the former Chancellor of the Exchequer's High Level Group on Financial Services and Chairman of the Edinburgh World City of Literature Trust. In 2007 he was the Prince of Wales' Ambassador for Corporate Social Responsibility in Scotland.

External appointment(s):

- Chairman of Creative Scotland
- Member and vice-chairman of the Board of Governors of The Royal Conservatoire of Scotland
- President of the Cockburn Association

Committee membership(s):

- Group Sustainability Committee (Chair)
- Board Risk Committee
- Group Nominations Committee
- Group Performance and Remuneration Committee
- RCR Board Oversight Committee

Alison Davis (age 52)

Date of appointment: 1 August 2011

Experience: Managing partner of Fifth Era, an investment firm focussed on early stage technology investments. Previously, she served as a director of City National Bank and First Data Corporation and as chair of the board of LECG Corporation. She has also worked at McKinsey & Company, AT Kearney, as Chief Financial Officer at Barclays Global Investors (now BlackRock) and managing partner of Belvedere Capital, a private equity firm focused on buy-outs in the financial services sector.

External appointment(s):

- Managing partner of Fifth Era Financial LLC
- Non-executive director and member of the finance and compensation committees of Unisys Corporation
- Non-executive director, chair of the compensation committee and member of the audit committee of Diamond Foods Inc.
- Non-executive director, and chair of the audit committee of Xoom Corporation
- Non-executive director and chair of the audit committee at Gamefly, Inc
- Director of the Governing Board of Women's Initiative for Self Employment

Committee membership(s):

- Group Nominations Committee
- Group Performance and Remuneration Committee
- Group Sustainability Committee

Tony Di Iorio (age 70)  
Date of appointment: 1 September 2011

External appointment(s):  
None

Experience: Began his career at Peat Marwick (now KPMG) where he worked in the firm's Financial Institutions Practice in New York and Chicago. After leaving Peat Marwick he worked for several leading financial institutions, including as Co-controller of Goldman Sachs, Chief Financial Officer of the Capital Markets business of NationsBank (now Bank of America), Executive Vice President of Paine Webber and CEO of Paine Webber International. He joined Deutsche Bank in Frankfurt in 2001 and later became the Bank's Chief Financial Officer and a member of its Board and Group Executive Committee. After retiring in 2008 he served as senior adviser to Ernst & Young working with the firm's financial services partners in the UK, Europe, the Middle East and Africa. He is a non-executive director of RBS Citizens Financial Group, Inc.

Committee membership(s):  
·Board Risk Committee  
·Group Audit Committee  
·Group Nominations Committee

## Our Board

### Independent non-executive directors

|  |   |
|--|---|
| <p>Robert Gillespie (age 58)<br/>Date of appointment: 2 December 2013</p> <p>Experience: Began his career with Price Waterhouse (now PricewaterhouseCoopers) where he qualified as a chartered accountant. He then moved into banking joining SG Warburg, specialising in corporate finance, and was appointed as Co-Head and Managing Director of its US investment banking business in 1989. Following the acquisition of Warburg by UBS in 1995, he then held the roles of Head of UK Corporate Finance, Head of European Corporate Finance and Co-Head of its global business and CEO of the EMEA region. He relinquished his management roles at the end of 2005, and was appointed Vice Chairman of UBS Investment Bank. Robert left UBS to join Evercore Partners, from where he was seconded to the UK Panel on Takeovers and Mergers, as Director General, from 2010 to 2013.</p> | <p>External appointment(s):</p> <ul style="list-style-type: none"> <li>· Independent Board Director at Ashurst LLP</li> <li>· Chairman of Council at the University of Durham</li> <li>· Chairman of the Somerset House Trust</li> <li>· Chairman of the Boat Race Company Limited</li> <li>· Director of Social Finance Limited</li> </ul> <p>Committee membership(s):</p> <ul style="list-style-type: none"> <li>· Group Nominations Committee</li> </ul>   |
| <p>Penny Hughes, CBE (age 54)<br/>Date of appointment: 1 January 2010</p> <p>Experience: Previously a director and chairman of the Remuneration Committee of Skandinaviska Enskilda Banken AB and a non-executive director of Home Retail Group plc and chairman of its Remuneration Committee. She spent the majority of her executive career at Coca-Cola where she held a number of leadership positions, latterly as President, Coca-Cola Great Britain and Ireland. Former non-executive directorships include Vodafone Group plc, Reuters Group PLC, Cable &amp; Wireless</p>  | <p>External appointment(s):</p> <ul style="list-style-type: none"> <li>· Non-executive director, chair of the corporate compliance and responsibility committee and member of the audit, nomination and remuneration committees of Wm Morrison Supermarkets plc</li> <li>· Trustee of the British Museum</li> </ul> <p>Committee membership(s):</p> <ul style="list-style-type: none"> <li>· Group Performance and Remuneration Committee (Chair)</li> <li>· Group Nominations Committee</li> </ul> |

Worldwide plc and The Gap Inc.

- Group Sustainability Committee

Brendan Nelson (age 64)

Date of appointment: 1 April 2010

External appointment(s):

Experience: Former global chairman, financial services for KPMG.

Previously held senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 to 2006 and as vice-chairman from 2006.

Chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland from 2005 to 2008.

- Non-executive director and chairman of the audit committee of BP plc

- Member of the Financial Reporting Review Panel

- President of the Institute of Chartered Accountants of Scotland

Committee membership(s):

- Group Audit Committee (Chair)

- Board Risk Committee

- Group Nominations Committee

- RCR Board Oversight Committee

## Our Board

### Independent non-executive directors

Baroness Noakes, DBE (age 64)  
[Date of appointment:](#) 1 August 2011

Experience: An experienced director on UK listed company boards with extensive and varied political and public sector experience. A qualified chartered accountant, she previously headed KPMG's European and International Government practices and has been President of the Institute of Chartered Accountants in England and Wales. She was appointed to the House of Lords in 2000 and has served on the Conservative front bench in various roles including as shadow treasury minister between 2003 and May 2010. Previously held non-executive roles on the Court of the Bank of England, Hanson, ICI, John Laing and SThree.

External appointment(s):

- Non-executive director and chairman of the audit committee of Severn Trent plc
- Deputy chairman and senior independent director and chairman of the nominations committee of Carpetright plc

Committee membership(s):

- Board Risk Committee
- Group Audit Committee
- Group Nominations Committee

Philip Scott (age 60)  
[Date of appointment:](#) 1 November 2009

Experience: Wide-ranging experience of financial services and risk management, including previous responsibility for Aviva's continental European and International life and long-term savings businesses. He held a number of senior executive positions during his career at Aviva including his role as group finance director until January 2010. Fellow of the Institute and Faculty of Actuaries and Fellow of the Association of Certified Public Accountants.

External appointment(s):

- Non-executive director and chairman of the audit committee of Diageo plc

Committee membership(s):

- Board Risk Committee (Chair)
- RCR Board Oversight Committee (Chair)
- Group Audit Committee
- Group Nominations Committee

### Group Secretary and Head of Corporate Governance

Aileen Taylor (age 41)  
[Date of appointment:](#) 1 May 2010



Experience: A qualified solicitor, She is a fellow of the Chartered  
joined RBS in 2000. She was appointed Institute of Bankers in Scotland  
Deputy Group Secretary and Head of and a member of the European  
Group Secretariat in 2007, and prior to Corporate Governance Council.  
that held various legal, secretariat and  
risk roles including Head of External  
Risk, Retail, Head of Regulatory Risk,  
Retail Direct and Head of Legal and  
Compliance at Direct Line Financial  
Services.

## Executive Committee

Ross McEwan, Group Chief Executive  
Nathan Bostock, Group Finance Director  
For biographies see page 42

Rory Cullinan (age 54)

Chief Executive, RBS Capital Resolution Group

Rory Cullinan became CEO of the RBS Capital Resolution Group (CRG) on 1 January 2014. CRG was set up to deliver, transform, optimise or exit the businesses and assets which will be the primary driver of the RBS capital build. CRG includes RBS Capital Resolution (RCR) and the divestments of both RBS Citizens Financial Group, Inc and Williams & Glyn. He previously served as CEO of the Group's Non-Core Division and also led the negotiation and establishment of RBS's entry into the UK Government's Asset Protection Scheme. Rory previously worked at RBS as Head of Equity Finance (2002-2005). Before rejoining RBS he was Co-Managing Partner and Group Board Member at Renaissance Group. Prior to 2002, he worked for a variety of banks and active financial investment companies in the Americas, Africa and Europe including Permira Advisors, Verdosso Investments (a company he co-founded), Pembridge Investments and Citibank.

Suneel Kamalani (age 52)

Co -Chief Executive, Markets

Suneel Kamalani joined the Group in 2010 and is currently Co-Chief Executive Officer of Markets with responsibility for global trading, sales, research and origination across interest rate products, foreign exchange, asset backed securities, emerging markets, credit fixed income and debt capital markets. In this capacity, he oversees businesses which provide financing, risk management and advisory services to major corporations, financial institutions and public sector clients around the world. Based in the Group's offices in Stamford, Connecticut, Suneel also serves in a regional capacity as Chairman of Markets and International Banking, Americas and Deputy Head of RBS Americas. Suneel has over 30 years of experience in investment banking, having previously served as Chief Operating Officer for UBS's Investment Bank and as a member of the UBS Group managing board. He has worked in New York, London, Hong Kong and Stamford, leading investment banking and capital markets businesses globally.

Les Matheson (age 54)

Chief Executive, UK Retail

Les Matheson was appointed Chief Executive of UK Retail on 11 February 2014. He joined RBS in January 2010 as Managing Director of Products, assumed additional responsibility for Marketing in October 2011 and then served as interim Chief Executive for UK Retail before assuming the role on a permanent basis. Prior to joining RBS, Les was Group Executive Retail for St George Bank (part of the Westpac Group of companies) and before that was with Citigroup for eleven years, where he was CEO Citibank Australia, Citigroup Country Officer for Australia and a member of the Citigroup Global Management Committee. Prior to Citigroup Les worked for a number of consumer marketing companies. He began his career with Procter & Gamble in Brand Management in the UK. Les is a member of the Board of Visa Europe and is a member of the Edinburgh University Court.

Simon McNamara (age 54)

Group Chief Administrative Officer

Simon McNamara was appointed Group Chief Administrative Officer in September 2013. Prior to joining the Group, Simon was Chief Information Officer of Standard Chartered's Consumer Bank based in Singapore and has previously held a number of senior Information Technology and Operations positions in the global financial services industry including with Westpac Banking Corporation, Deutsche Bank, BNP Paribas and Midland Bank. He was also a founding partner in a successful software start-up company, CATS INC, in Silicon Valley. Simon holds a Bachelor of Science (Hons) in Economics and Statistics from University College Swansea and a Post Graduate Diploma in

Computer Science from the University of Hertfordshire. He has also completed the Executive Programme at Stanford University.

Jon Pain (age 56)

Group Head of Conduct & Regulatory Affairs

Jon Pain joined the Group on 15 August 2013 as Head of Conduct & Regulatory affairs, from KPMG where he was a partner and Head of the Financial Services Risk Consultancy practice. Jon has over 30 years' experience in Financial Services including three years as Managing Director of Supervision at the Financial Services Authority (FSA) during the financial crisis (2008 - 2011). Prior to the FSA, Jon's executive career was with the Lloyds Banking Group (LBG) where he held a range of senior roles including Managing Director of LBG's C&G mortgage business, the General Insurance Business and the Private Banking Business.

David Stephen (age 49)

Group Chief Risk Officer

David Stephen joined RBS in July 2010 as Deputy Group Chief Risk Officer, and became Group Chief Risk Officer on 1 October 2013. He is responsible for risk globally across all divisions including credit risk, market risk and operational risk functions and enterprise risk management. Spanning a 28 year career in the finance industry across London, New York, Hong Kong and Melbourne, he has worked for both full service and investment banks. These included Credit Suisse Financial Products where he was Chief Credit Officer and ANZ Bank where he was Group Chief Risk Officer and was a member of ANZ Bank's Management Board. David is a graduate of Melbourne's Monash University.

## Executive Committee

Chris Sullivan (age 56)

Chief Executive, Corporate Banking

Chris Sullivan was appointed Chief Executive of the Corporate Banking Division in August 2009 and also has responsibility for Ulster Bank Group. Chris' previous role was as Chief Executive of RBS Insurance. Prior to this, Chris was Chief Executive of Retail and Deputy Chief Executive of Retail Markets. Chris is the Group sponsor for Gender Diversity and the Group's internal Women's Networks and was recognised as the European Diversity Champion of the Year in 2011. He is an active sponsor of professional and leadership development and is a member of the Chartered Banker Professional Standards Board and Governor of Ashridge College. Chris holds a number of positions outside the Group including Chairman of the Global Banking Alliance for women and is a member of the Westminster Abbey Investment Committee. Chris earned his Fellowship of the Chartered Institute of Bankers in Scotland for his services to Scottish Banking.

Bruce Van Saun (age 56)

Chairman & Chief Executive, RBS Citizens Financial Group, Inc. and Head of RBS Americas

Bruce Van Saun was appointed Chairman and Chief Executive Officer of RBS Citizens Financial Group, Inc. and Head of RBS Americas in October 2013. Prior to taking up his current role, Bruce was Group Finance Director and a director of the Company, RBS and NatWest having been appointed to those positions in 2009. Bruce has more than 30 years of financial services experience and has previously held senior positions with Bank of New York, Bank of New York Mellon, Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co. Bruce is currently a Director of Lloyd's of London and is a member of the Financial Services Roundtable and The Clearing House supervisory board and is active in several community organisations.

These are the biographies of Executive Committee members as at the date of the signing of the Annual Report and Accounts.

Executive Committee (effective 28 February 2014)

Ross McEwan, Group Chief Executive

Nathan Bostock, Group Finance Director

Chris Sullivan, Deputy Group Chief Executive

David Stephen, Chief Risk Officer

Jon Pain, Group Head of Conduct & Regulatory Affairs

Simon McNamara, Group Chief Administrative Officer

Bruce Van Saun, Chief Executive Officer, Citizens and Head of Americas

Les Matheson, Chief Executive Officer, Personal and Business Banking

Alison Rose, Chief Executive Officer, Commercial and Private Banking

Donald Workman, Chief Executive Officer, Corporate & Institutional Banking

Rory Cullinan, Chief Executive Officer, RBS Capital Resolution Group

Elaine Arden, Group Human Resources Director

## Corporate governance

### The Board

The Board has eleven directors comprising the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director.

| Name             | Position                           | Nationality |
|------------------|------------------------------------|-------------|
| Philip Hampton   | Chairman                           | British     |
| Ross McEwan      | Group Chief Executive              | New Zealand |
| Nathan Bostock   | Group Finance Director             | British     |
| Sandy Crombie    | Senior Independent Director        | British     |
| Alison Davis     | Independent non-executive director | British/USA |
| Tony Di Iorio    | Independent non-executive director | USA         |
| Robert Gillespie | Independent non-executive director | British     |
| Penny Hughes     | Independent non-executive director | British     |
| Brendan Nelson   | Independent non-executive director | British     |
| Baroness Noakes  | Independent non-executive director | British     |
| Philip Scott     | Independent non-executive director | British     |

Biographies for each director and details of which Board Committees they are members of can be found on pages 42 to 45. The Board considers that the Chairman was independent on appointment and that all non-executive directors are independent for the purposes of the Code.

### Board Changes

Joe MacHale retired from the Board on 14 May 2013 and Stephen Hester, Art Ryan and Bruce Van Saun all retired from the Board on 30 September 2013. Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013 and Robert Gillespie was appointed to the Board on 2 December 2013. Mr Bostock has since confirmed his resignation although his leaving date is still to be agreed.

### Roles and responsibilities

#### The Board

The Board is the main decision-making forum for the company. It is collectively responsible for the long-term success of the company and is accountable to shareholders for financial and operational performance.

The Board has overall responsibility for:

- the establishment of Group strategy and consideration of strategic challenges;

- the management of the business and affairs of the Group;
- ensuring the Group manages risk effectively through the approval and monitoring of the Group's risk appetite;
- considering stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations;
- the allocation and raising of capital; and
- the preparation and approval of the Group's annual report and accounts.

The Board's terms of reference include key aspects of the company's affairs reserved for the Board's decision and are reviewed at least annually. The terms of reference are available on [rbs.com>about us](http://rbs.com/about-us).

#### Chairman

The role of Chairman is distinct and separate from that of the Group Chief Executive and there is a clear division of responsibilities with the Chairman leading the Board and the Group Chief Executive managing the Group's businesses on a day to day basis.

The Chairman's key responsibilities are to:

- provide strong and effective leadership to the Board;
- ensure the Board is structured effectively and observes the highest standards of integrity and corporate governance;
- manage the business of the Board and set the agenda, style and tone of Board discussions to promote effective decision-making and constructive debate;
- facilitate the effective contribution and encourage active engagement by all members of the Board;
- in conjunction with the Group Chief Executive and Group Secretary, ensure that members of the Board receive accurate, timely and clear information, to enable the Board to lead the Group, take sound decisions and monitor effectively the performance of executive management;

- ensure that the performance of individual directors and of the Board as a whole and its committees is evaluated regularly; and
- ensure the Group maintains effective communication with shareholders and other stakeholders.

#### Group Chief Executive

The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated by the Board.

The Group Chief Executive's key responsibilities are to:

- exercise executive responsibility for the Group's businesses;
- develop and implement strategy approved by the Board;
- act in accordance with authority delegated by the Board;
- consult regularly with the Chairman and Board on matters which may have a material impact on the Group;
- lead the senior executive team and ensure there are clear accountabilities for managing the Group's business and managing risk; and
- in conjunction with the Group Chairman and Group Secretary, ensure the Board receives accurate, timely and clear information.

## Corporate governance

### Senior Independent Director

Sandy Crombie, as Senior Independent Director, acts as a sounding board for the Chairman and as an intermediary for other directors when necessary. He is also available to shareholders to discuss any concerns they may have, as appropriate.

### Non-executive directors

Along with the Chairman and executive directors, the non-executive directors are responsible for ensuring the Board fulfils its responsibilities under its terms of reference. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership across the Group's business activities.

The standard terms and conditions of appointment of non-executive directors are available on [rbs.com](http://rbs.com) or from RBS Secretariat.

### Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. Please see the corporate governance framework on page 41 for more details. The work of the Board committees are also discussed in their individual reports as follows

Nominations Committee - pages 53 and 54.

Group Audit Committee - pages 55 to 60.

Board Risk Committee - pages 61 to 66.

Group Sustainability Committee - pages 67 and 68.

Group Performance and Remuneration Committee - pages 69 to 93.

The terms of reference for each of these committees is available on [rbs.com](http://rbs.com) and copies are also available on request from RBS Secretariat.

### Group Secretary

Aileen Taylor is the Group Secretary and Head of Corporate Governance. She is responsible for advising the Board on all governance matters and for ensuring that Board procedures are followed. In conjunction with the Chairman and the Group Chief Executive, she is also responsible for ensuring that the Board receive accurate, timely and clear information, particularly on the Group's performance and matters reserved to the Board; facilitating good information flows between Board members; leading on the implementation of the recommendations from the annual Board Evaluation and developing and maintaining the induction and continuing professional development programme for directors. A key element of the role is to ensure alignment between the Board and Executive Management to ensure the appropriate escalation of issues to the Board. Aileen also leads on all aspects of corporate governance across the Group.

### Conflicts of interests

The company has procedures in place to ensure that the Board's powers for authorising actual or potential conflicts of interest are operating effectively. On appointment, each director is provided with the Group's guidelines for referring conflicts of interest to the Board. Each director is required to notify any actual or potential conflicts of interest to the Board for consideration and to update the Board on an ongoing basis when he or she becomes aware of any changes.



The Board considers each director's notification separately on the facts and can impose conditions or limitations as part of the authorisation process. Actual and potential conflicts of interest can be authorised by the Board in accordance with the company's Articles of Association. Details of all conflicts of interest are recorded in a register which is maintained by the Group Secretary and reviewed annually by the Board.

Board meetings

In 2013, nine Board meetings were scheduled and individual attendance by directors at these meetings is shown in the table below. One of the Board meetings took place overseas during the Board's visit to the Group's US businesses.

In addition to the nine scheduled meetings, 35 additional meetings of the Board and committees of the Board were held, including meetings to consider and approve financial statements. The Chairman and the non-executive directors meet at least once per year without executive directors present.

|                      | Attended/<br>scheduled |
|----------------------|------------------------|
| Philip Hampton       | 9/9                    |
| Ross McEwan (1)      | 2/2                    |
| Nathan Bostock (1)   | 2/2                    |
| Sandy Crombie        | 9/9                    |
| Alison Davis         | 9/9                    |
| Tony Di Iorio        | 9/9                    |
| Robert Gillespie (2) | 1/1                    |
| Penny Hughes         | 9/9                    |
| Brendan Nelson       | 9/9                    |
| Baroness Noakes      | 9/9                    |
| Philip Scott         | 9/9                    |
| Former directors     |                        |
| Stephen Hester (3)   | 7/7                    |
| Joe MacHale (4)      | 4/4                    |
| Art Ryan (3)         | 7/7                    |
| Bruce Van Saun (3)   | 7/7                    |

Notes:

(1) Appointed to the Board on 1 October 2013. Nathan Bostock has since confirmed his resignation although his leaving date is still to be agreed.

(2) Appointed to the Board on 2 December 2013

(3) Retired from the Board on 30 September 2013.

(4) Retired from the Board on 14 May 2013.

## Corporate governance

## Principal activities of the Board during 2013

In advance of each Board meeting, the directors are supplied with comprehensive papers in hard copy and/or electronic form. During 2013 there has been an enhanced focus on culture and values, conduct and customers. These have been recurring themes underpinning Board discussions during the year and the Board received regular updates on the cultural change programme. An overview of the principal activities of the Board during 2013 is shown below.

| Each meeting           |                           |
|------------------------|---------------------------|
| · Chairman's Report    | · Risk Report (including  |
| · Group Chief          | updates on conduct        |
| Executive's Report     | matters)                  |
| · Monthly Results      | · Reports from            |
| · Capital, Funding &   | committee Chairs          |
| Liquidity              | · Secretary's Report      |
|                        | (routine matters for      |
|                        | approval / noting)        |
| 1st Quarter            | 2nd Quarter               |
| · UK Retail Deep Dive  | · Non-Core Deep Dive      |
| · Budget Update        | · AGM Preparations        |
| · Markets Strategy     | · Q1 Results              |
| Updates                | · Markets Strategy        |
| · Remuneration         | Updates                   |
| Proposals              | · Lending Updates         |
| · Lending Updates      | · Recovery and            |
| · Risk Appetite        | Resolution Planning       |
| Framework              | · Board Session with      |
| · Annual Results &     | the Financial Conduct     |
| AGM Notice             | Authority                 |
| · Board and committee  | · Good Bank/Bad Bank      |
| Evaluations            | Review                    |
| · Group Internal Audit | · Board Strategy Offsite  |
| Evaluation             | · Succession Planning     |
| · External Auditor     |                           |
| Evaluation             |                           |
| 3rd Quarter            | 4th Quarter               |
| · Good Bank/Bad        | · Launch of Strategic     |
| Bank Review            | Review                    |
| · Parliamentary        | · Review of Capital       |
| Commission on Banking  | Position                  |
| Standards              | · Independent Lending     |
| Recommendations        | Review                    |
| · Interim Results      | · Board Session with      |
| · Lending Updates      | the Prudential Regulatory |
| · Board Evaluation     | Authority                 |
| Update                 | · Corporate Banking       |
| · RBS Citizens Deep    | Deep Dive                 |
| Dive                   | · Q3 Results              |
|                        | · Markets Deep Dive       |

- Board Session with the Federal Bank of Boston

Other senior executives, such as the Group Chief Risk Officer and the Head of Conduct and Regulatory Affairs, also attend Board meetings as required to present reports. Divisional Chief Executives, accompanied where appropriate by other senior executives from the division, attend Board meetings to present the divisional deep dives. This provides the Board with an opportunity to engage directly with divisional management on key issues and supports the Board's succession planning activity.

#### Board effectiveness

##### Skills and experience on the Board

The Board is structured to ensure that the directors provide the Group with the appropriate balance of skills, experience and knowledge as well as independence. Given the nature of the Group's businesses, experience of banking and financial services is clearly of benefit, and we have a number of directors with substantial experience in that area, but the Board also benefits from directors with experience in other fields.

The table below illustrates the breadth of experience on the Board.

- |                         |                              |
|-------------------------|------------------------------|
| · Retail Banking        | · Government & Public Sector |
| · Risk                  | · Consulting                 |
| · Finance & Accountancy | · Chief Executive            |
| · Private Equity        | · Technology                 |
| · Investment Banking    | · Retailing                  |
| · Insurance & Actuarial | · Utilities                  |
| · Manufacturing         |                              |

Board committees also comprise directors with a variety of skills and experience so that no undue reliance is placed on any individual.

#### Induction and professional development

Each new director receives a formal induction on joining the Board, which is co-ordinated by the Group Secretary. This includes visits to the Group's major divisions and meetings with directors and senior management. Each induction programme has a core element that the director is required to complete with the remainder of the programme tailored to the new director's specific requirements. An example of an induction programme for a new non-executive director is set out below:

| Core meetings                          | Tailored elements                   |
|--|-------------------------------------|
| Group Chairman                         | Divisional Chief Executives         |
| Group Chief Executive                  | Divisional visits (UK and overseas) |
| Group Finance Director                 | Group Finance                       |
| Senior Independent Director            | Group Risk                          |
| Board committee Chairs                 | Group Internal Audit                |
| Group Secretary                        | Group Tax                           |
| Group Chief Risk Officer               | Investor Relations                  |
| Head of Conduct and Regulatory Affairs | Group Strategy                      |
| Group Treasurer                        | Group                               |
| General Counsel                        | Communications                      |
| External Auditor                       |                                     |

External Counsel

Institutional  
Investors

Ross McEwan and Nathan Bostock joined the Board on 1 October 2013. Mr Bostock has since confirmed his resignation, although his leaving date is still to be agreed. Robert Gillespie joined the Board on 2 December 2013. Both Mr McEwan and Mr Bostock were serving executives in the Group prior to their appointment to the Board and as such their induction has been focussed on enhancing their knowledge of Board matters and continuing to build relationships with Board members. A comprehensive induction programme was prepared for Mr Gillespie and is underway.

## Corporate governance

The Group Secretary advises directors of appropriate external training and professional development opportunities and internal training is also provided which is relevant to the business of the Group. Business visits are also arranged as part of the Group Audit Committee and Board Risk Committee schedule (details of which can be found on pages 56 and 63) and all non-executive directors are invited to attend. Directors undertake the training they consider necessary to assist them in carrying out their duties and responsibilities as directors.

During 2013, the directors received updates on a range of subjects to enhance their knowledge, including:

- Parliamentary Commission on Banking Standards - Recommendations;
- Banking Reform Bill;
- Department for Business, Innovation and Skills (BIS) Proposals on Transparency and Trust;
- BIS review of Voluntary Code of Conduct for Executive Search Firms;
- Fourth Capital Requirements Directive (CRD IV);
- Competition Commission's investigation into statutory audit services;
- Government reforms on executive remuneration and reporting; and
- Developments in European company law and corporate governance.

The Group Secretary maintains continuing professional development logs. These are reviewed regularly with directors to assist in identifying future training and development opportunities that are specific to the individual director's requirements.

## Information

All directors receive accurate, timely and clear information on all relevant matters and have access to the advice and services of the Group Secretary. In addition, all directors are able, if necessary, to obtain independent professional advice at the company's expense.

## Time commitment

There is an anticipated time commitment in line with the recommendations of the Walker Review in respect of general Board duties and additional time as necessary in respect of committee duties. However, as stated in the Chairman's introductory letter to his Corporate governance report, the time commitment currently required of our non-executive directors is significant. Each director is required to seek the agreement of the Chairman before accepting additional commitments that might affect the time the director is able to devote to his or her role as a non-executive director. The Board is aware of the other commitments of the Chairman and the other directors are able to allocate sufficient time to enable them to discharge their duties and responsibilities effectively.

## Election and re-election of directors

In accordance with the provisions of the Code, all directors of the company are required to stand for election or re-election annually by shareholders at the company's Annual General Meeting. The notice of Annual General Meeting sent to shareholders separately includes details of the proposed resolutions for the election and re-election of directors.

#### Performance evaluation

In accordance with the Code, an external evaluation of the Board takes place every three years. An internal evaluation takes place in the intervening years.

The 2012 evaluation was conducted externally by a specialist board evaluation consultancy, and a number of initiatives were implemented aimed at improving the overall performance and effectiveness of the Board. These included keeping Board and committee composition under review; reviewing board and executive succession planning; introducing further enhancements to Board information packs; and implementing an expanded remit for the Group Sustainability Committee. These topics will be kept under regular review as a matter of good practice. However, the 2013 evaluation concluded that the recommendations from the 2012 evaluation were being appropriately addressed.

In 2013, the Board and committee evaluation process was conducted internally by the Group Secretary.

#### Performance evaluation process

The Group Secretary undertook a formal and rigorous evaluation by:

- preparing a detailed framework of key themes for discussion and questions which was used to structure individual meetings held with each director;
- discussing the outcomes and recommendations with the Chairman; and
- recommending the outcomes and areas for improvement to the Board.

Amongst the areas reviewed were Board composition (including diversity), strategy, risk management, Board meetings and processes, external relationships, and the quality of support and information provided to the Board.

## Corporate governance

### Outcomes of the 2013 performance evaluation

The 2013 performance evaluation concluded that the Board was strong and operated effectively and within its terms of reference throughout 2013. Key strengths identified included the following:

- the Board performed strongly during a challenging 2013, both as individuals and collectively;
- the dynamic between Board members was good, the Chairman successfully steered the Board through a very difficult and complex agenda, and the directors dedicated a significant amount of time and effort to their role; and
- the Board's committees undertook their complex work well throughout the year, providing strong support to the Board.

A summary of the key themes arising from the 2013 performance evaluation is set out below, together with an overview of the proposed actions:

|                                       |  |
|---------------------------------------|--|
| Key themes included                   | Proposed action  |
| Board and Board committee composition | Keep Board and Board committee composition under review during 2014, to ensure balance of skills, experience, independence, knowledge and diversity remains appropriate.               |
| Strategic oversight                   | Ensure that Board agendas for 2014 allocate sufficient time for Board oversight of key areas of strategic focus.   |
| Risk reporting                        | Consideration to be given to the Board Risk Committee leading a review of risk reporting at Board and Board committee level to further enhance the format and content of risk reports. |
| External relationships                | Ensure regular contact with key external stakeholders in order to maintain effective working relationships at Board level.   |

### Individual director and Chairman effectiveness reviews

The Chairman met with each director individually to discuss their own performance and ongoing professional development and also shared peer feedback that had been provided as part of the evaluation process. Separately, the Senior Independent Director sought feedback on the Chairman's performance and canvassed views on the Chairman's performance from the non-executive directors collectively. The results of the Chairman's effectiveness review were then discussed by the Chairman and the Senior Independent Director.

### Relations with investors

The Chairman is responsible for ensuring effective communication with shareholders. The company communicates with shareholders through the Annual Report and Accounts and by providing information in advance of the Annual General Meeting. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time throughout the year by letter, telephone or email via [rbs.com/ir](mailto:rbs.com/ir)

Shareholders are given the opportunity to ask questions at the Annual General Meeting or can submit written questions in advance. Directors including the chairs of the Board Committees are available to answer questions at the Annual General Meeting. The Senior Independent Director is also available.

Communication with the company's largest institutional shareholders is undertaken as part of the Investor Relations programme:

- the Group Chief Executive and Group Finance Director meet regularly with UKFI, the organisation set up to manage the Government's investments in financial institutions, to discuss the strategy and financial performance of the business. The Group Chief Executive and Group Finance Director also undertake an extensive annual programme of meetings with the company's largest institutional shareholders.
- the Chairman independently meets with the Group's largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman, Senior Independent Director and chairs of the Board committees met with the governance representatives of a number of institutional shareholders during the year.
- the Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels.
- the Chair of the Group Performance and Remuneration Committee consults extensively with major shareholders in respect of the Group's remuneration policy.

In 2013, the Group introduced a programme of UK based events aimed at individual shareholders. These events provided an opportunity for shareholders to meet with directors and senior management to learn more about the business.

Throughout the year, the Chairman, Group Chief Executive, Group Finance Director and Chair of the Group Performance and Remuneration Committee communicate shareholder feedback to the Board. The directors also receive independent analyst notes and reports reviewing share price movements and performance against the sector. Detailed market and shareholder feedback is provided to the Board after major public announcements such as a results release. The arrangements in place are to ensure that directors develop an understanding of the views of major shareholders and that these are considered as part of the annual Board evaluation.

The Group's Investor Relations programme also includes communications aimed specifically at its fixed income (debt) investors. The Group Finance Director and/or Group Treasurer give regular presentations to fixed income investors to discuss strategy and financial performance. There is also a separate section on the Group's website for fixed income investors which includes information on credit ratings, securitisation programmes and securities documentation. Further information is available at [rbs.com/ir](http://rbs.com/ir).



## Report of the Group Nominations Committee

Dear Shareholder,

As Chairman of the Board, I also chair the Group Nominations Committee and I am pleased to present our report on the committee's activity during 2013.

### Role and responsibilities

The Group Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Board and making recommendations to the Board on any appropriate changes;
- assisting the Board in the formal selection and appointment of directors (executive and non-executive) having regard to the overall balance of skills, knowledge, experience and diversity on the Board;
- reviewing membership and chairmanship of Board committees;
- considering succession planning for the Chairman and the executive and non-executive directors, taking into account the skills and expertise which will be needed on the Board in the future. No director is involved in decisions regarding his or her own succession; and
- making recommendations to the Board concerning the election and re-election by shareholders of directors under the provisions of the Code. In so doing, they will have due regard to their performance and ability to continue to contribute to the Board in light of the knowledge, skills and experience required and the need for progressive refreshing of the Board.

The Group Nominations Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board. The terms of reference of the Group Nominations Committee are reviewed annually and approved by the Board and are available at [rbs.com](http://rbs.com)

### Membership and meetings

All non-executive directors are members of the Group Nominations Committee which is chaired by the Chairman of

the Board. The Group Chief Executive is invited to attend meetings.

The Group Nominations Committee holds at least two scheduled meetings per year, and also meets on an ad hoc basis as required. In 2013, five meetings of the Group Nominations Committee were held and the following table illustrates members' attendance at these meetings.

|                           | Attended/<br>scheduled |
|---------------------------|------------------------|
| Philip Hampton (Chairman) | 5/5                    |
| Sandy Crombie             | 5/5                    |
| Alison Davis              | 5/5                    |
| Tony Di Iorio             | 5/5                    |
| Robert Gillespie (1)      | 1/1                    |
| Penny Hughes              | 5/5                    |
| Brendan Nelson            | 5/5                    |
| Baroness Noakes           | 5/5                    |
| Philip Scott              | 5/5                    |
| Former members            |                        |
| Joe MacHale (2)           | 1/1                    |
| Art Ryan (3)              | 4/4                    |

Notes:

- |     |  |
|-----|--|
| (1) | Appointed to the Board on 2 December 2013.   |
| (2) | Retired from the Board on 14 May 2013.       |
| (3) | Retired from the Board on 30 September 2013. |

#### Principal activity during 2013

The Committee continues to monitor succession planning on an ongoing basis taking into account business requirements and industry developments. In 2013 discussions focused principally on executive director succession and the search for new non-executive directors. The Board also held a separate session on succession planning for the Executive Committee in June 2013.

#### Group Chief Executive succession

On 12 June 2013, it was announced that Stephen Hester would step down as Group Chief Executive and the search for his successor commenced immediately, led by the Chairman on behalf of the Board. MWM Consulting was engaged to support the recruitment process for the new Group Chief Executive and conducted a global search for potential external candidates as well as engaging fully with internal candidates. This enabled the internal candidates to be benchmarked against the very best in the market. The Committee held a number of discussions on potential candidates (internal and external) and agreed that Ross McEwan was the strongest candidate on the basis of his extensive experience in banking, the leadership he had already demonstrated during his time as CEO Retail at RBS and his strong focus on serving our customers. Ross McEwan was announced as the new Group Chief Executive on 2 August 2013 and took over from Stephen Hester on 1 October 2013. MWM Consulting does not provide services to any other part of the Group.

#### Consideration of new non-executive directors

Egon Zehnder International continued to support the search for new non-executive directors during 2013. Egon Zehnder International were tasked with identifying suitable candidates both to fill existing vacancies (e.g. replacements for Joe MacHale and Art Ryan who both retired from the Board during 2013) and to support future Board succession planning. The Committee considered a number of potential candidates during 2013 and Robert Gillespie was appointed to the Board on 2 December 2013. Robert was appointed on the basis of his strong background in

finance and banking and his experience of business and regulatory environments in the UK, US and Europe. The search for future potential candidates is continuing. Egon Zehnder International does not provide services to any other part of the Group.

## Report of the Group Nominations Committee

### Tenure of non-executive directors

The chart below sets out the tenure of non-executive directors.

### Board and committee membership

The Committee reviewed the membership of the Group Sustainability Committee during 2013 following feedback from the 2012 evaluation. It was agreed that an additional non-executive director should be appointed to the Group Sustainability Committee and Penny Hughes was appointed as a member in July 2013.

### Boardroom diversity

The Board remains supportive of Lord Davies' recommendations and currently meets the target of 25 per cent female board representation as set out in Lord Davies' report.

The chart below details the gender diversity of the Board.

In accordance with the recommendations contained within Lord Davies' report, the Board operates a boardroom diversity policy and a copy of the Board's diversity statement is available on [rbs.com>about us](http://rbs.com/about-us).

The Group understands the importance of diversity and, with regard to gender diversity, recognises the importance of women having greater representation at key decision making points in organisations. The search for Board candidates will continue to be conducted, and nominations/appointments made, with due regard to the benefits of diversity on the Board, however, all appointments to the Board are ultimately based on merit, measured against objective criteria, and the skills and experience the individual can bring to the Board.

The balance of skills, experience, independence, knowledge and diversity (including gender diversity) on the Board, and how the Board operates together as a unit is reviewed annually as part of the Board evaluation. Where appropriate, findings from the evaluation will be considered in the search, nomination and appointment process. If appropriate, additional targets on diversity will be developed in due course.

Further details on the Group's approach to diversity can be found on page 99.

Philip Hampton  
Chairman of the Group Nominations Committee  
26 February 2014

## Report of the Group Audit Committee

Letter from Brendan Nelson,  
Chairman of the Group Audit Committee

Dear Shareholder,

2013 has been a year of significant change for the Group, presenting a number of challenges to the Group Audit Committee. The priority of the Committee has been to ensure the quality and transparency of disclosure and the integrity of the Group's financial statements. Most notably the Committee supported the Board in its decision to release a trading statement in advance of announcing the Group's full year results prompted by the recognition of further provisions relating to conduct and litigation, primarily relating to mortgage-backed securities litigation and past conduct issues. These provisions are substantial and have had a significant impact on the Group's performance for the year.

During 2013, the Committee also scrutinised the disclosures relating to management actions to accelerate the rebuild of capital strength and to focus on core businesses (including the creation of RCR), included in the Group's Q3 2013 Interim Management Statement.

A key aspect of the Committee's responsibilities is to satisfy itself that the key accounting decisions, risks and significant management judgements that underlie the financial statements are appropriate through discussion and deliberation with management. The Committee reviewed the conclusions of the External Auditor and, where applicable, other experts and has concluded that disclosures in the financial statements about these judgements and estimates are transparent and appropriate.

Progress on remediating known control issues has remained a focus of the Committee during 2013. On behalf of the Board, the Committee has overseen the Controls and Culture Remediation Programmes within the Markets division and has questioned management in relation to the prioritisation of issues, delivery of remediation, quality assurance and contingency plans. The Committee received reports from Risk Management and Internal Audit and commissioned independent assurance that the programmes were progressing according to plan; that issues were being remediated to industry standard; and that internal reporting accurately reflected progress. On behalf of the Committee I discussed progress and prioritisation with the Prudential Regulatory Authority (PRA). The progress made by management during the course of 2013 was encouraging. However, we will continue to exercise oversight of the areas remediated to ensure improvements are sustained and that further progress is made during 2014.

The Markets Controls and Culture Remediation Programmes have served to underline the importance of an effective three lines of defence model. This was a priority in 2013 and the Committee received regular reports on embedding the model within divisions and functions and articulating the responsibilities and capabilities of the business. Embedding the model and maintaining standards of internal control will continue to be a key priority for the Group during 2014 as the organisational changes announced following the strategic review are implemented. The Committee will monitor this closely.

The Committee has also monitored the progress of various regulatory investigations and claims based on allegations that the Group had inappropriately tried to influence benchmark interest rates. Working closely with the Group Performance and Remuneration Committee, recommendations were made in relation to individual accountability. The Committee continues to consider the output of the review of certain high-risk rates which were not subject to investigation by external authorities.

The annual programme of joint visits by the Group Audit and Board Risk Committees to the Group's business divisions and control functions continued in 2013. The programme allows members of the Committees to spend additional time with areas of the business which the Committees judge would benefit from a more detailed review. Invitations to attend are extended to all non-executive directors. During 2013, the Committees undertook a total of eight visits, including a week long visit to the Group's operations in Asia and a two-day visit to Ulster Bank. During these visits I took the opportunity to meet with local regulators to gain a better understanding of their perspectives and concerns on our business and key control issues.

In all our work we seek to strike the right balance between on the one hand providing independent oversight and on the other encouragement and support to management. It has been another demanding year for the Group Audit Committee and I would like to extend my thanks to my fellow Committee members for their continued dedication and support throughout 2013.

Brendan Nelson  
Chairman of the Group Audit Committee  
26 February 2014

## Report of the Group Audit Committee

### Report of the Group Audit Committee

#### Meetings and visits

A total of seven scheduled meetings of the Group Audit Committee were held in 2013, including meetings held immediately before the annual and interim financial statements and the quarterly Interim Management Statements were considered by the Board. The Group Audit Committee also held two ad hoc meetings. Group Audit Committee meetings are attended by relevant executive directors, the Internal and External Auditor and Finance and Risk Management executives. Other executives, subject matter experts and external advisers are also invited to attend, as required, to present and advise on reports commissioned by the Committee. At least twice a year the Group Audit Committee meets privately with the External Auditor. The Committee also meets privately with Internal Audit management.

As in previous years, the Committee has undertaken a programme of visits to those business areas which it considers merit additional focus. During 2013, the Committee spent a week in Asia to review the Markets, International Banking, Wealth, Business Services and Group Finance operations in the region. Internal Audit management made presentations to the Committee at two separate visits, covering functional strategy, bench-strength and capability. Internal Audit Technology resources and capability were discussed during these meetings and over the course of the year the Committee has monitored progress in strengthening capability through recruitment and co-sourcing strategies. The Committee also spent time in Ireland to gain better insight into the issues facing Ulster Bank and held additional in depth meetings with the Markets, International Banking and Wealth divisions in the UK.

#### Membership of the Group Audit Committee

The Group Audit Committee comprises four independent non-executive directors. The Chairman and members of the Committee, together with their attendance at scheduled meetings, are shown below.

|                              | Attended/<br>scheduled |
|------------------------------|------------------------|
| Brendan Nelson<br>(Chairman) | 7/7                    |
| Tony Di Iorio                | 7/7                    |
| Baroness Noakes              | 7/7                    |
| Philip Scott                 | 7/7                    |

All members of the Group Audit Committee are also members of the Board Risk Committee facilitating effective governance of finance and risk issues. The Group Audit and Board Risk Committees have strong links with the Group Performance and Remuneration Committee ensuring that compensation decisions reflect relevant finance and risk considerations.

The members of the Group Audit Committee are selected with a view to the expertise and experience of the Group Audit Committee as a whole. The Board is satisfied that all Group Audit Committee members have recent and relevant financial experience and that each member of the Group Audit Committee is independent as defined in the SEC rules under the US Securities Exchange Act of 1934 (the "Exchange Act") and related guidance ("Exchange Act Rules") and the applicable New York Stock Exchange standards ("NYSE Standards"). The Board has further determined that each of Mr Brendan Nelson, Committee Chairman, Baroness Noakes and Philip Scott are "financial experts" for the purposes of compliance with the Exchange Act Rules and NYSE Standards. Full biographical details of the Committee members are set out on pages 42 to 45.

#### Performance evaluation

An external evaluation of the effectiveness of the Group Audit Committee takes place every three to five years with internal reviews by the Board in the intervening years. An internal review of the Board and its senior committees took place during 2013 following an external review in 2012. Overall, the review concluded that the Group Audit Committee continued to operate effectively.

The role and responsibilities of the Group Audit Committee

The Group Audit Committee's primary responsibilities are shown below and are set out in its terms of reference which are reviewed annually by the Committee and approved by the Board. These terms of reference are available on the Group's website [rbs.com](http://rbs.com).



## Report of the Group Audit Committee

### Financial reporting and policy

The Group Audit Committee focused on a number of salient judgements and reporting issues in the preparation of the 2013 accounts. In particular, the Committee considered:

- the evidence (including in relation to the Group's capital, liquidity and funding position) to support the directors' going concern conclusion. Further information is set out on page 100;
- the adequacy of loan impairment provisions, with special emphasis on exposures in Global Restructuring Group (GRG) and Ulster Bank in light of the creation of RCR which resulted in increased impairment provisions being recognised in the fourth quarter of 2013. The Committee was satisfied that the Group loan impairment provisions and underlying assumptions and methodologies are robust;
- the level of provisions held for outstanding litigation and regulatory investigations, including Payment Protection Insurance redress, LIBOR, Interest Rate Hedging Products and US RMBS litigation. Following review, the Committee was satisfied that overall the level of provision held is appropriate and that disclosure is sufficiently transparent. However, these issues will be kept under close review by the Committee in 2014, as matters develop;
- valuation methodologies and assumptions for financial instruments carried at fair value including the Group's credit market exposures;
- the appropriateness of the carrying value of goodwill and other intangible assets, placing particular focus on International Banking and RBS Citizens Financial Group, Inc. Following an impairment review at year end, goodwill allocated to International Banking of £1.1 billion was impaired in full;

- the judgements that had been made by management in assessing the recoverability of the Group's deferred tax assets. The deferred tax asset relating to tax losses recognised in The Royal Bank of Scotland plc has been written down by £0.7 billion;
- valuation of the Group's main defined benefit pension scheme. The Committee considered the assumptions that had been set in valuing the fund and the sensitivities of those assumptions;
- the accounting treatment of businesses that the Group has committed to sell, in particular the classification of Direct Line Insurance Group plc in light of the sale of tranches of shares in 2013 and the loss of control by the Group;
- the assessment by management of the adequacy and effectiveness of internal controls over financial reporting which had identified weaknesses in the Group's privileged access and user entitlement controls within Technology Services. The Committee considered the potential impact of those issues upon financial reporting systems and requested assurance directly from management regarding prioritisation of remediation and compensating controls. The Committee will continue to monitor delivery of the required remediation programme in 2014;
- the form and content of the newly introduced Strategic Report contained within the Annual Report and Accounts. As part of its overall assessment of the Annual Report and Accounts, the Committee assisted the Board in determining that the Annual Report and Accounts taken as a whole was fair, balanced and understandable, providing the information necessary for shareholders to assess the company's performance, business model and strategy. A comprehensive review process supports both the Group Audit Committee and ultimately the Board in reaching their conclusion:-
- the production of the Annual Report and Accounts is co-ordinated centrally by the Group Chief Accountant with guidance on requirements being provided to individual contributors;

- The Annual Report and Accounts are reviewed by the Group Disclosure Committee prior to consideration by the Group Audit Committee;
- A management certification process requires members of the Executive Committee and other senior executives to provide confirmation following their review of the Annual Report and Accounts that they consider them to be fair, balanced and understandable; and
- Directors are given sufficient time to consider the Annual Report and Accounts.

This process is also undertaken in respect of quarterly results announcements. In addition, the External Auditor considers the Board's statement as part of its audit requirements.

## Report of the Group Audit Committee

### Systems of internal control

In addition to the Markets Control and Culture Remediation Programmes, oversight of the three lines of defence model and consideration of accountability in relation to inappropriate rate setting activity (all as more fully described in the letter from the Committee Chairman), the Committee reviewed the progress of the Finance and Risk Transformation Programme. The Committee challenged management on the pace of delivery, cost, prioritisation and benefits. Management is considering the delivery and direction of the programme in light of the organisational changes announced following the strategic review and the Committee will exercise close oversight of the revised programme in 2014.

The Committee has also tracked progress in relation to other mandatory and remedial projects and has challenged individual business areas on the ability to meet regulatory expectations, responsibilities and required resource. The Committee has considered ongoing regulatory reviews and investigations and has monitored the Group's relationship with its principal regulators. It has received reports from the Sensitive Investigations Unit and has considered the appropriateness of action being taken by management in relation to identified issues. The Committee has considered the Group's compliance with the requirements of the Sarbanes-Oxley Act of 2002 and was advised of whistle-blowing events which occurred within the Group. The Committee has requested that Internal Audit consider how whistle-blowing processes can be audited and will seek to identify enhancements to the process.

The Committee also reviewed the effectiveness of the internal Notifiable Event Process during the year; alerts on each event are received by the Chairman of the Committee, and the Chairman of the Board Risk Committee.

Regular reports were received by the Committee on wholesale credit quality assurance testing and consumer credit quality assurance testing. The Committee reviewed the Group's various pension obligations and discussed the status of funding and triennial valuation discussions underway with the RBS Group Pension Fund. The Committee will monitor the investment strategy, capital impact and funding of the scheme during 2014, as negotiations progress.

As discussed in the report of the Board Risk Committee, changes to the Divisional Risk and Audit Committee structure, designed to enhance the effectiveness and transparency of the consideration of risk and audit issues at a divisional level are currently under consideration. Detailed proposals will be presented to the Committee in the first quarter of 2014.

#### Internal audit

The Group Audit Committee oversaw the work of Internal Audit throughout 2013. Through regular reports and opinions, the Committee obtained insights into Internal Audit's assessment of the control environment across all divisions and of management's level of awareness. The reports from Internal Audit enabled the Committee to monitor internal control within the Group by reporting on areas where improvements to the control environment were needed.

In response to Internal Audit findings during the latter half of 2013, the Committee received at its request a presentation from executives of the Markets division on controls relating to trade and transaction reporting and actions underway to address identified weaknesses. The Committee has asked for regular updates on remediation progress to be provided during 2014.

Internal Audit also highlighted that the volume of change underway across the organisation and some specific regulatory remediation efforts, are key risk areas for the Group. The Committee will focus on these areas in 2014, particularly as the recently announced strategic changes are executed.

During bi-annual visits with Internal Audit, the Committee considered the bench-strength and capability of the function and areas where enhancement was required, including Technology and Markets. Plans in place to make improvements, including strategies to externally co-source certain activities and to accelerate recruitment were discussed to ensure that risks were appropriately covered. The Committee also reviewed Internal Audit's budget and succession-planning.

The Head of Internal Audit continues to report to the Chairman of the Group Audit Committee. In 2013, his secondary reporting line was changed and he now also reports directly to the Group Chief Executive (previously the Group Finance Director). Consideration was given to the presence of the Head of Internal Audit and divisional Heads of Audit at Executive Committee and other senior meetings. The Committee will continue to monitor the participation and influence of Internal Audit at senior level meetings during 2014.

The Committee considered and approved enhancements to the reporting methodology in Internal Audit reports and agreed that the changes to the criteria underlying ratings would improve transparency and provide additional evidence about culture and attitude. These improvements to reporting will be introduced in 2014. Proposed improvements to the evaluation of risk and enhancement to the audit universe, that will enable scoping and prioritisation of the work of Internal Audit that better reflects the scale and complexity of the business, were also considered by the Committee. The impact of assurance work initiated by the Group's regulators on risk coverage was discussed and the annual plan of audit activity was approved.

An external review of the effectiveness of Internal Audit takes place every three to five years, with internal reviews continuing in intervening years. In December 2013, the Group Audit Committee undertook an internal evaluation of Group Internal Audit. The evaluation concluded that Group Internal Audit had operated effectively throughout 2013. Minor

observations and recommendations will be progressed. Benchmarking of Internal Audit against the Chartered Institute of Internal Auditors “Effective Internal Audit in the Financial Services Sector” guidance recommendations was explicitly included in the evaluation of effectiveness. Internal Audit currently meets these recommendations in the majority of areas and has incorporated actions within its strategic plan to address identified shortcomings.

## Report of the Group Audit Committee

### Oversight of the Group's relationship with its regulators

The Group Audit Committee has a responsibility to monitor the Group's relationship with the Prudential Regulatory Authority (PRA), Financial Conduct Authority (FCA) and other regulators. During 2013, it received regular reports on the Group's relationship with all its regulators highlighting significant developments. It received reports on regulatory actions and investigations. Over the course of the year the Chairmen of the Group's senior Board committees met with the PRA and the FCA on an individual basis and also participated in Regulatory College meetings with the Group's primary regulators. The Chairman of the Group Audit Committee also met with the PRA and with the External Auditor on a trilateral basis.

The Committee closely monitored the Group's relationship with its international regulators and significant time was dedicated in particular to understanding the regulatory requirements in the US and their implications for the Group's US operations and structure. The Committee Chairman also met with the Japanese Financial Services Authority, the Central Bank of Ireland and the Federal Reserve Bank of Boston during local visits.

### External audit

During 2013, the External Auditor provided the Group Audit Committee with reports summarising their main observations and conclusions arising from their year end audit, half year review and work in connection with the first and third quarters' financial results and their recommendations for enhancements to the Group's reporting and controls. The External Auditor also presented for approval to the Committee their audit plan and audit fee proposal and engagement letter, as well as confirmation of their independence and a comprehensive report of all non-audit fees.



The Group Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the External Auditor and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The annual evaluation is carried out in two stages. An initial review was carried out in early 2014. In assessing the effectiveness of the Group's External Auditor, the Group Audit Committee had regard to:

- the experience and expertise of the senior members of the engagement team;
- the proposed scope of the audit work planned and executed;
- the quality of dialogue between the External Auditor, the Committee and senior management;
- the clarity, quality and robustness of written reports presented to the Committee setting out the External Auditor's findings arising from the audit;
- the quality of observations provided by the External Auditor on the Group's systems of internal control;
- the views of management on the performance of the External Auditor; and
- the findings of any reviews of the work of the External Auditor by relevant regulators and the actions taken, where appropriate, to address any matters raised.

The second phase of the review will be conducted following completion of the 2013 audit and will involve targeted interviews with individuals based on outputs from the initial phase and their level of interaction with the External Auditor.

In addition to the annual evaluation performed by the Group Audit Committee, the External Auditor will also conduct their own annual review of audit quality. Twelve service criteria for the audit have been defined by them to measure their performance against the quality commitments set out in their annual audit plan. Feedback will be

obtained and discussed with relevant internal stakeholders. The results of this exercise will be presented to the Group Audit Committee, with actions defined and agreed to address any areas where performance has fallen below expected standards.

The Group Audit Committee is responsible for making recommendations to the Board in relation to the appointment, re-appointment and removal of the External Auditor. In order to make a recommendation to the Board, the Group Audit Committee considers and discusses the performance of the External Auditor, taking account of the outcomes of the annual evaluation carried out. The Board submits the Group Audit Committee's recommendations to shareholders for their approval at the Annual General Meeting.

Deloitte LLP has been the company's auditor since March 2000. There are no contractual obligations restricting the company's choice of External Auditor. The revised UK Corporate Governance Code, issued by the Financial Reporting Council in September 2012 provides that companies should put the external audit contract out to tender at least every ten years. The Competition Commission following their investigation into the supply of statutory audit services also concluded that FTSE 350 companies should tender the audit engagement every ten years. The Group Audit Committee has considered the requirements and emerging developments in the EU and currently intends to put the contract for the 2016 (and future periods) audit of the Group out to tender later this year. In the interim, the Board has endorsed the Group Audit Committee's recommendation that shareholders be requested to approve the reappointment of Deloitte LLP as External Auditor at the Annual General Meeting in 2014.

The Group Audit Committee approves the terms of engagement of the External Auditor and also fixes their remuneration as authorised by shareholders at the Annual General Meeting.

#### Audit and non-audit services

The Group Audit Committee has adopted a policy on the engagement of the External Auditor

to supply audit and non-audit services, which takes into account relevant legislation regarding the provision of such services by an external audit firm.

In particular, the Group does not engage the External Auditor to provide any of the following non-audit services:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions or contribution-in-kind reports;

## Report of the Group Audit Committee

- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit; and
- other services determined to be impermissible by the US Public Company Accounting Oversight Board.

The Group Audit Committee reviews the policy annually and prospectively approves the provision of audit services and certain non-audit services by the External Auditor. Annual audit services include all services detailed in the annual engagement letter including the annual audit and interim reviews (including US reporting requirements) and periodic profit verifications.

Annual audit services also include statutory or non-statutory audits required by Group companies that are not incorporated in the UK. Terms of engagement for these audits are agreed separately with management, and are consistent with those set out in the audit engagement letter to the extent permitted by local regulations. During 2013, prospectively approved non-audit services included the following classes of service:

- capital raising, including consents, comfort letters, reviews of registration statements and similar services in respect of documents that incorporate or include the audited financial statements of the Group;
- accounting opinions, including accounting consultations and support related to generally accepted accounting principles and financial

reporting matters relating to the financial statements of the Group and its subsidiaries;

- any reports that, according to law or regulation in the relevant jurisdiction, must be (and may only be) rendered by the External Auditor;
- reports providing assurance to third parties over certain of the Group's internal controls prepared under US Statement of Auditing Standards 70 "Service Organisations" or similar auditing standards in other jurisdictions; and
- reports and letters providing assurance to the Group in relation to a third party company where the Group is acting as equity/ debt underwriter in a transaction, in the ordinary course of business.

For all other permitted non-audit services, Group Audit Committee approval must be sought, on a case-by-case basis, in advance. The Group Audit Committee reviews and monitors the independence and objectivity of the External Auditor when it approves non-audit work, taking into consideration relevant legislation, ethical guidance and the level of non-audit services relative to audit services. The approval process is rigorously applied to prevent the External Auditor from functioning as management, auditing their own work, or serving in an advocacy role.

A competitive tender process is required for all proposed non-audit services engagements where the fees are expected to exceed £100,000. Engagements below £100,000 may be approved by the Chairman of the Group Audit Committee; as an additional governance control all engagements have to be approved by the Group Chief Accountant and Group Procurement. Where the engagement is tax related, approval must also be obtained from the Head of Group Taxation. Ad hoc approvals of non-audit services are ratified by the Group Audit Committee each quarter. During 2013, the External Auditor were approved to undertake certain significant engagements which are categorised and explained more fully below:

Regulatory requests and attestations (three engagements)

Regulators, both UK-based and overseas, requested certain work be undertaken by the Group during 2013 to provide assurances and meet certain requirements. In all three such engagements undertaken by the External Auditor, their existing knowledge of the Group was highlighted as a strong benefit. It allowed the work to commence quickly and with minimal disruption in all instances. The benefits of maintaining consistency between similar engagements was also highlighted.

Tax advisory and compliance services (one engagement)

Tax advisory services were provided to a subsidiary established by RBS and Blackstone. The External Auditor had been involved in establishing the subsidiary company and so had an in-depth understanding of its structure and tax liabilities.

Membership of a company acquired by Deloitte (one engagement)

Bersin has provided an annual membership to the RBS Group since 2010. This has allowed our HR and Learning & Talent Practitioners to access extensive online research libraries. Bersin was acquired by Deloitte in December 2012 and so at the point the Group's Bersin membership was due for renewal ad hoc approval by the Group Audit Committee was sought.

Non-statutory audit of full year accounts (one engagement)

As part of the disposal of certain UK branches, it has been necessary to prepare audited accounts for the business for 2012 and 2013. The External Auditor was selected to provide audit services based on its extensive experience of the Group's systems and process, as well as its specific knowledge of the project. In addition, following the completion of the banking licence application for the business, the new legal entity would be a wholly-owned subsidiary of the Group; it is the Group's policy to use the Group's External Auditor to audit the accounts of all subsidiaries except in exceptional circumstances.

In addition, the External Auditor is engaged from time to time by the Group to perform services in relation to the restructuring of loans and other financing. The Group is not liable for these fees, and often has a limited role in the selection process. As an additional governance control, these engagements are subject to the ad hoc approval process. Information on fees paid in respect of audit and non-audit services carried out by the External Auditor can be found in Note 5 to the consolidated accounts on page 395.

Brendan Nelson  
Chairman of the Group Audit Committee  
26 February 2014

## Report of the Board Risk Committee

Letter from Philip Scott,  
Chairman of the Board Risk Committee

Dear Shareholder,

Throughout 2013, the Board Risk Committee has sought to continue to provide assurance that the Group is operating in a safe and controlled manner and within the agreed risk appetite framework approved by the Board. This has been done against a backdrop of difficult external market conditions and increased regulatory scrutiny by the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) and the Group's overseas regulators.

In particular, the Committee has focussed on market risk, operational risk, credit risk, conduct and regulatory risk and reputational risk. In its consideration of each area of risk, culture has been the priority and the Committee has emphasised the importance of instilling the correct behaviours within the organisation, alongside processes and tools designed with the customer at the fore. It is vital that the business is able to get these things right in order to meet its target of becoming a 'really great bank'. The Committee is working hard to drive cultural change and increase accountability throughout the organisation.

Oversight of risk has been enhanced in the period, through the separation of the Risk Management and Conduct and Regulatory Affairs functions. The restructure of the Risk function has enabled the Committee to achieve clearer and more effective oversight of conduct and regulatory issues, which will have long-lasting benefits. The Committee dedicates substantial time each year to the oversight of the risk operating model and succession planning and will continue to monitor these changes during 2014 as the respective functions continue to strengthen and embed.

Conduct risk standards continue to be communicated to employees using the four pillars of conduct risk: employee conduct; market conduct; corporate conduct; and conduct towards customers. These standards have been applied in the Committee's consideration of issues including the review of the sale of interest rate hedging products to SME customers. The Committee has also placed renewed focus on the quality of advice provided to customers, particularly in relation to mortgages, investment products and private client products.

In response to the allegations set out in the Tomlinson Report that the Group's restructuring division systemically set out to make profit at the expense of distressed customers, an independent review by the law firm Clifford Chance was commissioned to investigate these claims fully. The Group's regulators will also undertake their own review. While no evidence has been produced that supports the claims set out in the Tomlinson Report, the allegations have damaged our reputation and threaten to undermine our ability to build trust with customers and to increase lending to businesses in the UK economy. Therefore it is essential that the Group verifies the facts as quickly as possible. The Board Risk Committee has undertaken to review the outputs of both investigations, in depth, on behalf of the Board and make recommendations as to action required.

During 2013, the Board Risk Committee has continued to oversee the remediation activity following the major IT incident in 2012 and the ongoing effort to ensure the Group is more resilient in this respect in future. The Committee has also considered other potential single points of failure and how these can be identified and prevented or mitigated. This focus will continue in 2014 and the Committee will continue to liaise with its principal regulators during the first quarter of the year as the investigation of the IT incident concludes.

The Committee has considered reports on data quality, information security and corporate security with a particular focus on cyber security. This continues to be a significant issue for the banking industry as a whole and will remain a



priority for the Committee in 2014.

Consideration of the case for RCR and substantiation of the capital plan was a major undertaking for the Group in the latter half of 2013. Given the fundamental strategic importance of this review, consideration, analysis and approval was undertaken collectively by the Group Board rather than at Committee level, which I consider to be appropriate. As a priority in 2014, the Board Risk Committee will monitor the risks in execution of this plan and also execution of the measures announced following the strategic review.

While 2013 has presented significant challenges, there has also been significant progress in the oversight of risk and control in many areas. In particular I would highlight the following:

- the Committee has continued to enhance its relationship with other Committees, in particular the Group Performance and Remuneration Committee. It has advised on matters such as assessing risk performance of both divisions and individuals, reviewing the risk objectives of members of the Executive Committee and considering the accountability of individuals in relation to specific matters;
- the role of Divisional Risk and Audit Committees has been reviewed in conjunction with the Group Audit Committee to ensure that they provide more transparency and more effective consideration of risk at a divisional level. Proposed changes to the existing model will be considered by the Committee in Q1 2014;

### Report of the Board Risk Committee

- the Committee has overseen the refinement and further embedding of the Group's risk appetite framework into the business divisions;
- the Committee considered the outputs of stress testing and approved a reverse stress test trigger framework to further assist the risk management team in assessing how the business is positioned to respond to various potential scenarios; and
- an economic capital framework was presented and the Committee considered how this would be transitioned into business as usual.

More detailed information on each of these areas is set out in the Board Risk Committee report that follows.

2013 was a challenging year for the Board Risk Committee and I would like to extend my gratitude to my fellow members and to the Group's senior leadership team for the additional time that they have dedicated to the business of the Committee.

Philip Scott,  
Chairman of the Board Risk Committee  
26 February 2014

## Report of the Board Risk Committee

### Report of the Board Risk Committee

#### Meetings and visits

The Board Risk Committee held seven scheduled meetings in 2013. Meetings are held alongside Group Audit Committee meetings to ensure that the work of the two Committees is coordinated and consistent. Board Risk Committee meetings are attended by relevant executive directors, risk management, finance and internal audit executives. External advice may be sought by the Board Risk Committee where considered appropriate. During 2013, the members of Board Risk Committee, in conjunction with the members of the Group Audit Committee, took part in an annual programme of visits to the Group's business divisions and control functions. This programme included two in depth sessions with the Risk Management function to consider key risk areas and the risk strategy and operating model. Full details about the programme of visits is set out in the Report of the Group Audit Committee on page 56.

#### Membership of the Board Risk Committee

The Board Risk Committee comprises at least three independent non-executive directors. The Chairman and members of the Committee, together with their attendance at meetings, are shown below.

|                                    | Attended/<br>scheduled |
|------------------------------------|------------------------|
| Philip Scott<br>(Chairman)         | 7/7                    |
| Sandy Crombie                      | 7/7                    |
| Tony Di Iorio (1)                  | 6/7                    |
| Brendan Nelson                     | 7/7                    |
| Baroness Noakes                    | 7/7                    |
| Former director<br>Joe MacHale (2) | 2/4                    |

#### Notes:

- (1) Missed one meeting due to travel disruption.  
 (2) Retired from the Board on 14 May 2013.

Philip Scott, Tony Di Iorio, Brendan Nelson and Baroness Noakes are also members of the Group Audit Committee. Sandy Crombie is also a member of the Group Performance and Remuneration Committee. This common membership ensures effective governance across all finance, risk and remuneration issues, and that agendas are aligned and overlap is avoided, where possible.

#### Performance evaluation

A review of the effectiveness of the Board and senior committees, including the Board Risk Committee, during 2013 was conducted internally. The Committee has considered and discussed the report on the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted, the conclusions and the recommendations for action. Overall, the review concluded that the Board Risk Committee continued to operate effectively but some areas where further enhancements could be made, were identified. The outcomes of the evaluation have been reported to the Board, and during 2014, the Committee will place focus on driving further improvements to risk reporting and prioritisation of Committee time.

#### The role and responsibilities of the Board Risk Committee

The Board Risk Committee's primary responsibilities are shown below and are set out in its terms of reference which are reviewed annually by the Committee and approved by the Board. These are available on [rbs.com](http://rbs.com).

## Report of the Board Risk Committee

### Risk strategy and policy

RBS has a clear risk strategy supported by well defined strategic risk objectives. The members of the Board Risk Committee provide input to the overarching strategy for the business on an ongoing basis.

During 2013, the Board Risk Committee reviewed the implementation of the Group Policy Framework across the organisation. It also reviewed the output of control environment certifications which provided the Committee with an assessment of the effectiveness of the Group's internal control environment. Particular focus was placed on how the operational risk framework was structured to identify single points of failure and "black swan" events, being those events that were difficult to predict but would have a high impact. The Committee agreed that Risk Management should reinforce with divisions that risk assessments and scenario analysis should extend to these events and that consideration should also be given to resilience.

Together with the Group Audit Committee, throughout 2013, the members placed particular focus on the implementation and embedding of the three lines of defence model across divisions. While progress has been made, the Committee recognises that additional work is required to fully delineate responsibilities across front line management, risk and internal audit. The Committee has emphasised that it considers effective operation of the model to be a priority and will closely monitor progress in 2014 alongside strategic and organisational change.

The Committee also considered management's plans to deliver a holistic Enterprise Risk Management (ERM) framework, intended to deliver an increase in effectiveness and make risk more relevant to the operation of the business. This would involve rationalising existing risk management tools and making them integral to business as usual. The Committee noted its emphatic support to the accelerated programme

of work planned for 2013/2014 which including the development of outcome-focused principles of business and the use of tools such as the “yes check” to align values with customer outcomes based on integrity, safety, soundness, reputation and standards.

The members closely reviewed implementation plans and delivery of solutions to meet the requirements of the Single European Payments Area. The Committee in particular has monitored the relationship with the Central Bank of Ireland in this regard.

The Committee has received reports on plans underway to enhance data quality across the organisation. It has also considered information security, corporate security and cyber risk.

## Risk profile

### Reporting

The Committee received a detailed report on key risks and metrics at each meeting and the Group Chief Risk Officer provided a verbal update on the key risks to the organisation. Following his appointment, the Head of Conduct and Regulatory Affairs also provided a verbal update on current pertinent matters to the Committee at each meeting. These reports enabled the Committee to identify the key risk areas where additional focus was required.

During 2013, the Committee has continued to focus on enhancing risk reporting and some improvements have been made, including the creation of a risk report at entity level of National Westminster Bank Plc. However, the annual Committee performance evaluation has highlighted that more work is required to rationalise the reports that are received by the Committee; to ensure that key risks are conveyed succinctly and prominently; and to standardise and simplify presentations. This will be taken forward in 2014.

The Committee reported to the Board following each meeting on its consideration of the risk profile of the business and made recommendations as appropriate.

Risk Incidents and Regulatory reviews and investigations

As in previous years, regulatory risk featured highly on the agenda of the Committee during 2013. Most significantly, as highlighted above, in the letter from the Committee Chairman, the Committee continued to play a central role in the oversight and remediation of the Group's 2012 IT incident. It received regular reports on the work being undertaken to enhance resilience and address root causes of the issue and has challenged management on the robustness of plans and in relation to capability across the three lines of defence. Significant progress has been made to address the deficiencies highlighted by the incident. However, longer term investment in further enhancement to the Group's infrastructure is ongoing. The Committee will continue to oversee the remediation activity and wider enhancement required to systems and resilience during 2014. The Committee will also work with its regulators to address findings as their investigation of the incident concludes and will ensure accountability is fully considered and learnings are adopted, across the organisation.

The Committee was dismayed to learn of the most recent system outage in late 2013 and will ensure that this matter and any correlation with the earlier IT incident is fully understood.

The allegations set out in the Tomlinson Report have been taken very seriously by the Group and while there is no evidence of systemic wrongdoing in the way distressed customers were treated by the Group's restructuring division, an independent review by Clifford Chance has been commissioned. The FCA has separately appointed a skilled person to undertake a review under section 166 of the Financial Services and Markets Act. The Board Risk Committee will review the outputs of these investigations and will liaise with its regulators as required.

## Report of the Board Risk Committee

A number of other internal and regulatory investigations arose or continued throughout 2013. During the period, the Committee received reports on;

- the investigation of the alleged mis-selling of interest rate hedging products to small and medium sized enterprises and considered the appropriateness of remediation activity;
- the investigation of allegations of inappropriate rate setting activity in particular foreign exchange rates;
- anti-money laundering remediation including divisional remediation plans, prioritisation and resource requirements;
- the sale of complex products and the quality of investment advice to customers. In particular, it received reports on required enhancements to the mortgage sales process. The sales and product design and approvals process were also reviewed;
- the status of key litigation cases, in particular the US residential mortgage-backed securities litigation claims; and
- the remediation of known regulatory issues in the RBS Americas region.

Where appropriate, the Committee oversaw liaison with regulators; made recommendations regarding required remediation, training and process controls and enhancements; and made recommendations to the Group Performance and Remuneration Committee in relation to accountability. Progress to address identified weaknesses will be closely monitored throughout 2014.

In 2013, the Balcony Oversight Committee was established in acknowledgment of the volume of ongoing conduct issues, particularly in the Markets division. The aim of the Balcony



Oversight Committee chaired by the Head of Conduct and Regulatory Affairs, is to provide independent oversight, identify common themes and to share lessons learned. The Balcony Oversight Committee reports to the Board Risk Committee and regular updates were provided on the status of ongoing investigations and emerging themes.

#### Capital and liquidity

The Committee reviewed the capital and liquidity position of the business regularly in light of external conditions.

The Committee made recommendations to the Board concerning the Individual Liquidity Adequacy Assessment, the Internal Capital Adequacy Assessment Process (ICAAP) and the Contingency Funding Plan, in line with the Group's commitments to its regulators.

#### Risk appetite framework and limits

The risk appetite framework for the Group was reviewed in 2013 to ensure it remained fit for purpose in light of internal restructuring, market positioning and changes to regulation.

Consideration was given to how risk appetite linked to strategic objectives and how quantitative risk appetite targets had been set. The Committee discussed earnings volatility, including the impact of diversification benefit on the targets. Following detailed discussion, the Committee recommended the framework to the Board for approval and noted its support to management as the framework was embedded across the Group at divisional level. The Board Risk Committee separately reviewed the country risk appetite and Group Market Risk Control Framework and noted new market risk caps and changes to the existing limits.

In the second half of 2013 the Committee reviewed proposed changes to the Single Name Concentration framework for Banks and a new Single Name Concentration grid for Large Corporates.

The Committee also considered the Economic Capital model, which had been under delivery since 2010. It was noted that the model was now

being transitioned to business as usual activity and had been used to assess credit concentration risk for Pillar 2 capital as part of the 2011 ICAAP, resulting in a more accurate capital calculation. The Committee is confident that the model will provide management with a clearer understanding of risk.

The Committee continued to review the output of stress testing and discussed the stress scenarios and underlying assumptions. In the second half of 2013, the Committee noted the output of a reverse stress testing exercise and recommended it for approval to the Board.

#### Risk management operating model

During the course of two separate visits to Risk Management, the Committee reviewed the risk management operating model to ensure the function had the appropriate structure and resources in place to deliver its strategic plan. Bench-strength of the risk function was reviewed and consideration was given to succession-planning, resource and budget.

The strengthening of the Conduct and Regulatory Affairs function during the second half of the year resulted in various changes to the risk management operating model which were discussed in detail with the Committee. Further developments to Risk Management, Conduct and Regulatory Affairs and the risk committee framework that underpins the Board Risk Committee will continue to be progressed in 2014 and the Committee will remain involved in the discussions and changes as appropriate.

As referenced in the Group Audit Committee report on pages 56 to 60, a framework of Divisional Risk and Audit Committees is responsible for reviewing the business of each division and reporting to the Group Audit Committee and Board Risk Committee. During 2013, the Committee reviewed the operation of the committees and requested that management consider alternative mechanisms that could more effectively provide a line of sight into divisional risk issues and activity. The output of that review, will be more fully discussed in Q1 2014.



## Report of the Board Risk Committee

### Risk architecture

The Committee reviewed the preparations underway to ensure compliance with the new best practice principles that had been defined by the Basel Committee of Banking Supervision (BCBS) for internal risk reporting and data aggregation practices, which would be effective in 2016. Consideration was given to how these requirements reaffirmed priorities and direction of travel with the Finance and Risk Transformation (FiRST) Programme and it was noted that work was in progress to both accelerate usage of the FiRST strategic solution by Risk and enhance existing capabilities. In conjunction with the Group Audit Committee, the Board Risk Committee will closely monitor delivery of the FiRST programme in 2014 and any required changes as a result of the strategic review.

### Remuneration

The Committee recognises that embedding the correct conduct and culture in the organisation requires an emphasis on performance management and conduct standards. The Board Risk Committee has continued to work closely with the Group Chief Executive and Group Performance and Remuneration Committee to consider the risk aspects of Executive Committee members' objectives and remuneration arrangements as appropriate.

The Committee considered the risk performance of divisions in light of known risk and control issues and under advice from Risk Management and Internal Audit. It made recommendations regarding appropriate adjustments, to the Group Chief Executive and Group Performance and Remuneration Committee.

The Committee has reviewed specific accountability cases as required and made recommendations accordingly.

Philip Scott  
Chairman of the Board Risk Committee  
26 February 2014

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## Report of the Group Sustainability Committee

Letter from Sandy Crombie  
Chairman of the Group Sustainability Committee

Dear Shareholder,

Early in 2013 the remit of the Group Sustainability Committee was increased to include broader sustainability issues including conduct, culture, reputation and most importantly, how the Group serves its customers.

Membership was strengthened with an additional non-executive director and meeting frequency was also increased, all underlining our commitment to the sustainability agenda.

While 2013 presented significant challenges, progress was made by the Committee in overseeing and challenging how management was addressing sustainability and reputation issues relating to all stakeholder groups. Key areas of work during the year included:

- oversight of the introduction and embedding of the purpose, vision and values work intended to promote behavioural change and strengthen our culture Group-wide. This included the introduction of the Code of Conduct which lays out the standard of conduct that supports the Group's values of serving customers, working together, doing the right thing and thinking long term;
- oversight of how the Group is balancing the needs of all its stakeholder groups including customers, investors, employees, regulators and communities/society and alignment with the Group's strategic intent;
- ongoing commitment to the stakeholder engagement programme through regular face to face sessions with advocacy groups on key issues of concern. This has been a key area of progress for the Committee allowing for challenge and debate in an open and collaborative environment (more details on next page);
- oversight of development of Environmental, Social and Ethical (ESE) policies to ensure increased transparency and disclosure and more responsible management of risks in sensitive and high risk sectors. ESE policies reviewed in 2013 included Mining and Metals, Oil and Gas and Gambling;
- receiving reports on the sustainability activities across the company including supporting enterprise, employee engagement, citizenship, environment, safety and security;
- improved reporting through the annual Sustainability Report which provides a review of our activities and details future commitments, goals and priorities. We adhere to best practice standards for our reporting, following a principles framework of inclusivity, materiality and responsiveness. Deloitte LLP undertake independent assurance of our reporting and were able to provide an unqualified assurance statement in respect of the 2012 Sustainability Report which was published in May 2013;
- receiving reports on people issues including health and safety, diversity and inclusion, employee wellbeing and employee opinion; and
- receiving reports on legal issues and legislative changes that impact the sustainability agenda.

Other areas supported by the Committee included the adoption of a number of internationally accepted voluntary codes notably the Equator Principles, United Nations Global Compact and Natural Capital Declaration (see pages 35 to 37 for more detail).

Although much still has to be done, it is pleasing that the efforts to build a sustainable and responsible business have been recognised through independent and external measures such as inclusion in the Dow Jones Sustainability World Index with our highest score to date in 2013. We have also been included in the FTSE4Good Index Series which measures the performance of companies that meet globally recognised corporate responsibility standards (see pages 35 to 37 for more information on these external commitments).

To continue the progress made in 2013, a priority for the Committee will be to ensure that its strategic direction is aligned with business priorities and that sustainability is embedded in everything that we do.

Finally I would like to thank my fellow Committee members for their expertise and guidance and all those who have supported us, whether inside or outside RBS, for their contribution to our work.

More detailed information on the Committee and the Group's approach to sustainability is found on pages 35 to 37.

Sandy Crombie  
Chairman of the Group Sustainability Committee  
26 February 2014

## Report of the Group Sustainability Committee

### Report of the Group Sustainability Committee Meetings

The Group Sustainability Committee held six Committee meetings in 2013 in addition to seven stakeholder engagements sessions. Both were attended by senior representatives from the customer facing divisions as well as Human Resources, Sustainability, Risk Management, Communications, Legal, Strategy and Corporate Services. The Chairman of the Board regularly attends the meeting as well as internal and external specialists who may be requested to attend for specific items.

### Stakeholder Engagement Sessions

Balancing the needs of stakeholders means understanding the views of all those who have an interest in our business. In addition to ongoing engagement throughout RBS with internal and external stakeholders, during the year, the Group Sustainability Committee participated in seven stakeholder engagement sessions covering the following topics:

- Fair Banking;
- Safety and Security;
- Citizenship;
- Supporting Enterprise;
- Sustainability priorities in the USA;
- Investor Perspective; and
- Employee Engagement.

These stakeholder engagement discussions help inform decision making across the Group, shape future policies and influence strategic priorities and will continue to play a key role. For more information see pages 35 to 37.

In 2013, a programme of UK based events aimed at individual shareholders was introduced. These events provided an opportunity for shareholders to meet directors and senior management to learn more about the business.

### Membership

The Group Sustainability Committee comprises three independent non-executive directors. The Chairman and members of the Committee, together with their attendance at meetings, are shown below.

|                          | Attended/<br>scheduled |
|--------------------------|------------------------|
| Sandy Crombie (Chairman) | 6/6                    |
| Alison Davis (1)         | 5/6                    |
| Penny Hughes (2)         | 3/3                    |

### Notes:

- (1) One meeting missed due to time zone differences.  
 (2) Appointed to the Committee with effect from 30 July 2013.

### Performance evaluation

An internal review of the effectiveness of the Group Sustainability Committee took place in 2013. Overall the review concluded that the Group Sustainability Committee continued to operate effectively. An ongoing challenge will be to ensure that the Group's strategy covers the long term needs of all stakeholders and that the work of the Group Sustainability Committee is fully aligned with that strategy.



Role and responsibilities of the Group Sustainability Committee

The Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by another Board committee.

Authority is delegated to the Group Sustainability Committee by the Board and the Committee will report and make recommendations to the Board as required. The terms of reference of the Group Sustainability Committee are available on the Group's website [rbs.com](http://rbs.com) and these are considered annually by the Group Sustainability Committee and approved by the Board. A report on the activities of the Group Sustainability Committee in fulfilling its responsibilities is provided to the Board following each Committee meeting. The principal responsibilities of the Group Sustainability Committee are shown below aligned to the Group's values.

## Directors' Remuneration Report

### Annual Statement from the Chair of the Group Performance and Remuneration Committee Penny Hughes

Dear Shareholder,

This year's remuneration report is published at an important moment for RBS. Five years on from the company's rescue, RBS is substantially safer and smaller, has a new Group Chief Executive, and has embarked on a new strategy positioning customers at its centre. In this changing environment, the complex challenges surrounding remuneration that I have written about in this space for the last few years, have not gone away.

The Committee is tasked with making decisions on pay that encourage good service to our customers, are fair to all of our employees, and are in the interests of all of our shareholders. These decisions are never easy and are rarely popular in all quarters. Sometimes it would be easier for the Committee to make different decisions, prioritising the needs of one stakeholder group over another. We understand why RBS is subject to public and political scrutiny and has an obligation to the public that goes beyond that of our competitors. But truly living up to our responsibilities means we have to reject easy options which are not in the long-term interests of our stakeholders.

#### 2013 performance – a challenging year

Although now safer and more secure than it was five years ago, RBS is still beset by issues that have their roots in the past. Our substantial loss for 2013 arises primarily from the decision to remove more of the bad assets from our balance sheet and make additional provisions for conduct and litigation issues. It is a matter of great regret that it is against this background that I have to make this report. I know shareholders had hoped that losses like this would have been well behind RBS by now. Those who served on the Executive Committee during the year did not receive any bonus for 2013. Most of this team is relatively new, but this was an important leadership issue.

#### Continuing pay reform

There has been a fundamental cultural shift in our approach to pay:

- Over the last four years alone, bonus pools have fallen by 58% at a Group level and by 75% within the Markets division.
- The Group bonus pool has fallen between 2012 and 2013 in line with the fall in pre-RCR operating profit.
- The underlying reduction is significantly greater when taking account of the deduction made last year for LIBOR.
- The percentage of staff receiving no bonuses has increased over the last year from 40% to 43% as we continue to target high performers.
- In our UK retail business, incentive schemes for customer facing staff have minimum standards relating to customer and risk measures which must be met before any payments can be considered.
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Performance related pay is linked to a combination of performance measures covering financial and non-financial metrics.

Operating in markets where absolute and relative levels of pay are still high, RBS has been a back-marker. But we do not and cannot operate in a vacuum. Many of our employees have done good work this year to help rebuild the company for the future. While pay in aggregate will continue to remain at the lower end of current market practice, I firmly believe our pay levels must remain competitive to attract and retain a high calibre of staff. This is essential if we are to build a business of value for our customers and our shareholders.

It is worth noting that bonuses and other variable pay arrangements are standard practice for FTSE100 companies, not just banks. Research indicates that 99% of executives in the FTSE100 at Executive Committee level or above have a variable to fixed pay ratio that exceeds 1:1.

I know it is not always easy to accept, but if RBS is to thrive we must do what it takes to attract and keep the people who will help us achieve our goals. We think that the right positioning of the business is to be commercial. While we are sensitive to public opinion, particularly given our ownership structure, the ability to pay competitively is fundamental to getting RBS to where we need it to be.

## Directors' Remuneration Report

There is an understandable public focus on the highest paid specialist talent at RBS. However, as a Committee, we are equally concerned about pay for staff at all levels. We provide oversight and guidance on all RBS remuneration arrangements. In 2014 we are directing a greater proportion of our salary budget to our lower paid employees. We continue to pay our permanent employees in the UK at or above the "Living Wage" benchmarks (National and London) and intend to apply for full accreditation.

Our remuneration policy promotes transparency and accountability; pay is clawed back when things go wrong, and awards are suspended when investigations are ongoing. Clawback is a powerful tool and we have put it to use. This year we have suspended awards pending investigations triggered by serious allegations of misconduct. It is important for the company and the executives involved that discretionary awards are put on hold until all the facts are clear.

### CRD IV

Many of you will be aware that a "bonus cap" has been introduced under the fourth European Capital Requirements Directive (CRD IV). Whilst the actual regulation and setting of a hard cap is not what we would have wished for, it is essentially aligned to our own actions to moderate pay levels and reduce pay leverage. We will therefore seek to comply with the spirit as well as the letter of the regulations.

We are considering whether to ask shareholders to approve a maximum ratio of variable to fixed pay at 2:1, rather than the default ratio of 1:1, at the 2014 AGM. As the legislation is now in force, we are reviewing how best to structure remuneration arrangements that are both compliant and aligned with shareholders' interests. The Board will agree its final position in light of emerging market practice and details of any proposals will be contained in the Letter to Shareholders prior to the AGM.

### New Share Plan

At the 2014 AGM we will seek approval for the RBS 2014 Employee Share Plan. This will replace the Deferral Plan which expires in December 2014 and the Long Term Incentive Plan. Further details will be set out in the Letter to Shareholders.

### Review of year and Group performance

Further progress was made in the run down of Non-Core during 2013. Our balance sheet and capital levels indicate how far RBS has come in building a safe and sustainable foundation. From a strategic point of view, progress was also made in re-shaping the Markets business, selling a further stake in Direct Line Group, agreeing a pre-IPO investment of the Williams and Glyn branches and bringing forward the IPO of Citizens. However, I won't shy away from the fact that overall it's been a tough year for RBS in terms of financial performance. Results in certain divisions have been disappointing and revenue growth is not what we would like it to be at this point in our recovery.

The regulatory landscape and increasing capital requirements have an impact on our returns to shareholders and, in turn, this must be reflected in our returns to employees. The Committee considers all these factors when determining appropriate reward levels.

### Performance considerations for 2013

- Group Operating Profit, excluding the impact of RBS Capital Resolution (RCR) of £2,520 million, a reduction of 15% on 2012.
- Loss before tax of £8,243 million, due in part to the impact of RCR which will help to remove uncertainty associated with legacy issues.

- Markets division making strategic progress, staff costs are down 19% and RWAs are down 36%.
- Core Tier 1 capital ratio improved to 10.9% from 10.3% at the end of 2012.
- Reduction in Non-Core assets to £28 billion.
- RBS offered £58.5 billion of loans and facilities to UK businesses in 2013 of which £31.5 billion was to SMEs. RBS also helped UK companies, universities and housing associations to raise £24.7 billion through bond issues in 2013.
- Employee engagement is strong and clear evidence that key values are being embedded across the Group.

#### Decisions made on pay

- Full details of decisions for both current and former directors are set out in this report.
- Ross McEwan's salary on appointment as Group Chief Executive represented a 17% reduction to his predecessor.
- In line with existing policy, Ross McEwan will receive a long-term incentive award in March 2014.
- Nathan Bostock has announced his departure and all outstanding share awards will lapse.
- Total compensation, both on an overall and per employee level, has been reduced for 2013.
- Total variable compensation reduced again for 2013, down 15% at a Group level and 17% for Markets compared to 2012. This includes a £25 million reduction as part of the committed LIBOR related actions.
- Total Group variable compensation as a percentage of operating profit (pre-RCR and before variable compensation), a key ratio, has remained at 19%.
- The proportion of deferred variable compensation delivered in shares has increased significantly for 2013, representing 63% for Group and 81% for Markets. Further details on the bonus pool can be found in Note 3 to the accounts on page 389.
- Incentive awards continue to be targeted towards high performers. 43% of employees who are eligible will not receive a bonus.

## Directors' Remuneration Report

- Of those employees who do receive an award, 47% will receive £2,000 or less and 70% will receive less than £5,000.
- Any awards above £25,000 will be delivered 100% in shares and deferred over a three year period.
- Average salary increases made across the business in 2014 will be less than 2%.

In conclusion, I believe our decisions on pay take account of performance while giving us the flexibility to attract and retain the expertise needed to build for the future. The Committee continues to receive valuable and independent advice from PwC and I would like to thank my fellow Committee members and those who support the Committee for their insight and guidance during another eventful year. I am also greatly encouraged by the willingness of shareholders to engage constructively in the pay debate and grateful for their support.

Following the publication of the Parliamentary Commission on Banking Standards report in June 2013 and the announcement from the Prudential Regulation Authority (PRA) that they intend to consult on a revised Remuneration Code in 2014, it is likely that remuneration will continue to be an important part of the agenda facing banks in the year ahead. We welcome any developments that help to make banks safer and ensure fair returns for both shareholders and employees.

RBS is a major UK employer and, as a bank playing a key role in the economic recovery, we understand the importance of getting our pay decisions right. We are committed to a high level of transparency and I believe the new reporting and voting requirements that apply to this year's remuneration report can add to this process.

My closing message is simple. Pay must align with the long-term strategy and be cut when performance disappoints. This is what RBS is doing. I hope shareholders find this year's report helpful and feel able to support the proposals at the AGM.

Penny Hughes  
Chair of the Group Performance and Remuneration Committee  
26 February 2014

## Directors' Remuneration Policy

## Directors' Remuneration Policy

## Future policy table for executive directors (EDs)

## Fixed pay elements

To provide a level of competitive remuneration for performing the role with less reliance on variable pay in order to discourage excessive risk-taking and with partial delivery in shares to align with long-term shareholder value.

| Element of pay        | Purpose and link to strategy  | Operation   | Maximum potential value   | Performance metrics and period   |
|-----------------------|---|---|---|--|
| Base salary           | To aid recruitment and retention of high performing individuals whilst paying no more than is necessary. To provide a competitive level of fixed cash remuneration, reflecting the skills and experience required, and to discourage excessive risk-taking. | <p>Paid monthly and reviewed annually.</p> <p>The rates for 2014 are as follows:<br/>           Group Chief Executive - £1,000,000<br/>           Group Finance Director - £765,000</p> <p>Further details on remuneration arrangements for the year ahead are set out on pages 85 to 87 of the annual report on remuneration.</p>  | <p>Determined annually.</p> <p>Any future salary increases will be considered against peer companies and will not normally be greater than the average salary increase for RBS employees over the period of the policy.</p> | <p>No performance conditions are directly applicable although any future salary increases will take into account performance rating during the year.</p> |
| Fixed share allowance | To provide fixed pay that reflects the skills and experience required for the role. This will be delivered in shares and held for the long term.  | <p>A fixed allowance, paid entirely in shares. Individuals will receive shares that vest immediately subject to any deductions required for tax purposes and a retention period will apply. Shares will be released in equal tranches over a five year period. The fixed share allowance will be paid in arrears, initially at six monthly intervals, and in the event of termination, only in respect of service completed(1).</p> | <p>An award of shares with an annual value of up to 100% of salary at the time of award.</p> <p>The fixed share allowance is not pensionable.</p>   | N/A  |
| Benefits              |   |   |   | N/A  |

|         |  |  |  |
|---------|--|--|--|
|         | <p>To provide a range of flexible and market competitive benefits to further aid recruitment and retention of key individuals.</p> | <p>A set level of funding is provided and EDs can select from a range of benefits including:</p> <ul style="list-style-type: none"> <li>· Company car</li> <li>· Private medical insurance</li> <li>· Life assurance</li> <li>· Ill health income protection</li> </ul> <p>Also entitled to use of a car and driver on company business and standard benefits such as holiday and sick pay.</p> <p>Further benefits including allowances when relocating from overseas may be provided to secure the most suitable candidate for the role.</p> | <p>Set level of funding for benefits (currently £26,250) which is subject to review.</p> <p>Further benefits such as relocation allowances and other benefits (e.g. tax advice, housing and flight allowances and payment of legal fees) may be offered in line with market.</p> <p>The value of benefits paid will be disclosed each year in the annual report on remuneration.</p> |
| Pension | <p>To encourage planning for retirement and long-term savings.</p>   | <p>Provision of a monthly cash pension allowance based on a multiple of salary.</p> <p>Opportunity to participate in a defined contribution pension scheme.</p>  | <p>Pension allowance of N/A 35% of salary.</p>   |

Note:

(1) The company believes that delivery in shares is the most appropriate construct for a fixed allowance to executive directors, qualifying as fixed remuneration for the requirements imposed under CRD IV. If regulatory requirements emerge that prohibit any such allowances being delivered in shares, then the company reserves the right to provide the value of the allowance in cash instead in order to comply.



## Directors' Remuneration Policy

## Variable pay

To further incentivise superior long-term performance, with rewards aligned with shareholders and adjusted for risk, based on the achievement of stretching performance measures.

| Element of pay                           | Purpose and link to strategy  | Operation  | Maximum potential value   | Performance metrics and period   |
|--|---|--|---|--|
| Variable pay award (long-term incentive) | <p>To support a culture where good performance against a full range of measures will be rewarded. To incentivise the delivery of stretching targets in line with the Strategic Plan. The selection of performance metrics will be closely aligned with Key Performance Indicators.</p> <p>Performance is assessed against a range of financial and non-financial measures to encourage superior long-term value creation for shareholders.</p> <p>Delivery in shares with the ability to clawback further supports longer-term alignment with shareholders.</p> | <p>Any variable pay award made will be delivered in the form of a long-term incentive, paid in shares (or in other instruments if required by regulators) and subject to a combination of time deferral and performance-based requirements. A minimum three year performance period will apply.</p> <p>As a minimum, shares will be subject to deferral and retention periods as required under the PRA Remuneration Code.</p> <p>The award will have an overall five year vest period, vesting in equal tranches in years four and five.</p> <p>Provision for clawback prior to and post vesting of awards.</p> <p>The award will be delivered under the RBS 2014 Employee Share Plan, subject to shareholder approval at the 2014 AGM.</p> | <p>The maximum level of award is subject to any limit on the ratio of variable to fixed pay as required by regulators. If shareholder approval is sought and obtained at the 2014 AGM, this will be 200% of fixed pay (i.e. base salary, fixed share allowance, benefits and pension). For these purposes awards will be valued in line with the European Banking Authority rules, including any available discount for long-term deferral.</p> <p>Our intention is that awards for executive directors will be maintained at a maximum of 300% of base salary in line with past practice(1).</p> <p>The vesting level of the award could vary between 0% and 100% dependent on the</p> | <p>Any award made will be subject to future performance conditions over a minimum three year period.</p> <p>Typical measures may fall under the following categories (weighted 25% each):</p> <ul style="list-style-type: none"> <li>·Economic Profit</li> <li>·Relative Total Shareholder Return (TSR)</li> <li>·Safe and Secure Bank</li> <li>·Customers and People</li> </ul> <p>A financial and risk performance underpin provides discretion to vary the vesting outcome if the Committee considers this does not reflect underlying performance.</p> <p>These or similar measures and weightings will be applied to reflect the strategy going forward.</p> <p>Details of the award and performance measures for each year will be set out in the annual report on remuneration.</p> |

achievement of  
performance  
conditions.  
Between 20% -  
25% will vest at  
threshold for each  
performance  
measure.

Note:

(1) In the event that shareholder approval is not sought or obtained for the 2:1 cap, corresponding adjustments will be made to ensure that executive directors remain within the variable to fixed limit.

## Directors' Remuneration Policy

## Other pay elements

| Element of pay            | Purpose and link to strategy  | Operation  | Maximum potential value   | Performance metrics and period     |
|---------------------------|---|--|---|------------------------------------|
| Shareholding requirements | To ensure EDs build and continue to hold a significant shareholding to align interests with shareholders. | A period of five years is allowed in which to build up shareholdings to meet the required levels.<br><br>Any unvested share awards are excluded in the calculation.  | Group Chief Executive - 250% of salary.<br><br>Other EDs - 125% of salary.<br><br>Requirements may be reviewed and increased in future. | N/A                                |
| All-employee share plans  | An opportunity to acquire RBS shares.   | Opportunity to contribute from salary to the RBS Sharesave and Buy As You Earn Plan.   | Statutory limits imposed by HMRC.   | N/A                                |
| Legacy arrangements       | To ensure RBS can continue to honour payments due to EDs.   | In approving this policy, authority is given to honour any previous commitments or arrangements entered into with current or former directors, including share awards granted under the 2010 Deferral Plan and 2010 Long Term Incentive Plan (LTIP) and awards granted prior to appointment as an executive director that may have different performance conditions aligned with divisional performance. | In line with existing commitments.  | In line with existing commitments. |

## Notes to policy table

- The Committee sets performance targets taking into account the Group's Strategic Plan, financial forecasts and wider non-financial metrics. The performance conditions for variable pay awards made to EDs have been chosen to promote the building of a safer, stronger and more sustainable business. The Committee selects the measures each year after consultation with major shareholders.
- Clawback - An accountability review process is operated that allows the Committee to respond in instances where new information would change the variable pay decisions made in previous years and/or the decisions to be made in the current year. As a result, clawback can be applied to reduce or lapse any unvested awards as well as reducing any current year's variable pay. The Committee will also consider its approach to the operation of post vesting clawback in light of emerging market practice and regulatory requirements. Further details can be found on page 92.
- Remuneration for EDs broadly follows the policy for all employees but with greater emphasis on delivery in shares and a significant element of variable performance-related pay. This is to ensure that total remuneration to EDs is

more aligned with the long-term interests of shareholders and dependent on specific performance measures being met. Further details on the remuneration policy for all employees can be found on page 91 and 92.

Changes for Executive Directors

- EDs will no longer be eligible to receive annual bonuses.
- The new structure outlined in the policy table introduces a fixed share allowance for EDs which will be released in equal tranches over a five year period. However, the Group Chief Executive will not receive a fixed share allowance for 2014.
- Future long-term incentive awards will be subject to an overall five year vest period, with a three year performance period and vesting in equal tranches in years four and five.
- The new structure results in a reduction of 16% of maximum remuneration opportunity, maintaining significant exposure to shares and clawback but with increased holding periods.
- The policy reflects our objective of moderating total remuneration while providing strong alignment with shareholders over the longer-term.

## Directors' Remuneration Policy

| Fees for non-executive directors |   |   |  | Performance metrics and period |
|----------------------------------|---|---|--|--------------------------------|
| Element of pay                   | Purpose and link to strategy  | Operation   | Maximum potential value  |                                |
| Fees                             | <p>To provide a competitive level of fixed remuneration that reflects the skills, experience and time commitment required for the role.</p> <p>No variable pay is provided so that non-executive directors can maintain appropriate independence, focus on long-term decision making and constructively challenge performance of the executive directors.</p> | <p>Fees are paid monthly.</p> <p>The level of remuneration for non-executive directors reflects their responsibility and time commitment and the level of fees paid to directors of comparable major UK companies.</p> <p>Non-executive directors do not participate in any incentive or performance plan.</p> <p>Non-executive directors' fees are reviewed regularly.</p> | <p>The rates for the year ahead are set out in the annual report on remuneration on page 85</p> <p>Any future increases to fees will be considered against non-executive directors at comparable companies and will not normally be greater than the average inflation rate over the period under review, taking into account that any change in responsibilities, role or time commitment may merit a larger increase.</p> <p>Fees have not yet been set for the recently established RCR Board Oversight Committee. Our policy is that additional fees may be paid for new Board Committees provided these are not greater than fees payable for the existing Board Committees as detailed in the annual report on remuneration.</p> | N/A                            |
| Benefits                         | Any benefits offered would be in line with market practice.   | Reimbursement of reasonable out-of-pocket expenses incurred in performance of duties. The Chairman  | The value of the private medical cover provided to the Chairman will be in line with market rates and disclosed in the   | N/A                            |

also receives private annual report on  
medical cover in line remuneration.  
with the scheme rules.

## Directors' Remuneration Policy

### Policy start date

The remuneration policy will be effective from the date of the 2014 AGM, subject to shareholder approval. It is intended that the policy will apply for three years unless changes are required in which case a revised policy will be submitted to shareholders for approval.

### Recruitment remuneration policy

- The approach to recruitment of directors is to consider both internal and external candidates and to pay no more than is required to attract the most suitable candidate for the role.
- The policy on the recruitment of new directors aims to structure pay in line with the framework and quantum applicable to current directors, competitive in a market context and including the components detailed in the policy table, taking into account that some variation may be necessary to secure the preferred candidate.
- Consideration will be given to the skills and experience held by the individual being recruited as well as the incumbent's position. The present circumstances of the company will also be taken into account.
- In the event of an internal promotion, existing contractual commitments can continue to be honoured.
- Any awards granted on recruitment may be made as part of the company's share plans from time to time or under the provisions provided by Section 9.4.2 of the Listing Rules and will need to comply with the requirements of the PRA Remuneration Code. No sign-on awards or payments will be offered over and above the normal buy-out policy to replace awards forfeited or payments foregone. The Committee will seek to minimise buy-outs wherever possible and will seek to ensure they are no more generous than, and on substantially similar terms to, the original awards or payments they are replacing.
- The maximum level of variable pay which may be granted to new executive directors is the same as that applicable to existing executive directors, excluding any buy-out arrangements. Non-executive directors do not receive variable pay. Full details will be disclosed in the next remuneration report following recruitment.

### Discretion

The Committee has certain discretions that allow it, in appropriate circumstances, to vary the remuneration provided to directors. For example, under the LTIP rules and also the proposed RBS 2014 Employee Share Plan, the Committee can determine: whether a leaver would fall into circumstances that would allow awards to vest following leaving; to decide to vest earlier than the normal vesting date; and to vary the pro-rating for time elapsed that would normally apply. Such discretions would only be used in exceptional circumstances to ensure a fair outcome for the director and for shareholders, taking into account the circumstances of departure, the performance of the director and the need to ensure an orderly transition. If discretion is applied in these circumstances then it will be disclosed.

Further discretions include the ability to: treat awards in a range of ways in the event of a change of control; change measures, targets, and adjust awards if major events occur (for example transaction and capital raisings); and make administrative changes to the plan rules.

In addition, the Committee retains discretion to apply clawback to awards and also adjust the vesting outcome in relation to certain long-term incentive awards through the application of a risk underpin. This allows the Committee to reduce or lapse awards if it considers that the vesting outcome does not reflect underlying financial results or if it considers that the results have been achieved with excessive risk.

Consideration of employment conditions  
elsewhere in the company

The Committee retains oversight of remuneration policy for all employees to ensure there is a fair and consistent approach throughout the organisation. This includes the use of deferral and clawback to promote effective risk management and alignment with shareholders. Further details on our remuneration policy for all employees are set out on pages 91 and 92.

While employees are not directly consulted on setting directors' remuneration, consultation on remuneration generally takes place with our social partners, including representatives from UNITE. We continue to pay our permanent employees in the UK at or above the "Living Wage" benchmarks (National and London), and intend to apply for full accreditation. An annual employee opinion survey takes place which includes a number of questions on pay and culture. This includes questions as to whether employees believe they are paid fairly for the work they do, how remuneration at RBS compares to other financial services organisations and how good a job the organisation is doing in matching reward to performance.

Around 34,000 of our employees are shareholders through incentive and all-employee share plans and have the ability to express their views through voting on the Directors' Remuneration Report.



## Directors' Remuneration Policy

| Service contracts and policy on payments for loss of office – directors |  |  |
|---|--|--|
| Provision   | Policy   | Details  |
| Payments for loss of office   | Payment in lieu of notice only   | <p>If either party wishes to terminate an executive director's service contract they are required to give 12 months' notice to the other party.</p> <p>The service contracts do not contain any pre-determined provisions for compensation on termination. The service contracts give RBS the discretion to make a payment in lieu of notice, which is on base salary only (with no payment in respect of any other benefits, including pension) and is released in monthly instalments. During the period when instalments are being paid, the executive director must take all reasonable steps to find alternative work and any remaining instalments will be reduced as appropriate to offset income from any such work.</p>   |
| Treatment of annual and long-term incentives on termination             | Treatment in line with the relevant plan rules as approved by shareholders | <p>Existing annual incentive awards under the Deferral Plan will not normally lapse on termination, unless termination is for Cause (as defined in the rules of the Deferral Plan). The awards will normally continue to vest on the original vesting dates, subject to provisions regarding clawback, competitive activity and detrimental activity.</p> <p>Existing long-term incentive awards normally lapse on leaving unless the termination is for one of a limited number of specified 'good leaver' reasons or the Committee exercises its discretion to prevent lapsing. The Committee may exercise this discretion where it believes this is an appropriate outcome in light of the contribution of the participant and shareholders' interests. Where awards do not lapse on termination, any vesting will normally take place on the original vesting dates, subject to the performance conditions being met and pro-rating to reflect the proportion of the period that has elapsed at the date of termination. Clawback provisions will also apply. These provisions will also apply to variable remuneration delivered under the RBS 2014 Employee Share Plan, subject to shareholder approval at the 2014 AGM.</p> |
| Fixed share allowances  | Treatment in line with the plan rules as approved by shareholders          | Any shares already received under fixed share allowances will not be forfeited on termination but must continue to be held for the original retention periods. In leaver circumstances executive directors will also be eligible to receive a pro-rated fixed share allowance.   |

|  |   |  |
|--|---|--|
| Other provisions   | Standard contractual terms in line with market practice | Contracts include standard clauses covering remuneration arrangements and discretionary incentive plans (as set out in the main policy table above), reimbursement of reasonable out-of-pocket expenses incurred in performance of duties, redundancy terms and sickness absence, the performance review process, the disciplinary procedure and terms for dismissal in the event of personal underperformance or breaches of RBS policies.  |
| Other payments   | Discretionary   | The Committee retains the discretion to make payments (including but not limited to professional and outplacement fees) to mitigate against legal claims, subject to any payments being made pursuant to a settlement or release agreement.  |
| Provisions for non-executive directors (NEDs) and the Group Chairman |   | <p>NEDs do not have service contracts or notice periods although they have letters of engagement reflecting their responsibilities and time commitments. No compensation would be paid to any NED in the event of termination of appointment.</p> <p>Arrangements for the Chairman<br/>Philip Hampton is entitled to receive a cash payment in lieu of notice of 12 months' fees in the event that his appointment is terminated as a result of the majority shareholder seeking to effect the termination of his appointment, or if RBS terminates his appointment without good reason, or if his re-election is not approved by shareholders in General Meeting resulting in the termination of his appointment.</p> |

In accordance with the provisions of the UK Corporate Governance Code, all directors of the company stand for annual election or re-election by shareholders at the company's Annual General Meetings.

## Directors' Remuneration Policy

### Illustration of the potential application of the remuneration policy

- Salary + Benefits + Pensions delivered in cash. The benefits include standard benefit funding as outlined in the policy but exclude exceptional items such as relocation allowances, the value of which will be disclosed in the total remuneration table each year.
- Fixed share allowance = an allowance of 100% of salary, paid in shares and released in equal tranches over a five year period.
- Target = Fixed remuneration and assuming payout of long-term incentive vesting at 45% of maximum (135% of salary).
- Maximum = Fixed remuneration and assuming full payout of long-term incentive vesting at 300% of salary.
- The graphs above illustrate the application of policy to executive directors for the first full year as the Group Chief Executive will not receive a fixed share allowance in 2014.

The charts shown above are for illustration only and do not take into account any share price movement. Any value receivable in respect of long-term incentive awards will depend on performance over the period and the share price when the holding period comes to an end.

### Shareholders views and their impact on remuneration policy

An extensive consultation is undertaken every year with major shareholders including UKFI and other stakeholders on our remuneration approach. The consultation process typically involves inviting our largest shareholders to attend either one-to-one meetings or roundtable sessions with relevant shareholder bodies. A range of topics are discussed including intended remuneration policy for the year ahead and any significant changes. The process takes place in sufficient time for shareholder views to be considered prior to the Committee making any final decisions on remuneration and variable pay awards. Details of shareholder voting on the resolution to approve the last remuneration report can be found in the annual report on remuneration.

In late 2013 and early 2014, meetings took place involving around 20 institutional shareholders and shareholder bodies representing a substantial portion of the non-UKFI shareholding. The topics discussed during the latest consultation included financial performance, determination of pay outcomes for the 2013 performance year, the Board changes, the impact of CRD IV and possible pay arrangements going forward. Shareholders asked wide-ranging questions including the ability to remain market competitive, the accountability review process, retaining and motivating employees through periods of change and the use of performance measures for long-term incentive awards.

The reaction to the consultation process was positive and allowed the Committee to gain valuable insight into areas that shareholders were likely to support and those areas of concern. There was general support for the possible use of role-based allowances for the small number of employees impacted by the cap imposed under CRD IV. Payment of any allowances in arrears, with delivery in shares for more senior roles and with deferral, were viewed as positive features. Many shareholders also welcomed the discontinuation of annual bonus arrangements for executive directors but stressed the need to ensure sufficient variable pay was available for performance adjustment and clawback. The move to a five year overall timeframe for future long-term incentive awards was also viewed favourably. Overall,

there was continuing support for simple and transparent pay structures.

A number of shareholders cautioned that legal advice should be obtained to confirm that the proposed pay arrangements complied with the requirements of CRD IV. The Committee responded to these concerns by obtaining independent legal advice. Another theme from shareholders was that there should be a demonstrable reduction in remuneration to reflect the benefits of pay certainty for the participants.

Some shareholders asked for the level of reduction in total compensation opportunity and rationale to be clearly explained. As set out in this report, annual bonus awards have been discontinued for executive directors. A fixed share allowance will be introduced that will deliver up to 100% of salary in shares to be released in equal tranches over a five year period. The new structure results in a reduction of 16% of maximum remuneration opportunity and still maintains alignment in shares and with longer holding periods.

Shareholders continue to play a vital role in developing remuneration practices that support the long-term interests of the business and the Committee is grateful and greatly encouraged by their involvement in the process.

## Annual report on remuneration

## Annual report on remuneration

## Total remuneration paid to directors

The sections as indicated on pages 79 to 84 have been audited.

## Total remuneration for executive directors (£000s) (audited)

|                    | Former directors   |       |                    |       | Current directors |      |                    |      |
|--------------------|--------------------|-------|--------------------|-------|-------------------|------|--------------------|------|
|                    | Stephen Hester (1) |       | Bruce Van Saun (2) |       | Ross McEwan (3)   |      | Nathan Bostock (3) |      |
|                    | 2013               | 2012  | 2013               | 2012  | 2013              | 2012 | 2013               | 2012 |
| Salary             | 900                | 1,200 | 570                | 750   | 250               | —    | 191                | —    |
| Benefits (4)       | 20                 | 26    | 74                 | 134   | 40                | —    | 7                  | —    |
| Pension            | 315                | 420   | 348                | 436   | 88                | —    | 67                 | —    |
| Annual bonus       | —                  | —     | —                  | 980   | —                 | —    | —                  | —    |
| LTIP (5)           | —                  | —     | —                  | —     | —                 | —    | —                  | —    |
| Total remuneration | 1,235              | 1,646 | 992                | 2,300 | 378               | —    | 265                | —    |

## Notes:

- (1) Stephen Hester stepped down from the Board on 30 September 2013 and did not receive any annual bonus entitlement for the 2013 performance year. See page 82 for details of termination arrangements and payment in lieu of notice.
- (2) Bruce Van Saun stepped down from the Board on 30 September 2013 to become CEO and Chairman of RBS Citizens Financial Group and Head of RBS Americas. Mr Van Saun also stepped down as a non-executive director of Direct Line Insurance Group plc and Worldpay (Ship Midco Limited), for which he did not receive any fees. He is a non-executive director of Lloyd's of London Franchise Board for which he received fees of £51,750 for the period to 30 September 2013. The amounts included in the table in respect of Mr Van Saun's pension relates to contributions that would have been made to his Unfunded Unapproved Retirement Benefit Scheme ("UURBS") (if it had been funded) comprising a pension allowance of 35% of salary, together with additional amounts through a salary sacrifice arrangement plus an investment return at a rate of 4.7% for 2013 (6.2% for 2012).
- (3) Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013 and the table reflects their pay for the period as Group Chief Executive and Group Finance Director respectively since appointment.
- (4) Benefits figure includes standard benefit funding of £26,250 per annum with the remainder being relocation expenses provided to Bruce Van Saun (housing allowance) and Ross McEwan (housing and flight allowances).
- (5) The zero value reflects awards granted to executive directors under the Long-term Incentive Plan in 2010 that did not vest in May 2013. See page 81 for details of subsequent LTIP assessments.

## Chairman and non-executive directors' remuneration (£000s) (audited)

Remuneration of non-executive directors, excluding the Chairman, was reviewed in 2013. Basic board fees were last increased in 2008 and Committee fees were last increased in 2010. It was recognised that time commitment at RBS had increased significantly over the period. This increased time commitment was due to a number of factors including an intense regulatory agenda, the extended remit of Board Committees, wider engagement with the business and the executive team and efforts to drive cultural change. Consideration was also given to evidence of market increases in Board fees over the period. For the current non-executive directors, the Board, excluding non-executive directors, approved a revised fee structure applicable from 1 April 2013 as set out on page 85.

| Board and Benefits and | 2013 Total | 2012 Total |
|------------------------|------------|------------|
|------------------------|------------|------------|

|                                | Committee fees | other fees |     |     |
|--------------------------------|----------------|------------|-----|-----|
| Philip Hampton (1)             | 750            | 1          | 751 | 750 |
| Sandy Crombie                  | 186            | —          | 186 | 150 |
| Alison Davis                   | 132            | —          | 132 | 114 |
| Tony Di Iorio (2)              | 136            | —          | 136 | 128 |
| Robert Gillespie (3)           | 7              | —          | 7   | n/a |
| Penny Hughes                   | 154            | —          | 154 | 150 |
| Brendan Nelson                 | 164            | —          | 164 | 150 |
| Baroness Noakes                | 136            | —          | 136 | 124 |
| Philip Scott                   | 164            | —          | 164 | 150 |
| Former non-executive directors |                |            |     |     |
| Joe MacHale (4)                | 49             | —          | 49  | 133 |
| Art Ryan (5)                   | 80             | —          | 80  | 93  |

## Notes

- (1) Philip Hampton is entitled to private medical cover and the value is shown in the benefits column.
- (2) Tony Di Iorio became a non-executive director of RBS Citizens Financial Group, Inc on 15 January 2014, the fees for which will be reported in future years.
- (3) Robert Gillespie was appointed to the Board with effect from 2 December 2013.
- (4) Joe MacHale retired from the Board with effect from 14 May 2013. Board Committee fee included membership of the Asset Protection Scheme Senior Oversight Committee.
- (5) Art Ryan is a non-executive director of RBS Citizens Financial Group, Inc. for which he received fees of US\$131,000 for the period to 30 September 2013, the date he retired from the Group Board.

There have been no payments made to non-executive directors for loss of office.

## Annual report on remuneration

## Total Pension Entitlements – Bruce Van Saun (audited)

Mr Van Saun's UURBS operates as a cash balance plan. The rate of return on the accrued fund is determined annually by the Committee to reflect a long-term low risk investment return on an unsecured basis. For 2013 this rate was 4.7%. His accrued entitlement at the year end is shown below. There is no provision for any additional benefit on early retirement.

|   | 2013  | 2012  |
|---|-------|-------|
|   | £000s | £000s |
| Balance at 1 January 2013                                   | 682   | 246   |
| Aggregate contributions that would have been made if funded | 306   | 408   |
| Investment return   | 42    | 28    |
| Total value of fund at 31 December 2013                     | 1,030 | 682   |

## Executive directors' annual bonus for 2013 (audited)

The normal maximum that could be paid to executive directors under the annual bonus arrangements for 2013 is 200% of salary. The table below sets out the outcome for the 2013 performance year.

## Stephen Hester

As part of the exit arrangements detailed on page 82, no annual bonus award is payable to Stephen Hester for 2013.

## Bruce Van Saun

As announced on 27 January 2014, no bonus award will be payable to executive directors or members of the 2013 Executive Committee in respect of 2013 performance.

## Ross McEwan

Ross McEwan indicated he did not wish to be considered for an annual bonus in respect of his Group Chief Executive role in 2013 or 2014. As announced on 27 January 2014, no bonus award will be payable in respect of the UK Retail role that Mr McEwan undertook during 2013.

## Nathan Bostock

Following announcement of his departure, no annual bonus is payable to Nathan Bostock.

## Executive directors' LTIP awards granted in 2010 – final assessment of performance outcome (audited)

| Performance measure      | Performance requirements   | Vesting outcome  |
|--------------------------|--|--|
| Economic profit<br>(50%) | Maximum vesting triggered by early delivery of Core business profitability, well ahead of the range implied by the published Strategic Plan targets and also in excess of the cost of capital. | The LTIP awarded in 2010 was due to vest in May 2013. The number of shares under award is set out in the table on page 83. |
| Relative TSR<br>(25%)    | 20% vesting if TSR is at the median rising to 100% vesting if TSR is at the upper quartile of the companies in the comparator group.   | Awards did not vest in May 2013 as a result of the threshold performance requirements not being met and the awards lapsed. |
| Absolute TSR<br>(25%)    | 20% vesting if RBS share price reaches £5.75.<br>100% vesting if RBS share price reaches £7.75.  |  |

## Share plan interests awarded under the LTIP during 2013 (audited)

| Grant date | Face value of | Performance |
|------------|---------------|-------------|
|------------|---------------|-------------|

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|                |              | award (£000) | Number of shares awarded | % that would vest at threshold and maximum                    | requirements   |
|----------------|--------------|--------------|--------------------------|---|--|
| Stephen Hester | 8 March 2013 | 3,600        | 1,164,295                |   | Conditional share awards subject to stretching performance conditions over a three year period ending on the third anniversary of the grant date, as detailed below.                             |
| Bruce Van Saun | 8 March 2013 | 2,250        | 727,685                  | Vesting between 0% - 100% with 20% - 25% vesting at threshold |  |
| Ross McEwan    | 8 March 2013 | 2,153        | 696,152                  |   |  |
| Nathan Bostock | 8 March 2013 | 2,500        | 808,539                  |   | The LTIP award granted to Ross McEwan will be assessed based on 12 months against the targets applicable as CEO UK Retail and 24 months against the targets applicable as Group Chief Executive. |

Notes:

The number of shares awarded is based on a multiple of salary and the award price is calculated based on the average share price over five business days prior to the grant date of £3.092

In addition to performance conditions, all awards are subject to clawback provisions prior to vesting and a six month retention period post vesting in line with the PRA Remuneration Code.

The treatment of outstanding LTIP awards held by Stephen Hester is detailed under the Payments for loss of office section.

The LTIP award held by Nathan Bostock has been lapsed following notification that he will be leaving the Group.



## Annual report on remuneration

## Performance conditions for outstanding LTIP awards granted to executive directors in 2011, 2012 and 2013 – current assessment

Awards are due to vest in 2014 to 2016. An assessment of performance of each relevant element is provided by the control functions and PwC assesses relative TSR performance. The Committee determines overall vesting based on these assessments including consideration of the drivers of performance and the context against which it was delivered. The assessment is analytical and if any discretion is used in the final assessment, it will be explained. The table below represents an early indication of potential vesting outcomes only.

| Performance measure       | Weighting | Rationale  | Vesting   | 2011 LTIP Current assessment of performance  | 2012 and 2013 LTIP Current assessment of performance   |
|---------------------------|-----------|--|---|--|--|
| Core Bank economic profit | 25%       | Ensures that performance reflects risk adjusted enduring earnings.                                     | Threshold: 25% vesting for meeting minimum economic profit targets.<br><br>Maximum: 100% vesting for performance ahead of the Strategic Plan.   | Continued difficult conditions mean that the economic profit target has not been met.  | Excluding the impact of the 2013 RCR action performance is currently broadly in line with expectations. The Committee notes the impact of the RCR impairment and will determine at the point of vesting how this should be taken into account. |
| Relative TSR              | 25%       | Ensure alignment with shareholders.  | Threshold: 20% vesting if TSR is at median of the comparator group.<br>Maximum: 100% vesting if TSR is at upper quartile of the comparator group.<br><br>Pro rata vesting in between. | Based on share price performance up to 31 December 2013, the threshold target is unlikely to be met by the vesting date.                       | Based on share price performance up to 31 December 2013, the threshold targets have not yet been met.  |
| Balance sheet and risk    | 25%       | Ensure alignment with the advancement of the strategic position and capability of the organisation and | Vesting will be qualified by Committee discretion. Indicative vesting levels are:   | All targets – including Non-Core run down, Core Tier 1 capital, wholesale funding, liquidity, leverage ratio, loan to deposit ratio and funded | Majority of Balance Sheet and Risk measures are currently on track or ahead of target.   |

|                     |     |   |  |   |  |
|---------------------|-----|---|--|---|--|
| Strategic Scorecard | 25% | the building of a sustainable business. | <ul style="list-style-type: none"> <li>· Over half of objectives not met: 0%;</li> <li>· Half of objectives met: 25%;</li> <li>· Two-thirds of objectives met: 62.5%; and</li> <li>· Objectives met or exceeded in all material respects: 100%.</li> </ul> | <p>assets - have been met or exceeded. Credit rating condition was not met, but given over-achievement on other measures, the Committee determined that the Balance Sheet and Risk element would vest in full.</p> <p>For the Strategic Scorecard, the cost:income ratio target has been missed driven by income shortfall. Overall the Committee determined that fewer than half of the objectives have been met and also took into account the extent of the shortfall on cost:income ratio and determined that this element should not vest.</p> | <p>Cost:income ratio remains challenging to achieve largely due to market-driven income pressures. Positive performance to date on some of the other Strategic Scorecard measures would result in some level of vesting for this element if continued over the performance period.</p> |
|                     |     |   |  |   |  |

In respect of the 2011 LTIP award which is due to vest on 7 March 2014, the latest performance assessment by the Committee indicates a vesting level for executive directors of 27% of the original number of shares under award. The Committee also received advice that BRC and the Group's risk management function is satisfied that risk performance of the Group has adversely impacted the Economic Profit and TSR outcomes and consequently no further adjustment is required to the proposed vesting level.

## Annual report on remuneration

## Payments to past directors (audited)

No payments were made to former directors during the year ended 31 December 2013.

## Payments for loss of office (audited)

## Stephen Hester

Stephen Hester stepped down from the Board on 30 September 2013 and, in line with his contractual arrangements, he received the following payments in lieu of 12 months' notice.

|          |            |
|----------|------------|
| Salary   | £1,200,000 |
| Benefits | £26,244    |
| Pension  | £420,000   |
| Total    | £1,646,244 |

Stephen Hester also received payment in lieu of five days accrued holiday, a nominal amount (£100) in respect of an undertaking to provide ongoing assistance to RBS with any investigations or claims and a commitment to pay directly to his lawyers legal fees of £23,000 + VAT incurred in connection with his departure. He did not receive any annual bonus award for 2013.

The Committee exercised discretion under the LTIP rules to allow unvested awards to continue subject to time pro-rating and performance assessment. The Committee believed this was an appropriate use of discretion in the circumstances recognising the significant contribution made by Stephen Hester over the period and his willingness to assist in an orderly handover period. The performance conditions will be assessed by the Committee at the end of the relevant performance periods in line with the LTIP rules. Stephen Hester and the Committee agreed that the maximum number of shares available for vesting under outstanding LTIP awards would be capped at 65% after the application of time pro-rating. The maximum number of shares available for vesting is therefore as follows:

|   |           |
|---|-----------|
| Unvested LTIP shares at departure                     | 3,461,886 |
| Shares remaining after time pro-rating                | 2,064,638 |
| Max number of time pro-rated shares capped at 65% (1) | 1,342,014 |

Note:

(1) The actual number of shares will depend on performance assessment and may be less.

## Bruce Van Saun

Bruce Van Saun stepped down from the Board on 30 September 2013 and became CEO and Chairman of RBS Citizens Financial Group and Head of RBS Americas. He continues to be employed within RBS and therefore no termination payment was made in connection with this change of role.

## Directors' interests in shares and shareholding requirements (audited)

The target shareholding level for the Group Chief Executive is 250% of salary and 125% of salary for other executive directors and members of the Executive Committee, in each case excluding any unvested share awards in the calculation. A period of five years is allowed in which to build up shareholdings to meet the required levels.

As at 31 December 2013 (or date of cessation if earlier)

|  |             |          |
|--|-------------|----------|
|  | % of issued | Value(1) |
|--|-------------|----------|

|                   | Shares beneficially owned | share capital | (£)       | % of shareholding requirement met | Unvested LTIP awards (subject to performance conditions) | Unvested Deferral Plan awards |
|-------------------|---------------------------|---------------|-----------|-----------------------------------|--|-------------------------------|
| Stephen Hester    | 761,218                   | 0.01227       | 2,740,385 | 91%                               | 2,064,638  | —                             |
| Bruce Van Saun    | 148,421                   | 0.00239       | 501,663   | 49%                               | 2,163,680  | 466,947                       |
| Ross McEwan       | 516,336                   | 0.00832       | 1,745,216 | 70%                               | 1,259,081  | 56,395                        |
| Nathan Bostock    | 375,969                   | 0.00606       | 1,270,775 | 133%                              | 2,151,234  | 289,536                       |
| Philip Hampton    | 27,630                    | 0.00045       |           | n/a                               |  |                               |
| Sandy Crombie     | 20,000                    | 0.00032       |           | n/a                               |  |                               |
| Alison Davis      | 20,000                    | 0.00032       |           | n/a                               |  |                               |
| Tony Di Iorio (2) | 30,000                    | 0.00048       |           | n/a                               |  |                               |
| Robert Gillespie  | nil                       | —             |           | n/a                               |  |                               |
| Penny Hughes      | 562                       | 0.00001       |           | n/a                               |  |                               |
| Joe MacHale       | 28,431                    | 0.00046       |           | n/a                               |  |                               |
| Brendan Nelson    | 12,001                    | 0.00019       |           | n/a                               |  |                               |
| Baroness Noakes   | 21,000                    | 0.00034       |           | n/a                               |  |                               |
| Art Ryan          | 5,000                     | 0.00008       |           | n/a                               |  |                               |
| Philip Scott      | 50,000                    | 0.00081       |           | n/a                               |  |                               |

## Notes:

- (1) Value is based on the share price at 31 December 2013, which was £3.38 other than for Stephen Hester where the value is based on the share price of £3.60 at 30 September 2013, the date he stepped down from the Board. During the year ended 31 December 2013, the share price ranged from £2.66 to £3.85.
- (2) Tony Di Iorio's interests in the company's shares are held in the form of American Depository Receipts (ADRs). Each ADR represents 2 ordinary shares of £1.00 each in the company. Tony Di Iorio has interests in 15,000 ADRs representing 30,000 ordinary shares

In line with the requirements of the PRA Remuneration Code and the RBS Staff Dealing Rules, executive directors must not engage in any personal hedging strategies to lessen the impact of a reduction in value of unvested share awards, for example if the RBS share price goes down. No other current director had an interest in the company's ordinary shares during the year or held a non-beneficial interest in the shares of the company at 31 December 2013, at 1 January 2013 or date of appointment if later. The interests shown above include connected persons of the directors. As at 26 February 2014, there were no changes to the directors' interests in shares shown in the table above.

## Annual report on remuneration

## Directors' interests under the Group's share plans (audited)

## Long-Term Incentive Plan (LTIP) awards

Awards to executive directors under the LTIP are structured as conditional rights to receive shares and are subject to performance conditions and clawback provisions prior to vesting.

|                      | Awards held<br>at<br>1 January<br>2013 (or date<br>of<br>appointment<br>if later) | Awards<br>granted<br>in 2013 | Award<br>price<br>£ | Awards<br>lapsed<br>in 2013 | Awards held<br>at<br>31<br>December<br>2013<br>(or date of<br>cessation) | End of period for<br>qualifying<br>conditions<br>to be fulfilled |
|----------------------|---|------------------------------|---------------------|-----------------------------|--|--|
| Stephen Hester (2)   | 857,843   |                              | 4.90                | 857,843                     | —  | —  |
|                      | 1,011,417   |                              | 4.45                | 56,189                      | 955,228  | 07.03.14   |
|                      | 1,286,174   |                              | 2.80                | 500,179                     | 785,995  | 09.03.15   |
|                      |   | 1,164,295                    | 3.09                | 840,880                     | 323,415  | 08.03.16   |
|                      | 3,155,434   | 1,164,295                    |                     | 2,255,091                   | 2,064,638(1)   |  |
| Bruce Van Saun (2)   | 518,280   |                              | 4.90                | 518,280                     | —  | —  |
|                      | 632,136   |                              | 4.45                |                             | 632,136  | 07.03.14   |
|                      | 803,859   |                              | 2.80                |                             | 803,859  | 09.03.15   |
|                      |   | 727,685                      | 3.09                |                             | 727,685  | 08.03.16   |
|                      | 1,954,275   | 727,685                      |                     | 518,280                     | 2,163,680  | 07.06.14   |
| Ross McEwan (3)      | 562,929   |                              | 2.14                |                             | 562,929(4)   | -07.08.15  |
|                      | 696,152   |                              | 3.09                |                             | 696,152  | 08.03.16   |
|                      | 1,259,081   |                              |                     |                             | 1,259,081  |  |
| Nathan Bostock (3,5) | 449,519   |                              | 4.45                |                             | 449,519  | 07.03.14   |
|                      | 893,176   |                              | 2.80                |                             | 893,176  | 09.03.15   |
|                      | 808,539   |                              | 3.09                |                             | 808,539  | 08.03.16   |
|                      | 2,151,234   |                              |                     |                             | 2,151,234  |  |

## Deferred awards

Awards are structured as conditional rights to receive shares under the RBS 2010 Deferral Plan and are subject to clawback prior to vesting.

|                | Awards held<br>at<br>1 January<br>2013 (or date<br>of<br>appointment<br>if later) | Awards<br>granted<br>in 2013 | Award<br>price<br>£ | Awards<br>vested<br>in 2013 | Market<br>price<br>on<br>vesting<br>£ | Value on<br>Vesting<br>£ | Awards<br>held at<br>31<br>December<br>2013<br>(or date of<br>cessation) | End of period for<br>qualifying<br>conditions<br>to be fulfilled |
|----------------|---|------------------------------|---------------------|-----------------------------|---------------------------------------|--------------------------|--|--|
| Stephen Hester | 229,254   |                              | 4.45                | 229,254                     | 3.06                                  | 701,517                  | —  | —  |
| Bruce Van Saun | 151,544   |                              | 4.45                | 151,544                     | 3.06                                  | 463,725                  | —  | —  |
|                |   | 300,000                      | 2.80                | 150,000                     | 3.06                                  | 459,000                  | 150,000  | 09.03.13 –<br>09.03.14   |

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|                   | (6)             |      |              |           |                                    |
|-------------------|-----------------|------|--------------|-----------|------------------------------------|
|                   | 316,947         | 3.09 |              | 316,947   | 08.03.14 –<br>08.03.15             |
|                   | 451,544 316,947 |      | 301,544      | 466,947   |                                    |
| Ross McEwan       | 56,395          | 3.09 |              | 56,395    | 08.03.14 -<br>08.03.16             |
|                   | 454,106         | 2.14 | 454,106 3.40 | 1,543,960 | — —                                |
|                   | 510,501         |      | 454,106      | 56,395    |                                    |
| Nathan Bostock(5) | 28,657          | 4.45 |              | 28,657    | 07.03.14<br>09.03.14 -<br>09.03.15 |
|                   | 125,045         | 2.80 |              | 125,045   | 08.03.14 -<br>08.03.16             |
|                   | 135,834         | 3.09 |              | 135,834   |                                    |
|                   | 289,536         |      |              | 289,536   |                                    |

Notes:

- (1) Stephen Hester and the Committee agreed that the maximum number of shares available for vesting would be capped at 65% (a total of 1,342,014 shares). The actual number of shares will depend on the performance assessment and may be less.
- (2) Stephen Hester and Bruce Van Saun stepped down from the Board on 30 September 2013.
- (3) Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013.
- (4) This relates to an award made to Ross McEwan on joining RBS as CEO UK Retail in September 2012, in recognition of awards forfeited on leaving Commonwealth Bank of Australia.
- (5) In accordance with the plan rules, Nathan Bostock's outstanding LTIP, Deferred awards and MPP award have subsequently been lapsed and the Executive Share Option will lapse on his final date of employment.
- (6) This relates to a bonus award in respect of the 2012 performance year, awarded in March 2013.

## Annual report on remuneration

## Share options

|                    | Share Plan                  | Options held at 1 January 2013 (or date of appointment if later) |                |                | Options held at 31 December 2013 |                     |
|--------------------|-----------------------------|--|----------------|----------------|----------------------------------|---------------------|
|                    |                             | Number of options  | lapsed in 2013 | Option price £ | Number                           | Exercise period     |
| Nathan Bostock (5) | Executive Share Option Plan | 207,467  | —              | 4.62           | 207,467                          | 17.08.12 – 16.08.19 |
|                    | Sharesave Plan              | 3,556  | 3,556          | 4.34           | —                                | —                   |
|                    |                             | 211,023  | 3,556          |                | 207,467                          |                     |

## Medium-Term Performance Plan (MPP)

|  | Scheme interests (nil cost option) at 1 January 2013 (or date of appointment if later) | Award price £ | Awards exercised in 2013 | Scheme interests (share equivalents) at 31 December 2013 | End of period for qualifying conditions to be fulfilled |
|--|--|---------------|--------------------------|--|---|
|  |  |               |                          |  |   |

For the notes to this table refer to the previous page.

## Total Shareholder Return (TSR) performance

The graph below shows the performance of RBS over the past five years in terms of TSR compared with that of the companies comprising the FTSE 100 Index. This index has been selected because it represents a cross-section of leading UK companies. The TSR for FTSE UK banks for the same period has been added for comparison. The TSR for the company and the indices have been rebased to 100 at 1 January 2009. Source: Datastream

## Historic Group Chief Executive pay over same period

|   | 2009  | 2010  | 2011  | 2012  | 2013(1)                |
|---|-------|-------|-------|-------|------------------------|
| Group Chief Executive single figure of total remuneration (£000s) | 1,647 | 3,687 | 1,646 | 1,646 | 1,235 (SH)<br>378 (RM) |
| Annual variable award against max opportunity                     | 0%    | 85%   | 0%    | 0%    | 0% (SH)<br>0% (RM)     |
| LTIP vesting rates against max opportunity                        | 0%    | 0%    | 0%    | 0%    | 0% (SH)<br>0% (RM)     |

## Note:

(1) Stephen Hester (SH) stepped down from the Board on 30 September 2013 and Ross McEwan (RM) became Group Chief Executive with effect from 1 October 2013.

**Change in Group Chief Executive pay compared to employees**

The table below shows the percentage change in remuneration for the Group Chief Executive between 2013 and 2012 compared with the percentage change in the average remuneration of RBS employees on a global basis. In each case, remuneration is based on salary, benefits and annual bonus. The Group Chief Executive remuneration reflects the change in remuneration arrangements for the new Group Chief Executive with effect from 1 October 2013 compared to the previous Group Chief Executive.

|                       | Salary<br>2013 to 2012 change | Benefits<br>2013 to 2012 change | Annual Bonus<br>2013 to 2012 change |
|-----------------------|-------------------------------|---------------------------------|-------------------------------------|
| Group Chief Executive | (16.7%)                       | —                               | —                                   |
| All employees         | 2.1%                          | 2.1%                            | (16.6%)                             |

## Note:

(1) No bonus was paid to the Group Chief Executive in respect of 2012 or 2013 performance. Standard benefit funding for executive directors remained unchanged between 2012 and 2013. The benefits for the Group Chief Executive excludes the relocation expenses provided to Ross McEwan as part of his recruitment as CEO UK Retail in 2012 and which will last for a set three year period other than an entitlement to two return business class flights which applies from year three onwards. The value of relocation benefits will be disclosed each year in the total remuneration table.



## Annual report on remuneration

## Relative importance of spend on pay

The table below shows a comparison of remuneration expenditure against other disbursements.

|  | 2013  | 2012  |        |
|--|-------|-------|--------|
|  | £m    | £m    | change |
| Remuneration paid to all employees (1)                                 | 6,371 | 7,231 | (12%)  |
| Distributions to holders of ordinary shares                            |       |       |        |
| Distributions to holders of preference shares                          | 398   | 301   | 32%    |
| Taxation and other charges recognised in the income statement:         |       |       |        |
| - Social security and other payments (2)                               | 486   | 562   | (14%)  |
| - Bank levy  | 200   | 175   | 14%    |
| - Corporation tax  | 382   | 441   | (13%)  |
| Other payments made by the Group                                       |       |       |        |
| - Irrecoverable VAT and other indirect taxes suffered by the Group (3) | 714   | 830   | (14%)  |

These measures have been included as they reflect the key stakeholders for the Group and the major categories of disbursements made by the Group to its key stakeholders, including its ordinary and preference shareholders and Governments in the Group's operational territories.

The amounts included above have been calculated in accordance with applicable accounting standards and reflect the amounts included in the Group Income statement and related Notes.

## Notes:

- (1) Remuneration paid to all employees represents total staff expenses per Note 3 to the Financial statements, exclusive of social security and other staff costs.
- (2) Income statement charge for social security costs per Note 3 to the Financial Statements.
- (3) Input VAT and other indirect taxes unable to be recovered by the Group due to it being partially exempt.

## Implementation of remuneration policy in 2014

The information below sets out how RBS intends to implement the policy in 2014.

## Executive directors

|                            | Salary     | Benefits                          | Pension       | Fixed Share Allowance (1) | LTIP award     |
|----------------------------|------------|-----------------------------------|---------------|---------------------------|----------------|
| Group Chief Executive      | £1,000,000 | £26,250 + relocation benefits (3) | 35% of salary | No award in 2014          | 300% of salary |
| Group Finance Director (2) | £765,000   | £26,250                           | 35% of salary | 100% of salary            | 300% of salary |

## Notes:

- (1) Fixed Share Allowance will be payable in arrears and the shares will be released in equal tranches over a five year period.
- (2) The search for a new Group Finance Director is underway and the remuneration package will be consistent with the recruitment policy as set out on page 76.
- (3)

Relocation benefits include housing and flight allowances, the value of which will be disclosed each year in the total remuneration table.

|   |          |
|---|----------|
| Chairman and non-executive directors' fees  |          |
| Chairman  | £750,000 |
| Non-executive Director Group Board  | £72,500  |
| Senior Independent Director   | £30,000  |
| Membership of Group Audit Committee, Board Risk Committee, Group Performance and Remuneration Committee or Group Sustainability Committee               | £30,000  |
| Additional fee to Chair the Group Audit Committee, Board Risk Committee, Group Performance and Remuneration Committee or Group Sustainability Committee | £30,000  |
| Membership of Group Nominations Committee   | £5,500   |

The non-executive directors do not receive any annual bonus payments or variable remuneration.

Annual report on remuneration

2014 Annual objectives for the Group Chief Executive and Group Finance Director

The executive directors' annual objectives, as set out below, are approved by the Committee and reflect the Group's key strategic priorities. The Board Risk Committee has approved the risk and control issues. Note that, as described in the Remuneration Policy section of the report, no annual bonus awards will be payable to executive directors. Nevertheless, the Committee believes that annual objectives are an important part of driving the business strategy and meeting agreed targets.

Core objectives Summary of objectives and targets (1)

Customer & Stakeholder (25%)

- Customer Strategy and Experience - clearly articulate customer strategy; effective customer experience framework and measurement approach.

- Customer Relationships - develop stronger and deeper customer relationships.

- Corporate reputation - enhance and support the company's reputation with all stakeholders.

Financial & Business Delivery (25%)

- Common Equity Tier 1 Ratio - deliver fully loaded Common Equity Tier 1 ratio in line with strategic targets, including successful execution of RCR reduction.

- Return on Equity (2) - improve return on equity through reduction of cost:income ratio; deliver income growth in line with strategic targets.

- Cost:Income Ratio (2) - reduce cost:income ratio in line with strategic targets.

People & Culture (25%)

- Operating Model - deliver first phase of efficient and effective bank-wide operating model.

- Values & Engagement - embed and role model the Group's values, setting the tone from the top, and building the pride and engagement of our people.

- Diversity - promote gender diversity in senior talent pools.

Risk & Control (25%)

- Risk Appetite - further progress on embedding enhanced risk appetite and risk frameworks.

- Governance & Control - maintain an effective control environment and deliver key systems and processes.

- Conduct - embed the agreed conduct risk framework across the business.

- End to End Risk Management Framework - maintain an effective risk management framework across the business.

Notes:

(1) Details of targets that are deemed to be commercially sensitive will be disclosed retrospectively.

(2) Excluding RBS Capital Resolution.



## Annual report on remuneration

## LTIP awards granted in 2014 – Performance criteria

In line with previous practice, awards granted to executive directors in March 2014 will be subject to four equally weighted performance categories, each of which can vest up to 100% of base salary subject to an overall cap of 300% of salary. The performance targets have been reviewed by the Committee and reflect the outcome of the Group's strategic review. In future years, long-term incentive awards will be made under the RBS 2014 Employee Share Plan on the basis of equally stretching measures following consultation with major shareholders and disclosed in the annual report on remuneration. A minimum three year performance period will apply. Any awards that vest will be subject to a minimum six month retention period in line with the PRA Remuneration Code.

## Economic profit (25%)

The Economic Profit measure will be based on the 'go-forward' RBS business to align with the long-term future and earnings for the business. Economic Profit, being a risk-adjusted financial measure, is consistent with the PRA Code and also provides a balance between measuring growth and the cost of capital employed in delivering that growth. Economic Profit is defined as Operating Profit after Tax and preference share charges less attributed equity multiplied by the cost of equity, where

- Operating Profit after Tax is Operating Profit taxed at a standard tax rate.
- Attributed Equity is defined as equity allocated to the businesses, calculated as a function of the businesses risk-weighted asset base.
- Current Cost of Equity is 11.0%, which is subject to review at least annually.

Details of the actual targets, and performance against these, will be disclosed retrospectively once the awards vest.

## Relative Total Shareholder Return (25%)

The relative TSR measure provides a direct connection between executive directors' awards and relative performance delivered to shareholders. The measure compares performance against a group of comparator banks. The comparator group has been changed for the 2014 awards to be more in line with the new strategic direction of RBS. This has involved removing from the comparator group non-European firms, which in particular reduces the exposure of the peer group to US and Markets activity.

## Relative TSR Comparator Group

|  | Weighting |
|--|-----------|
| 1 Barclays   | 200%      |
| 2 Lloyds Banking Group   |           |
| 3 HSBC   | 100%      |
| 4 Standard Chartered<br>BBVA, BNP Paribas, Credit  |           |
| 5 to 13 Agricole, Credit Suisse Group,<br>Deutsche Bank, Santander, Societe<br>Generale, UBS, Unicredito | 50%       |

• 20% of the award will vest if TSR is at the median of the companies in the comparator group

• 100% of the award will vest if TSR is at the upper quartile of the companies in the comparator group

## Safe &amp; Secure Bank (25%)

The Safe & Secure Bank measures have a particular focus on risk reduction and the building of a safer, sustainable franchise. The key measures in this category are Core Tier 1 ratio and Cost Income ratio.

#### Customers & People (25%)

These measures reward management for building a customer-focussed franchise with strength in terms of efficiency, reputation, and the engagement of employees. Net Promoter Score will be used as the primary bank-wide measure for the improvement in customer service, measured versus each segment's defined peer group. Employee engagement will be measured against the Global Financial Services norm.

#### Performance measures and weightings

|                                      |                                      |
|--------------------------------------|--------------------------------------|
| Safe & Secure Bank<br>measures (25%) | Core Tier 1 ratio (12.5%)            |
|                                      | Cost:Income ratio (12.5%)            |
|                                      | Net Promoter Score<br>(12.5%)        |
| Customers & People<br>measures (25%) | Employee Engagement<br>Index (12.5%) |

Commentary will be provided on an annual basis in relation to progress against the targets, where these are not commercially sensitive.

Target ranges will be set for each measure, and will determine vesting, although the overall vesting under the Safe & Secure Bank and Customers & People categories will be qualified by Group Performance and Remuneration Committee discretion taking into account changes in circumstances over the performance period, the margin by which individual targets have been missed or exceeded, and any other relevant factors.

#### Risk underpin and clawback

The Committee will also review financial and operational performance against the business strategy and risk performance prior to agreeing vesting of awards. In assessing this, the Committee will be advised independently by the Board Risk Committee. If the Committee considers that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect underlying financial results or if the Committee is not satisfied that conduct and risk management during the performance period has been effective then the terms of the awards allow for an underpin to be used to reduce vesting of an award, or to allow the award to lapse in its entirety. All awards are subject to clawback.

## Annual report on remuneration

### Consideration of matters relating to directors' remuneration

#### The role and responsibilities of the Committee

The Committee is responsible for setting the policy on remuneration and overseeing its implementation. It reviews performance and makes recommendations to the Board in respect of variable incentive pools and the remuneration arrangements of the executive directors. No director is involved in decisions regarding his or her own remuneration.

The Committee is also responsible for approving remuneration and severance arrangements for members of the Group's Executive and Management Committees and overseeing arrangements for PRA 'Code Staff'. Details of the PRA Remuneration Code can be found at [www.bankofengland.co.uk/pr](http://www.bankofengland.co.uk/pr). A definition of RBS Code Staff along with details of how risk is taken into account in the remuneration process is provided on pages 91 and 92.

The terms of reference of the Group Performance and Remuneration Committee are available on [www.rbs.com](http://www.rbs.com) and these are reviewed at least annually by the Committee and approved by the Board.

### Summary of the principal activity of the Committee during 2013

The Committee considered issues under the accountability review process at every meeting held in 2013 and CRD IV implementation at the majority of meetings held in 2013. Set out below is a summary of other key activities considered by the Committee.

#### First quarter

- 2012 performance reviews and arrangements for members of the Group's Executive and Management Committees, APS in scope employees, Code Staff and high earners. 2013 objectives for the Group's Executive and Management Committee members.

- Approval of Group and Divisional variable pay pools and Directors' Remuneration Report.
- Outcomes of the annual performance evaluation of the Committee.
- Assessment of the performance to date of unvested LTIP awards and performance targets for 2013 awards.
- Consideration of long-term incentive and deferral structure.

#### Second quarter

- Group Chief Executive departure terms and consideration of appointment and remuneration terms for various senior positions.
- Presentations from Markets, Corporate and Ulster Bank on business and strategic priorities and people plans.
- Review of the implementation of the remuneration policy.
- Review of the Committee's agenda planner, Terms of Reference and delegated authorities for individual remuneration governance.
- Terms of Reference for Group Sales and Service Incentives Committee – which considers short term incentive design principles.

Third quarter

- Half year performance reviews for members of the Group's Executive and Management Committees.
- Presentation from Retail on business and strategic priorities and people plans.
- Areas of focus for remuneration strategy.
- Purpose, Vision & Values and reward issues presentation.
- Consideration of the future shape of pay.

Fourth quarter

- 2013 preliminary variable pay pool discussions for Group and Divisions.
- Remuneration Policy Statement for the PRA.
- Update on Group Internal Audit's review of Code Staff processes.
- Share plan rules review update and AGM considerations.
- Update on shareholder consultation undertaken in December 2013 and planned for January 2014.

Performance evaluation process

A thorough internal review of the effectiveness of the Group Performance and Remuneration Committee was conducted during 2013 involving questionnaires and follow-up interviews. The Committee considered the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted.

The review concluded that the Committee continued to operate effectively. Themes that emerged from the evaluation included recognition of the Committee workload and time spent outside of meetings, the ongoing importance of independence, management support and interaction with other Board Committees. Priorities that were identified for 2014 included recruiting an additional member of the Committee and considering how to streamline the agenda to maintain rigorous scrutiny and challenge on key issues. The outcomes of the evaluation have been reported to the Board.

Membership of the Group Performance and Remuneration Committee

All members of the Committee are independent non-executive directors. The Committee held nine scheduled meetings in 2013 and a further seven unscheduled meetings.

|                      | Attended/<br>scheduled |
|----------------------|------------------------|
| Penny Hughes (Chair) | 9/9                    |
| Sandy Crombie        | 9/9                    |
| Alison Davis         | 9/9                    |
| Art Ryan (1)         | 7/7                    |

Note:

- (1) Art Ryan stepped down from the Committee on 30 September 2013





## Annual report on remuneration

### Advisers to the Group Performance and Remuneration Committee

The advisers are appointed independently by the Committee, which reviews its selection of advisers annually. The Committee Chair oversees the fees for the advisers. PricewaterhouseCoopers LLP (PwC) were appointed as the Committee's remuneration advisers on 14 September 2010 following a review of potential advisers, and their appointment was reconfirmed by the Committee in July 2013 after an annual review of the quality of the advice received and fees charged. PwC are signatories to the voluntary code of conduct in relation to remuneration consulting in the UK.

PwC also provide professional services in the ordinary course of business including assurance, advisory, tax and legal advice to RBS subsidiaries. The Committee Chair is notified of other work that is being undertaken by PwC and is satisfied that there are processes in place to ensure that the advice the Committee receives is independent.

As well as receiving advice from PwC in 2013, the Committee took account at meetings of the views of the Chairman, Group Chief Executive, Group Finance Director, Human Resources Director, Head of Reward, the Group Secretary and the Chief Risk Officer. The fees paid to PwC for advising the Committee in relation to directors' remuneration are charged on a time/cost basis and in 2013 amounted to £190,465.

### Statement of Shareholding Voting

The table below sets out the voting by shareholders on the advisory resolution to approve the Directors' 2012 Remuneration Report at the AGM held in May 2013.

| For                        | Against                | Total votes cast | Withheld    |
|----------------------------|------------------------|------------------|-------------|
| 20,058,440,088<br>(99.32%) | 138,246,040<br>(0.68%) | 20,196,686,128   | 148,371,848 |

### Shareholder dilution

During the ten year period to 31 December 2013, awards made that could require new issue shares under the company's share plans represented 4.2% of the company's issued ordinary share capital (including the B share capital), leaving an available dilution headroom of 5.8%. The company meets its employee share plan obligations through a combination of new issue shares and market purchase shares.

Penny Hughes  
Chair of the Group Performance and Remuneration Committee  
26 February 2014

## Other Remuneration Disclosures

## Remuneration of eight highest paid senior executives below Board (1)

All figures shown below are in GBP.

| (£000s)                                      | Executive<br>1 | Executive<br>2 | Executive<br>3 | Executive<br>4 | Executive<br>5 | Executive<br>6 | Executive<br>7 | Executive<br>8 |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Fixed remuneration                           | 639            | 1,352          | 700            | 199            | 463            | 415            | 189            | 350            |
| Annual incentives                            | —              | —              | —              | —              | —              | —              | —              | —              |
| Long-term incentive awards<br>(vested value) | 983            | 978            | 407            | —              | —              | 56             | —              | 114            |
| Total remuneration (2)                       | 1,622          | 2,330          | 1,107          | 199            | 463            | 471            | 189            | 464            |

## Notes

(1) Remuneration earned for period worked in 2013 at RBS for members of Group Executive Committee plus Group HR Director.

(2) Disclosure includes prior year long-term incentive awards which vested during 2013. The amounts shown reflect the value of vested awards using the share price on the day the awards vested.

## Other Remuneration Disclosures

## Our Group-wide Remuneration Policy

The remuneration policy supports the business strategy and is designed to:

- Attract, retain, motivate and reward high-calibre employees to deliver long-term business performance within acceptable risk parameters; and
- Provide clear alignment between annual and long-term targets for individuals and strategic plans

The remuneration policy applies the same principles to all employees including Code Staff (1). The current key principles underpinning the remuneration policy for all employees are set out below.

| Element of pay               | Objective  | Operation   |
|------------------------------|--|---|
| Base salary                  | To attract and retain employees by being competitive in the specific market in which the individual works.                         | Base salaries are reviewed annually and should reflect the talents, skills and competencies that the individual brings to the business.   |
| Role-based allowance         | To provide fixed pay that reflects the skills and experience required for, and the responsibilities of, the role.                  | From 2014 onwards, allowances will be provided to certain employees in key roles and reviewed at appropriate intervals, to reflect the skills, experience and competencies required for the role. They will be delivered in cash and/or shares depending on the level of the allowance and the seniority of the recipient. Shares will be subject to an appropriate retention period, not less than six months.   |
| Benefits (including pension) | To provide a range of benefits and give employees an opportunity to provide for their retirement.                                  | In most jurisdictions, employee benefits or a cash equivalent are provided from a flexible benefits account.  |
| Annual incentives            | To support a culture where employees recognise the importance of serving customers well and are rewarded for superior performance. | <p>The annual incentive pool is based on a balanced scorecard of measures including customer, financial, risk and people measures. Allocation from the pool depends on divisional, functional and individual performance. Individual performance assessment is supported by a structured performance management framework.</p> <p>Guaranteed awards are only used in very limited circumstances in accordance with the PRA Remuneration Code. Immediate cash awards are limited to a maximum of £2,000. Under the deferral arrangements a significant proportion of annual incentive awards for our more senior employees are deferred over a three year period. Deferred awards are subject to clawback. For Code Staff, a minimum 50% of any annual incentive is delivered in the form of RBS shares and subject to an additional six month retention period post vesting. Under the deferral arrangements for the 2013</p> |

performance year, the vast majority of any annual incentive award to Code Staff is delivered in shares.

In certain circumstances, formulaic short-term incentive arrangements are used to align the objectives of employees with the strategy of the relevant division in which they work.

|                            |  |  |
|----------------------------|--|--|
| Long-term incentive awards | To encourage the creation of value over the long term and to align further the rewards of the participants with the returns to shareholders. | <p>RBS provides certain employees in senior roles with long-term incentive awards. Awards are structured as performance-vesting shares. Vesting may occur after a three year period and will typically be based partly on divisional or functional performance and partly on performance across the business.</p> <p>The amount of the award that vests may vary between 0-100% depending on the performance achieved. All awards are subject to clawback and an additional six month retention period applies to Code Staff post vesting.</p> |
| Other share plans          | To offer employees in certain jurisdictions the opportunity to acquire RBS shares.   | Employees in certain countries are eligible to contribute to share plans which are not subject to performance conditions.  |

Note:

- (1) The following groups of employees have been identified as meeting the PRA's criteria for Code Staff:
- Members of the Board and Executive and Management Committees
  - Staff performing a Significant Influence Function within RBS
  - Employees who have approval authorities such that their decision-making could have a material impact on the income statement
  - Employees who are responsible for a business or businesses whose performance could have a material impact on the income statement; and
  - Key control function roles

The RBS Staff Dealing Rules and the conditions attaching to discretionary share-based awards prohibit the use of any personal hedging strategies to lessen the impact of a reduction in value of such awards.

## Other Remuneration Disclosures

### How risk is reflected in our remuneration process

The RBS remuneration policy explicitly aligns remuneration with effective risk management. Focus on risk is achieved through clear risk input into objectives, performance reviews, the determination of variable pools and incentive plan design as well as the application of clawback. The Committee is supported in this by the Group Audit Committee, the Board Risk Committee and the Group's risk management function.

A robust process is used to assess risk performance. A range of measures are considered, specifically the overall Risk Profile, Credit, Regulatory Risk & Conduct Risk, Operational Risk, Enterprise Risk and Market Risk. The steps we take to ensure appropriate and thorough risk adjustment are also fully disclosed and discussed with the PRA and the FCA.

### Variable pay pool determination

The process for determining variable pools is discretionary, to avoid the unintended consequences of formulaic systems. However, the Committee's discretion is applied within a structured framework which starts with an assessment of risk adjusted financial performance measured against budget, prior year capital position and long-term strategic plans. This analysis is used to adjust for performance and then consider outcomes in the context of competitive variable pay funding levels.

Risk is taken into account in the performance assessment through a thorough risk analysis carried out by the Group's risk management function to a pre-agreed framework. Performance assessments may be adjusted in situations where risk performance is outside risk appetite or strategic plans. Financial and non-financial performance factors (including risk) are taken into account in developing a final variable pay proposal. This decision also allows for considerations of market competitiveness and franchise protection.

Variable pay proposals are reviewed in the context of key compensation framework ratios including total compensation to revenue, total compensation to pre-compensation profit, variable pay to pre-variable pay profit and variable pool to pre-variable pool economic profit. These ratios help to ensure appropriate sharing of value between employees and shareholders and aim to provide transparency.

Finally, variable pay proposals are reviewed against our capital adequacy framework to ensure that regulatory requirements are met.

### Accountability review process

Our Accountability Review process is an important tool in how we manage remuneration and manage adjustments to remuneration.

A summary of the accountability review process is as follows:

- Exists to enable RBS to respond in instances where current and/or new information would change the annual bonus and/or LTIP decisions made in previous years, and/or the decisions to be made in the current year.
- The process for review assessments (which consider material risk management, control and general policy breach failures, accountability for those events and appropriate action against individuals) is operated across divisions and functions.

- Divisional reviews are undertaken on a quarterly basis.
-

Decisions must take into account not only any financial losses, but also behavioural issues and reputational or internal costs.

- Clawback may be up to 100% of unvested awards and can be applied regardless of whether or not disciplinary action has been undertaken.
- A key principle is that clawback quantum should not be formulaic.
- Collective responsibility may be considered where a committee or group of employees are deemed to have not appropriately discharged their duties.

How have we applied this in practice?

Variable pay is subject to deferral allowing the Committee scope to apply clawback. The accountability review process is fully embedded and is operated throughout the year. During 2013 a number of issues and events were considered under the accountability review framework.

The outcomes for the 2013 performance year cover a range of actions and have included: forfeiture of unvested awards through clawback; reduction of current year variable pay awards; dismissal; and suspended vesting pending further investigation. The Board Risk Committee concluded that all known key material events had been considered.

The RBS 2014 Employee Share Plan, subject to approval at the 2014 AGM, will allow RBS to apply post-vesting clawback to future awards. The policy for any post-vesting clawback will be considered in light of emerging regulatory requirements and shareholder best practice.

#### Remuneration Code

As part of the annual remuneration governance process we provide details of our approach to pay and how we comply with the Remuneration Code to the PRA and FCA. As in previous years we have received the required regulatory confirmation in order to conclude our year end remuneration process.

## Other Remuneration Disclosures

## Code Staff Remuneration Disclosure

These disclosures are in accordance with the Prudential sourcebook for banks, building societies and investment firms (BIPRU) 11.5.18 (6) and (7).

## 1. Aggregate remuneration expenditure

During the year, there were 342 Code Staff. Aggregate remuneration expenditure was as follows:

| Markets | Rest of RBS<br>Group |
|---------|----------------------|
| £m      | £m                   |
| 78.5    | 135.0                |

## 2. Amounts and form of fixed and variable remuneration

## Fixed remuneration

Consisted of salaries, pensions and benefits paid during the year.

| Senior management | Others |
|-------------------|--------|
| £m                | £m     |
| 56.9              | 42.9   |

## Variable remuneration for 2013 performance

Consisted of deferred awards payable over a three year period. Cash awards were limited to a maximum of £2,000 per employee.

|                                | Senior<br>management | Others |
|--------------------------------|----------------------|--------|
|                                | £m                   | £m     |
| Form of remuneration           |                      |        |
| Variable remuneration (cash)   | 0.2                  | 0.2    |
| Deferred remuneration (bonds)  | 2.4                  | 2.6    |
| Deferred remuneration (shares) | 31.1                 | 51.7   |

## Long-term incentives

Long-term incentive awards made each year are paid three years after the date of award based on the extent to which performance conditions are met and can result in zero payment.

| Senior management | Others |
|-------------------|--------|
| £m                | £m     |
| 18.5              | 6.9    |

## 3. Outstanding deferred remuneration through 2013

The table below includes deferred remuneration awarded or paid out in 2013. Deferred remuneration reduced during the year relates to long-term incentives lapsing when performance conditions are not met, long-term incentives and deferred awards forfeited on leaving and clawback of prior year deferred awards and long-term incentives.

| Category of deferred remuneration | Senior<br>management | Others |
|-----------------------------------|----------------------|--------|
|-----------------------------------|----------------------|--------|



|                                   | £m    | £m    |
|-----------------------------------|-------|-------|
| Unvested from prior year          | 110.0 | 131.7 |
| Awarded during the financial year | 47.9  | 57.6  |
| Paid out                          | 33.0  | 59.4  |
| Reduced from prior years          | 16.8  | 28.6  |
| Unvested at year end              | 107.8 | 98.2  |

#### 4. Sign-on and severance payments

Sign-on awards for guaranteed variable remuneration of £2.6 million are included in the tables above. These relate to commitments on recruitment made in respect of three new employees. No severance payments were made outside of contractual payments related to termination of employment such as pay in lieu of notice and benefits.

#### Notes on the presentation of remuneration

In the relevant tables above, assumptions have been made for the notional value of LTIP (verified by external advisors), forfeitures through resignation for deferred awards and the share price relevant to the date of the event or valuation point has been used.

#### All staff total remuneration

Total remuneration comprises; fixed pay, pension and benefit funding, variable remuneration and long-term incentives.

- The average salary for all employees is £34,000.
- 21,609 employees earn total remuneration between £50,000 and £100,000.
- 9,151 employees earn total remuneration between £100,000 and £250,000.
- 1,730 employees earn total remuneration over £250,000.

#### Total remuneration by band for all

| employees earning       | Number of employees |
|-------------------------|---------------------|
| >£1 million             |                     |
| £1,000,000 - £1,500,000 | 46                  |
| £1,500,001 - £2,000,000 | 14                  |
| £2,000,001 - £2,500,000 | 4                   |
| £2,500,001 - £3,000,000 | 4                   |
| £3,000,001 - £3,500,000 | —                   |
| £3,500,001 - £4,000,000 | 4                   |
| £4,000,001 - £4,500,000 | 1                   |
| £4,500,001 - £5,000,000 | 1                   |
| £5,000,001 - £5,500,000 | —                   |
| £5,500,001 - £6,000,000 | 1                   |

#### Notes:

- (1) Total remuneration includes fixed pay, pension and benefit funding and variable pay (including actual value of LTIP vesting in respect of the performance period ending 2013) after the application of clawback.
- (2) Excludes executive directors.

75 employees earn total remuneration of over £1 million which represent just 0.06% of our employees. This number reduces to 68 employees if we exclude pension and benefit funding.

These employees include those who manage major businesses and functions with responsibility for significant assets, earnings or areas of strategic activity and can be grouped as follows:

- The CEOs responsible for each division.
- Employees directly reporting to the CEO including those managing our functions and other activities of strategic importance.
- Employees managing large businesses within a division such as our Retail and Commercial Businesses in the US or our UK Corporate and Institutional Banking clients.
- Income generators responsible for high levels of income including those involved in managing trading activity and supporting clients with more complex financial transactions, including financial restructuring.
- Those responsible for managing our balance sheet and liquidity and funding positions across the business.
- Employees managing the successful disposal of Non-Core assets and reducing RBS's capital requirements.

## Compliance report

### Statement of compliance

The company is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 December 2013, the company has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated September 2012 (the “Code”) except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. The company considers that this is a matter which should rightly be reserved for the Board and this is an approach the company has adopted for a number of years. Remuneration for the Chairman and executive directors is first considered by the Group Performance and Remuneration Committee which then makes recommendations to the Board for consideration. This approach allows all non-executive directors, and not just those who are members of the Group Performance and Remuneration Committee, to participate in decisions on the executive directors’ and the Chairman’s remuneration and also allows the executive directors to input to the decision on the Chairman’s remuneration. The Board believes this approach is very much in line with the spirit of the Code and no director is involved in decisions regarding his or her own remuneration. We do not anticipate any changes to our approach on this aspect of the Code. Information on how the company has applied the main principles of the Code can be found in the Corporate governance report on pages 38 to 93. A copy of the Code can be found at [www.frc.org.uk](http://www.frc.org.uk)

The company has also implemented the recommendations arising from the Walker Review. The company has also complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in September 2012.

Under the US Sarbanes-Oxley Act of 2002, specific standards of corporate governance and business and financial disclosures apply to companies with securities registered in the US. The company complies with all applicable sections of the US Sarbanes-Oxley Act of 2002.

### Internal control

Management of The Royal Bank of Scotland Group plc is responsible for implementing a system of internal control that is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, management has regard to the nature and extent of the risk, the likelihood of it crystallising and the cost of controls. A system of internal control is designed to manage, but not eliminate, the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against the risk of material misstatement, fraud or losses.

### Management’s report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Group.

The Group’s internal control over financial reporting is a component of an overall system of internal control and is designed to provide reasonable assurance regarding the preparation, reliability and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards (“IFRS”) and it includes:

- Policies and procedures that relate to the maintenance of records that, in reasonable detail, fairly and accurately reflect the transactions and disposition of assets.

- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management.
- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with policies or procedures may deteriorate.

Management assessed the effectiveness of the Group's internal control over financial reporting as of 31 December 2013 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 1992 publication of "Internal Control – Integrated Framework".

Based on its assessment, management believes that, as of 31 December 2013, RBS Group's internal control over financial reporting is effective.

The effectiveness of RBS Group's internal control over financial reporting as of 31 December 2013 has been audited by Deloitte LLP, the Group's independent registered public accounting firm. The report of the independent registered public accounting firm to the directors of the Royal Bank of Scotland Group plc expresses an unqualified opinion on the effectiveness of the Group's internal control over financial reporting as of 31 December 2013.

## Compliance report

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc  
We have audited the internal control over financial reporting of The Royal Bank of Scotland Group plc and subsidiaries (“the Group”) as of 31 December 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Group’s management is responsible for maintaining effective internal control over financial reporting and for assessing its effectiveness as described in Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk of whether a material weakness existed, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of 31 December 2013, based on the criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended 31 December 2013 of the Group and our report dated 26 February 2014 (27 March 2014 as to the consolidating financial information included in Note 43 of the financial statements) expressed an unqualified opinion on those financial statements.

/s/ Deloitte LLP  
London, United Kingdom  
26 February 2014

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## Compliance report

### Disclosure controls and procedures

Management, including our Chief Executive Officer and our Group Finance Director, conducted an evaluation of the effectiveness and design of our disclosure controls and procedures (as such term is defined in Exchange Act Rule 13a-15(e)). Based on this evaluation, our Chief Executive Officer and our Group Finance Director concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

### Changes in internal control

There was no change in the company's internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

### The New York Stock Exchange

As a foreign issuer with American Depository Shares representing ordinary shares, preference shares and debt securities listed on the New York Stock Exchange (the "NYSE"), the company is not required to comply with all the NYSE standards applicable to US domestic companies (the "NYSE Standards") provided that it follows home country practice in lieu of the NYSE Standards and discloses any significant ways in which its corporate governance practices differ from the NYSE Standards. As a foreign private issuer, the company must, however, comply fully with the provisions of the NYSE Standards that relate to the composition, responsibilities and operation of audit committees. These provisions incorporate the relevant rules concerning audit committees of the Exchange Act.

The company has reviewed its corporate governance arrangements and is satisfied that these are consistent with the NYSE Standards, with the exception that the Chairman of the Board is also the Chairman of the Group Nominations Committee, which is permitted under the Code (since the Chairman was considered independent on appointment). In addition, although the members of the Group Performance and Remuneration Committee are deemed independent in compliance with the provisions of the Code, the Group Board has not assessed the independence of the members of the Group Performance and Remuneration Committee and of its compensation committee advisers in accordance with the independence tests prescribed by the NYSE standards. The company's Group Audit, Board Risk, Group Sustainability and Group Nominations Committees are otherwise composed solely of non-executive directors deemed by the Group Board to be independent. In addition, the NYSE Standards require that a compensation committee has direct responsibility to review and approve the Group Chief Executive's remuneration. As stated at the start of this Compliance report, in the case of the company, the Group Board, rather than the Group Performance and Remuneration Committee, reserves the authority to make the final determination of the remuneration of the Group Chief Executive.

The Group Audit Committee complies with the provisions of the NYSE Standards that relate to the composition, responsibilities and operation of audit committees. In April 2013, the company submitted its required annual written affirmation to the NYSE confirming its full compliance with those and other applicable provisions. More detailed information about the Group Audit Committee and its work during 2013 is set out in the Group Audit Committee report on pages 55 to 60.

This Compliance report forms part of the Corporate governance report and the Report of the directors.

## Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2013.

### Group structure

The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc, the principal direct operating subsidiary undertaking of the company. The Group comprises the company and all its subsidiary and associates, including the Royal Bank and NatWest.

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HMT. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HMT's holding of ordinary shares of the company remained at 70.3%, although its economic interest rose to 84.4%.

At 31 December 2013, HMT's holding in the company's ordinary shares was 63.9% and its economic interest was 80.2%.

### Results and dividends

The loss attributable to the ordinary and B shareholders of the company for the year ended 31 December 2013 amounted to £8,995 million compared with a loss of £6,055 million for the year ended 31 December 2012, as set out in the consolidated income statement on page 362.

The company did not pay a dividend on ordinary shares in 2012 or 2013.

On 26 November 2009, RBS entered into a State Aid Commitment Deed with HMT containing commitments and undertakings that were designed to ensure that HMT was able to comply with the commitments to be given by it to the European Commission for the purposes of obtaining approval for the State aid provided to RBS. As part of these commitments and undertakings, RBS agreed not to pay discretionary coupons and dividends on its existing hybrid capital instruments for a period of two years. This period commenced on 30 April 2010 for RBS Group instruments and ended on 30 April 2012; the two year deferral period for RBS Holdings N.V. instruments commenced on 1 April 2011 and ended on 1 April 2013.

The Group has now resumed payments on all discretionary non-equity capital instruments. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

In the context of prior macro-prudential policy discussions, the Board decided to partially neutralise any impact on Core Tier 1 capital of coupon and dividend payments in respect of 2013 Group hybrid capital instruments through equity issuances of c.£300 million. Consequently during the year, approximately £255 million was raised through the issue of new ordinary shares and a further £44 million was raised in connection with equity funding of employee incentive awards through the sale of surplus shares held by the Group's Employee Benefit Trust.

For 2014, the Board has decided to continue partially neutralising the Core Tier 1 impact of Group hybrid capital instruments. It is expected that £300 million of new equity will be issued during the course of 2014 to achieve this aim.

## Business review



#### Activities

The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its divisions and the competitive markets in which they operate, are contained in the Business review on pages 106 to 108. Details of the strategy for delivering the company's objectives can be found in the Strategic report.

#### Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Certain risk factors the Group faces are summarised in the Business review on pages 109 and 110. Fuller details of these and other risk factors are set out on pages 513 to 526.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 378 to 381.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Business review: risk and balance sheet management.

#### Financial performance

A review of the Group's performance during the year ended 31 December 2013, including details of each division, and the Group's financial position as at that date is contained in the Business review on pages 111 to 166.

#### RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2007, RFS Holdings B.V., which was jointly owned by the Group, the Dutch State (successor to Fortis) and Santander (together, the "Consortium Members") completed the acquisition of ABN AMRO Holding N.V.

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V.").

In October 2011, the Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank. Substantially all of the Netherlands and EMEA businesses were transferred to the Royal Bank in September 2012. Russia, Korea and the North American businesses were transferred to the Royal Bank in 2013. Certain assets of RBS N.V. continue to be shared by the Consortium Members.

## Report of the directors

### Business divestments

To comply with the European Commission State Aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These include the divestment of Direct Line Insurance Group plc (DLG), the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK ("UK branch-based businesses").

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales and 6 NatWest branches in Scotland. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985.

The Group sold a first tranche of ordinary shares representing 34.7% of the ordinary issued share capital of Direct Line Group (DLG) in October 2012 through an initial public offering. On 13 March 2013, the Group sold a further 16.8% of the ordinary issued share capital in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013. On 20 September 2013, the Group sold a further 20% of the ordinary issued share capital in DLG.

On 26 February 2014 the Group announced that it had entered into a placing agreement to complete the sale of its remaining interest in DLG (except for 4.2 million shares held to satisfy long term incentive plan awards granted by the Group to DLG management). Accordingly, on settlement of the placing, the Group will have completed the disposal of DLG as required by the European Commission.

### Strategic plan

#### Citizens Financial Group

In February 2013, the Group announced that it would commence work on a partial flotation of RBS Citizens Financial Group, Inc and in November 2013 confirmed that a partial initial public offering is now planned for 2014. The Group intends to fully divest the business by the end of 2016. The sale of RBS Citizens Financial Group, Inc is the cornerstone of the Group's new capital plan. The Group has appointed advisers and this is on schedule for later this year.

#### RBS Capital Resolution

In November 2013, the Group announced the creation of RBS Capital Resolution (RCR), to manage a pool of assets with particularly high long term capital intensity and/or potentially volatile outcomes in stressed environments. RCR became operational on 1 January 2014 with a portfolio of £29 billion assets. The RCR Board Oversight Committee has been established to provide oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

### Strategic review

In November 2013, the Group announced that it was undertaking a comprehensive business review of its customer-facing businesses, IT and operations and organisational and decision making structures. As described on pages 10 and 11, the Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved

resilience.

#### Employees

As at 31 December 2013, the Group employed 118,600 (full-time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the consolidated accounts.

The Group operates certain employee share plans in which eligible employees are able to participate and which align the interests of employees with those of shareholders.

#### Employee learning and development

The Group maintains a strong commitment to providing all its employees with the opportunity to grow through learning and development, which in turn helps to achieve business objectives and drive excellent customer service. Supporting the professionalisation of our front line staff, just over 18,000 customer facing employees are now part of accreditation programmes aligned to the Chartered Banker professional standards. This helps our employees deliver the best service to our customers whilst working towards a recognised professional standard.

#### Employee communication

Employee engagement is encouraged through a range of communication channels, at both local and Group level. These channels provide access to news and information in a number of ways, including the intranet, magazines, video, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Group Chief Executive and other senior Group executives regularly communicate with, and encourage feedback from, employees across a range of channels.

#### Employee feedback

Every year since 1999, through the Your Feedback survey, employees in all our businesses have shared their thoughts about what it's like working for RBS. In 2013, we renamed the survey Our View, reflecting the emphasis we place on a shared responsibility to build a better bank. The survey enables the business to monitor levels of employee satisfaction and engagement and how these compare with other companies. It also provides a further mechanism for RBS to track employee perception of the progress we are making in strengthening our culture. Insights from Our View inform what the business needs to do to improve the way it works, whether it's a local issue or something that affects everyone.

## Report of the directors

### Employee consultation

The Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries.

The Group has a European Employee Council that provides an opportunity for elected representatives and management to discuss developments in the Group's European operations.

### Diversity and inclusion

During 2013, the Group executive continued its commitment to making workplace policies, processes and experiences inclusive for staff, customers and stakeholders.

Inclusion is built into various policy areas and people management processes. For example: the business continues to support disabled persons, ensuring there are equal opportunities in recruitment, employment, promotion and training.

The business also supports employee-led networks, with three being introduced this year relating to the areas of disability, multi-culturalism and carers. These new networks run alongside existing ones, such as Focused Women and Rainbow, who provide personal and career development opportunities through networking and training events.

This commitment to inclusion extends to supporting and participating in positive action programmes outside of the Group aimed at cultivating future leaders, including 'An Inspirational Journey' and FTSE-100 cross-company mentoring programmes. The Group continues to maintain its involvement with external charitable networks and events such as Manchester Pride.

This approach to inclusion also extends to the marketplace with the RBS Women in Business specialists supporting and guiding more and more women to take the step of starting their own business.

Performance on gender diversity is monitored and reviewed at Group and local level and RBS remains supportive of the recommendations of Lord Davies' Report. There are currently three female directors on the Board out of a total of eleven, which exceeds Lord Davies' aspirational target of 25 per cent female Board representation. Further information on male/female representation at various levels of employment in the Group is included in the Strategic report on page 37.

Further details on the Board diversity policy can be found at [rbs.com>about us](http://rbs.com/about-us).

This year the business has been recognised for its work on Equality, Diversity and Inclusion by achieving platinum ranking from Opportunity Now (gender), one of only a few organisations to achieve this; achieving Silver for Race for Opportunity (race); and securing a position in the Working Families Top 10.

### Wellbeing

Ensuring the wellbeing of employees is an important responsibility for the Group.

A wide range of health benefits and services is in place to help employees maintain good physical and psychological health, and support them if they do become unwell. We continue to enhance and promote these services, targeting those issues that we know affect our employee's ability to bring the best of themselves to work. In 2013, we made Lifematters, the Group's Employee Assistance Programme, even more accessible with the introduction of our Lifematters mobile App.

#### Code of conduct

The code of conduct was fundamentally revised in 2013. How we behave forms the character of our company and dictates how others see us. "Our Code" reflects our values and applies to everyone who works for RBS. It lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed.

The code of conduct is available at [rbs.com>sustainability>governance> reporting and engagement](http://rbs.com/sustainability/governance/reporting-and-engagement). It will also be provided to any person without charge, upon request, by contacting RBS Secretariat at the telephone number listed on page 561.

#### Sustainability

Sustainability at RBS means building our future on long term thinking that focuses on our customers and supporting the communities in which they live. Our core duty is to be safe and strong. This underpins everything that RBS does and enables people to run their daily lives and businesses. This, in turn, supports economic growth and brings wider benefits to society. The final strand to building a sustainable business centres on how we choose to operate and how we can go further to shape the world in a positive way.

Sustainability is therefore not just about the many responsibilities and obligations that the Group has in a legal sense, but is about broad issues that need to be addressed to ensure that the Group is a healthy and respected business operating on a sustainable basis.

The Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups and reports to the Board. For more information on the Committee, see pages 67 and 68.

#### Greenhouse gas emissions

Disclosures relating to greenhouse gas emissions are included in the Strategic report on page 36.

## Report of the directors

### Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Business review. The risk factors which could materially affect the Group's future results are set out on pages 513 to 526. The Group's regulatory capital resources and significant developments in 2013 and anticipated future developments are detailed on pages 187 to 203. The liquidity and funding section on pages 204 to 221 describes the Group's funding and liquidity profile, including changes in key metrics, the build up of liquidity reserves and the outlook for 2014.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

### BBA disclosure code

The Group's 2013 financial statements have been prepared in compliance with the principles set out in the Code for Financial Reporting Disclosure published by the British Bankers' Association in 2010. The Code sets out five disclosure principles together with supporting guidance. The principles are that the Group and other major UK banks will provide high quality, meaningful and decision-useful disclosures; review and enhance their financial instrument disclosures for key areas of interest to market participants; assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; seek to enhance the comparability of financial statement disclosures across the UK banking sector; and clearly differentiate in their annual reports between information that is audited and information that is unaudited.

### Corporate governance

The company is committed to high standards of corporate governance. Details are given in the Corporate governance report on pages 38 to 93. The Corporate governance report and compliance report (pages 94 to 96) form part of this Report of the directors.

### Share capital

Details of the ordinary and preference share capital at 31 December 2013 and movements during the year are shown in Note 26 on the consolidated accounts.

During 2013, the company allotted and issued a total of 78.6 million new ordinary shares of £1 each for the purposes of ensuring 2013 coupon payments on discretionary hybrid capital securities were partly neutralised from a Core Tier 1 capital perspective. The shares were allotted to UBS AG at the subscription prices and determined by reference to the average market prices during the sale periods set out below.

| Number of Subscription shares sold price | Sale period                       | Gross proceeds | Share price on allotment |
|--|-----------------------------------|----------------|--------------------------|
| 42,967,903 314.188p                      | 3 May 2013 - 17 July 2013         | £135 million   | 321.6p                   |
| 20,473,967 341.898p                      | 2 August 2013 - 12 September 2013 | £70 million    | 360.4p                   |
| 15,091,674 331.309p                      |                                   |                | 336.8p                   |

1 November £50  
2013 - million  
9 December  
2013

In addition, the company issued 53.7 million ordinary shares of £1 each in connection with employee share schemes.

#### Additional information

Where not provided elsewhere in the Report of the directors, the following additional information is required to be disclosed by Part 6 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The rights and obligations attaching to the company's ordinary shares and preference shares are set out in the company's Articles of Association, copies of which can be obtained from Companies House in the UK or can be found at [rbs.com>about us](http://rbs.com/about-us).

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares or cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held. The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.015% of the total voting rights of the company, the remainder being represented by the ordinary shares.

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws). Pursuant to the Listing Rules of the FCA, certain employees of the company require the approval of the company to deal in the company's shares.

## Report of the directors

The rules governing the powers of directors, including in relation to issuing or buying back shares and their appointment are set out in the company's Articles of Association. It will be proposed at the 2014 Annual General Meeting that the directors be granted authorities to allot shares under the Companies Act 2006. The company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

A number of the company's share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

The rights and obligations of holders of non-cumulative preference shares are set out in Note 26 on the consolidated accounts.

Except in relation to the Dividend Access Share, the company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank and Ulster Bank Dublin Trust Company as Trustees. Voting rights are exercised by the Trustees on receipt of participants' instructions. If a participant does not submit an instruction to the Trustee no vote is registered.

The Royal Bank of Scotland plc 1992 Employee Share Trust, The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of the Group's employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.

Awards granted under the company's employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company's employee benefit trusts.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company's employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

## Directors

The names and brief biographical details of the current directors are shown on pages 42 to 45.

Sandy Crombie, Alison Davis, Tony Di Iorio, Philip Hampton, Penny Hughes, Brendan Nelson, Baroness Noakes and Philip Scott all served throughout the year and to the date of signing of the financial statements.

Joe MacHale and Art Ryan stepped down from the Board on 14 May 2013 and 30 September 2013 respectively.

Stephen Hester and Bruce Van Saun stepped down from the Board on 30 September 2013.

Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013. Nathan has since confirmed his resignation although his leaving date is still to be agreed.



Robert Gillespie was appointed to the Board on 2 December 2013.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting.

#### Directors' interests

The interests of the directors in the shares of the company at 31 December 2013 are shown on page 82. None of the directors held an interest in the loan capital of the company or in the shares or loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2013 to 26 February 2014.

#### Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the company to directors, members of the Group's Executive and Management Committees, PRA/FCA Approved Persons and certain directors and/or officers of the Group's subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Group's pension schemes.

#### Post balance sheet events

Other than those matters detailed in Note 42 on the consolidated accounts, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

## Report of the directors

### Shareholdings

The table below shows shareholders that have notified the Group that they hold more than 3% of the total voting rights of the company at 31 December 2013.

| Solicitor For The Affairs of Her Majesty's Treasury as Nominee for Her Majesty's Treasury | Number of shares<br>(millions) | % of share class<br>held | % of total<br>voting rights<br>held |
|---|--------------------------------|--------------------------|-------------------------------------|
| Ordinary shares   | 3,964                          | 63.9                     | 63.9                                |
| B shares (non-voting)   | 51,000                         | 100                      | —                                   |

On 8 January 2014, the Group was notified that Her Majesty's Treasury's shareholding of ordinary shares as at 31 December 2013 represented 63.9% of the total voting rights. The decrease was as a result of a change in the total voting rights.

### Political donations

At the Annual General Meeting in 2013, shareholders gave authority under Part 14 of the Companies Act, for a period of one year, for the company (and its subsidiaries) to make political donations and incur political expenditure up to a maximum aggregate sum of £100,000. This authorisation was taken as a precaution only, as the company has a longstanding policy of not making political donations or incurring political expenditure within the ordinary meaning of those words. During 2013, the Group made no political donations, nor incurred any political expenditure in the UK or EU and it is not proposed that the Group's longstanding policy of not making contributions to any political party be changed. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2014.

### Directors' disclosure to auditors

Each of the directors at the date of approval of this report confirms that:

- (a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- (b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

### Auditors

The auditors, Deloitte LLP, have indicated their willingness to continue in office. A resolution to re-appoint Deloitte LLP as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor  
Secretary  
26 February 2014

The Royal Bank of Scotland Group plc  
is registered in Scotland No. SC45551

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## Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 361.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the company. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' report (incorporating the Business review) include a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, the directors are of the opinion that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

By order of the Board

Philip Hampton  
Chairman

Ross McEwan  
Group Chief Executive

Nathan Bostock  
Group Finance Director

26 February 2014

Board of directors

Chairman

Philip Hampton

Executive directors

Ross McEwan

Nathan Bostock

Non-executive directors

Sandy Crombie

Alison Davis

Tony Di Iorio  
Robert Gillespie  
Penny Hughes  
Brendan Nelson  
Baroness Noakes  
Philip Scott

Business review

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## Revisions

### Direct Line Group

The Group sold the first tranche of ordinary shares representing 34.7% of the share capital of DLG in October 2012 via an Initial Public Offering. On 13 March 2013, the Group sold a further 16.8% of ordinary shares in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013. On 20 September 2013, the Group sold a further 20% of ordinary shares in DLG which is a step toward complete disposal by the end of 2014, as required by the European Commission. At 31 December 2013, the Group held 28.5% of the share capital in DLG.

In accordance with IFRS 5, DLG was classified as a discontinued operation in 2012. From 13 March 2013, DLG was classified as an associate and at 31 December 2013, the Group's interest in DLG was transferred to disposal groups.

### Revised allocation of Business Services costs

In 2013, the Group reclassified certain costs between direct and indirect expenses for all divisions. Comparatives have been restated accordingly; the revision did not affect total expenses or operating profit.

### Implementation of IAS 19 'Employee Benefits' (revised)

The Group implemented IAS 19 with effect from 1 January 2013. IAS 19 requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £84 million for the year ended 31 December 2012 and £154 million for the year ended 31 December 2011. This also resulted in an increase in the loss per ordinary and B share of 0.8p for the year ended 31 December 2012 and 1.4p for the year ended 31 December 2011. Prior periods have been restated accordingly.

### Implementation of IFRS 10 'Consolidated Financial Statements'

The Group implemented IFRS 10 with effect from 1 January 2013. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity so as to vary returns for the reporting entity. IFRS 10 requires retrospective application. Following implementation of IFRS 10, certain entities that have trust preferred securities in issue are no longer consolidated by the Group. As a result there has been a reduction in non-controlling interests of £0.5 billion with a corresponding increase in Owners' equity (Paid-in equity); prior periods have been restated accordingly.

### Glossary

A glossary of terms is provided on pages 549 to 556.

## Business review

### Description of business

#### Introduction

The Royal Bank of Scotland Group plc is the holding company of a large global banking and financial services group. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its principal subsidiaries, the Royal Bank and NatWest. Both the Royal Bank and NatWest are major UK clearing banks. In the United States, the Group's subsidiary RBS Citizens is a large commercial banking organisation. Globally, the Group has a diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

Following the placing and open offers in December 2008 and in April 2009, HM Treasury owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HM Treasury. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HM Treasury's holding of ordinary shares of the company remained at 70.3% although its economic interest rose to 84.4%.

At 31 December 2013, HM Treasury's holding in the company's ordinary shares was 63.9% and its economic interest was 80.2%.

The Group had total assets of £1,028 billion and owners' equity of £59 billion at 31 December 2013. The Group's risk asset ratios at 31 December 2013 were a Total capital ratio of 16.5%, a Core Tier 1 capital ratio of 10.9% and a Tier 1 capital ratio of 13.1%.

#### Organisational structure

The Group's activities during 2013 were organised on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile. UK Retail is committed to serving customers well, making banking easier and convenient whilst ensuring that we do business in an open, honest and sustainable manner.

UK Corporate is a leading provider of banking, finance and risk management services to the corporate and SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes invoice finance through the RBSIF brand and asset finance through the Lombard brand.

Wealth provides private banking and investment services in the UK through Coutts & Co and Adam & Company, offshore banking through RBS International, NatWest Offshore and Isle of Man Bank, and international private banking through Coutts & Co Ltd.

International Banking serves the world's largest companies with a leading client proposition focused on financing, risk management and transaction services. It serves as the delivery channel for Markets products to international corporate clients. The division also serves international subsidiaries of clients from other RBS Group divisions (e.g. UK Corporate, Ulster Bank and US Retail & Commercial) through its international network.

Ulster Bank is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides



services to businesses and corporate customers.

US Retail & Commercial provides financial services primarily through the Citizens and Charter One brands. US Retail & Commercial is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states.

In February 2013, the Group announced that it would commence work on a partial flotation of RBS Citizens and in November 2013 confirmed that a partial initial public offering is now planned for 2014. The Group intends to fully divest the business by the end of 2016.

The divisions discussed above are collectively referred to as Retail & Commercial.

Markets is a leading origination, sales and trading business across debt finance, fixed income and currencies. The division offers a unified service to the Group's corporate and institutional clients. The Markets' origination, sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division's trading and structuring teams to meet the client's objectives across financing, risk management, investment, securitisation and liquidity.

A new strategy for the Markets division was announced in June 2013 enabling RBS to concentrate on its core customers' needs where the Markets business is strongest. Markets is now focused on our core fixed income capabilities across rates, foreign exchange, asset backed products, credit and debit capital markets, while de-emphasising some more capital intensive structured product areas.

Central Functions comprises Group and corporate functions, such as treasury, finance, risk management, compliance, legal, communications and human resources. The Centre manages the Group's capital resources and Group-wide regulatory projects and provides services to the operating divisions.

Non-Core Division managed separately assets that the Group intended to run off or dispose of. The division contained a range of businesses and asset portfolios primarily from the legacy GBM businesses, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also included a number of other portfolios and businesses including regional markets businesses that the Group had concluded were no longer strategic.

## Business review

### Description of business continued

Business Services supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Business Services drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and is the Group's centre of excellence for managing large-scale and complex change. For reporting purposes, Business Services costs are allocated to the divisions above. It is not deemed a reportable segment.

### Business divestments

To comply with the European Commission State Aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These include the divestment of Direct Line Insurance Group plc, the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK ("UK branch-based businesses").

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales and 6 NatWest branches in Scotland. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985.

In March 2013 and September 2013, the Group sold a further 16.8% and 20% respectively of the total issued share capital in Direct Line Insurance Group plc (DLG). This followed the sale in October 2012 via an initial public offering of 520.8 million ordinary shares representing 34.7% of the total issued share capital. At 31 December 2013, the Group held 28.5% of the issued ordinary share capital of DLG.

On 26 February 2014 RBS announced that it had entered into a placing agreement to complete the sale of its residual interest in DLG (except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to DLG management). Accordingly, on settlement of the placing, the Group will have completed the disposal as required by the European Commission.

### RBS Capital Resolution (RCR)

In response to a recommendation by the Parliamentary Commission on Banking Standards, RBS worked closely with HM Treasury (HMT) and its advisers on a 'good bank/bad bank' review and identified a pool of c.£38 billion of assets with particularly high long-term capital intensity, credit risk and/or potentially volatile outcomes in stressed environments.

The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified and consequently RBS decided to create an internal 'bad bank', RBS Capital Resolution (RCR), to manage these assets down so as to release capital. RCR brings assets under common management and increases focus on the run down.

RCR became fully operational on 1 January 2014 with a pool of c.£29 billion of assets, down from the forecast of c.£38 billion due to accelerated disposals and increased impairments. Whilst RCR is of a similar size to the Non-Core division, the assets have been selected on a different basis and no direct comparisons can be drawn.

### Strategic review

In November 2013, the Group announced that it was undertaking a comprehensive business review of its: Customer-facing business, IT and operations and Organisational and decision making structures.

The aim of the review is to improve the bank's performance and effectiveness in serving its customers, shareholders and wider stakeholders.

The Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved resilience.

## Business review

### Competition

The Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand remains subdued as many customers continue to deleverage even as the UK economy begins to show signs of recovery. Competition for retail deposits has eased somewhat as institutions have made progress towards building strong and diverse funding platforms for their balance sheets.

Competition for corporate and institutional customers in the UK and abroad is from UK banks and from large foreign universal banks that offer combined investment and commercial banking capabilities. In addition, the Group's Markets division faces strong competition from dedicated investment banks. In asset finance, the Group competes with banks and specialist asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets the Group competes with the large domestic banks active in these markets and with the major international banks.

In the small business banking market, the Group competes with other UK clearing banks, specialist finance providers and building societies.

In the personal banking segment, the Group competes with UK clearing banks and building societies, major retailers and life assurance companies. In the mortgage market, the Group competes with UK clearing banks and building societies. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms by acquiring businesses made available through restructuring of incumbents. The Group distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

In the UK credit card market large retailers and specialist card issuers are active in addition to the UK banks. In addition to physical distribution channels, providers compete through direct marketing activity and the internet.

In Wealth Management, The Royal Bank of Scotland International competes with other UK and international banks to offer offshore banking services. Coutts and Adam & Company compete as private banks with UK clearing and private banks, and with international private banks. Competition in wealth management remains strong as banks maintain their focus on competing for affluent and high net worth customers.

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market. The challenging conditions in the Irish economy persist and many of the domestic Irish banks have required State support and are engaged in significant restructuring actions.

In the United States, RBS Citizens competes in the New England, Mid-Atlantic and Mid-West retail and mid-corporate banking markets with local and regional banks and other financial institutions. The Group also competes in the US in large corporate lending and specialised finance markets, and in fixed-income trading and sales. Competition is principally with the large US commercial and investment banks and international banks active in the US. The economic recovery in the US is proving weaker than expected and loan demand is weak in Citizens' markets.

## Business review

### Risk factors

#### Summary of our Principal Risks and Uncertainties

Set out below is a summary of certain risks which could adversely affect the Group; it should be read in conjunction with the Risk and Balance Sheet management section on pages 169 to 359. This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 513 to 526.

- The Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of its efforts to refocus on its core strengths and the timely divestment of RBS Citizens. The Group has undertaken since 2009 an extensive restructuring, including the disposal of non-core assets as well as businesses as part of the State Aid restructuring plan approved by the EC. The Group recently created RBS CRG to manage the run down of problem assets with the goal of removing such assets from the balance sheet over the next three years. The Group has also taken steps to strengthen its capital position and established medium term targets which will require the timely divestment of RBS Citizens to achieve. The Group is also undertaking a new strategic direction which will result in a significant downsizing of the Group, including simplifying the Group by replacing the current divisional structure with three customer segments. The level of structural change required to implement the Group's strategic and capital goals together with other regulatory requirements such as ring fencing are likely to be disruptive and increase operational risks for the Group. There is no assurance that the Group will be able to successfully implement its new strategy on which its capital plan depends or achieve its goals within the time frames contemplated or at all.
- Despite the improved outlook for the global economy over the near to medium-term, actual or perceived difficult global economic conditions and increased competition, particularly in the UK, create challenging economic and market conditions and a difficult operating environment for the Group's businesses. Uncertainties surrounding the referendum on Scottish independence and the implications of an affirmative outcome for independence are also likely to affect the Group. These factors, together with additional uncertainty relating to the recovery of the Eurozone economy where the Group has significant exposure and the risk of a return of volatile financial markets, in part due to the monetary policies and measures carried out by central banks, have been and will continue to adversely affect the Group's businesses, earnings, financial condition and prospects.
- The Group is subject to substantial regulation and oversight, and any significant regulatory or legal developments such as that which has occurred over the past several years could have an adverse effect on how the Group conducts its business and on its results of operations and financial condition. Certain regulatory measures introduced in the UK and in Europe relating to ring-fencing of bank activities may affect the Group's borrowing costs, may impact product offerings and the viability of certain business models and require significant restructuring with the possible transfer of a large number of customers between legal entities.
- The Group could fail to attract or retain senior management, which may include members of the Group Board, or other key employees, and it may suffer if it does not maintain good employee relations.
- The Group is subject to a number of regulatory initiatives which may adversely affect its business, including the UK Government's adoption of the Financial Services (Banking Reform) Act 2013, the US Federal Reserve's new rules for applying US capital, liquidity and enhanced prudential standards to certain of the Group's US operations and ongoing reforms in the European Union with respect to capital requirements, stability and resolution of financial institutions, including CRD IV and other currently debated proposals such as the Resolution and Recovery Directive.
- The Group's ability to meet its obligations including its funding commitments depends on the Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise or to do so at a reasonable cost due to increased regulatory constraints, could adversely affect the Group's

financial condition and results of operations. Furthermore, the Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings which would be likely to be negatively impacted by political events, such as an affirmative outcome of the referendum for the independence of Scotland.

- The Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements, including those arising out of Basel III implementation (globally or by European, UK or US authorities) as well as structural changes that may result from the implementation of ring-fencing under the Financial Services (Banking Reform) Act 2013 or proposed changes of the US Federal Reserve with respect to the Group's US operations. The Group's ability to reach its target capital ratios in the medium term will turn on a number of factors including a significant downsizing of the Group in part through the sale of RBS Citizens.
- The Group is, and may be, subject to litigation and regulatory and governmental investigations that may impact its business, reputation, results of operations and financial condition. Although the Group settled a number of legal proceedings and regulatory investigations during 2013, the Group is expected to continue to have a material exposure to legacy litigation and regulatory matter proceedings in the medium term. The Group also expects greater regulatory and governmental scrutiny for the foreseeable future particularly as it relates to compliance with new and existing laws and regulations such as anti-money laundering and anti-terrorism laws.
- Operational and reputational risks are inherent in the Group's businesses.

## Business review

### Risk factors continued

- The Group is highly dependent on its information technology systems and has been and will continue to be subject to cyber attacks which expose the Group to loss of customer data or other sensitive information, and combined with other failures of the Group's information technology systems, hinder its ability to service its clients which could result in long-term damage to the Group's business and brand.
- The Group or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures, including recapitalisation of the Group or any of its UK bank subsidiaries, through bail-in which has been introduced by the Financial Services (Banking Reform) Act 2013 and will come into force on a date stipulated by HM Treasury. These various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the Group's businesses.
- As a result of the UK Government's majority shareholding in the Group it may be able to exercise a significant degree of influence over the Group including on dividend policy, the election of directors or appointment of senior management or limiting the Group's operations. The offer or sale by the UK Government of all or a portion of its shareholding in the company could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of the Group from the Official List.
- The actual or perceived failure or worsening credit of the Group's counterparties or borrowers, including sovereigns in the Eurozone, and depressed asset valuations resulting from poor market conditions have led the Group to realise and recognise significant impairment charges and write-downs which have adversely affected the Group and could continue to adversely affect the Group if, due to a deterioration in economic and financial market conditions or continuing weak economic growth, it were to recognise or realise further write-downs or impairment charges.
- The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate.
- Recent developments in regulatory or tax legislation and any further significant developments could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the Group is subject to uncertainty.
- The Group is required to make planned contributions to its pension schemes and to compensation schemes in respect of certain financial institutions, either of which, independently or in conjunction with additional or increased contribution requirements may have an adverse impact on the Group's results of operations, cash flow and financial condition.

## Business review

## Key financials

|   | 2013    | 2012*   | 2011*   |
|---|---------|---------|---------|
| for the year ended 31 December  | £m      | £m      | £m      |
| Total income  | 19,757  | 17,941  | 24,651  |
| Profit before impairment losses   | 189     | 2       | 7,311   |
| Impairment losses   | (8,432) | (5,279) | (8,707) |
| Operating (loss)/profit   | (8,243) | (5,277) | (1,396) |
| Loss attributable to ordinary and B shareholders                                  | (8,995) | (6,055) | (2,151) |
| Cost:income ratio   | 99%     | 100%    | 70%     |
| Basic loss per ordinary and equivalent B share from continuing operations (pence) | (81.3p) | (54.5p) | (22.7p) |

\*Restated – see page 105.

| At 31 December                  | 2013      | 2012      | 2011      |
|---------------------------------|-----------|-----------|-----------|
|                                 | £m        | £m        | £m        |
| Funded balance sheet (1)        | 739,839   | 870,392   | 977,249   |
| Total assets                    | 1,027,878 | 1,312,295 | 1,506,867 |
| Loans and advances to customers | 440,722   | 500,135   | 515,606   |
| Deposits (2)                    | 534,859   | 622,684   | 611,759   |
| Owners' equity                  | 58,742    | 68,678    | 75,367    |
| Risk asset ratios - Core Tier 1 | 10.9%     | 10.3%     | 10.6%     |
| - Tier 1                        | 13.1%     | 12.4%     | 13.0%     |
| - Total                         | 16.5%     | 14.5%     | 13.8%     |

## Notes:

(1) Funded balance sheet represents total assets less derivatives.

(2) Comprises deposits by banks and customer accounts.



## Business review

## Summary consolidated income statement for the year ended 31 December 2013

|   | 2013     | 2012*    | 2011*    |
|---|----------|----------|----------|
|   | £m       | £m       | £m       |
| Net interest income   | 10,981   | 11,402   | 12,303   |
| Fees and commissions receivable   | 5,460    | 5,709    | 6,379    |
| Fees and commissions payable  | (942)    | (834)    | (962)    |
| Other non-interest income   | 4,258    | 1,664    | 6,931    |
| Non-interest income   | 8,776    | 6,539    | 12,348   |
| Total income  | 19,757   | 17,941   | 24,651   |
| Operating expenses  | (19,568) | (17,939) | (17,340) |
| Profit before impairment losses   | 189      | 2        | 7,311    |
| Impairment losses   | (8,432)  | (5,279)  | (8,707)  |
| Operating loss before tax   | (8,243)  | (5,277)  | (1,396)  |
| Tax charge  | (382)    | (441)    | (1,075)  |
| Loss from continuing operations   | (8,625)  | (5,718)  | (2,471)  |
| Profit/(loss) from discontinued operations, net of tax                    |          |          |          |
| - Direct Line Group   | 127      | (184)    | 301      |
| - Other   | 21       | 12       | 47       |
| Profit/(loss) from discontinued operations, net of tax                    | 148      | (172)    | 348      |
| Loss for the year   | (8,477)  | (5,890)  | (2,123)  |
| Non-controlling interests   | (120)    | 136      | (28)     |
| Other owners' dividends   | (398)    | (301)    | —        |
| Loss attributable to ordinary and B shareholders                          | (8,995)  | (6,055)  | (2,151)  |
| Basic loss per ordinary and equivalent B share from continuing operations | (81.3p)  | (54.5p)  | (22.7p)  |

\*Restated - see page 105.

## Business review

### Results summary continued

#### 2013 compared with 2012

##### Operating loss

Operating loss before tax for the year was £8,243 million compared with £5,277 million in 2012.

##### Total income

Total income increased 10% to £19,757 million in 2013 primarily reflecting a lower accounting charge for own credit partially offset by lower income in Markets.

##### Net interest income

Net interest income decreased by 4% to £10,981 million largely reflecting lower interest-earning asset balances partially offset by re-pricing initiatives. Group net interest margin improved by 10 basis points driven by moves to reprice deposits in a number of divisions, partially offset by a roll-off in higher yielding securities.

##### Non-interest income

Non-interest income increased to £8,776 million from £6,539 million in 2012. This included a loss on own credit adjustments of £120 million (2012 - £4,649 million), net gain on redemption of own debt of £175 million (2012 - £454 million) and movements in the fair value of the Asset Protection Scheme resulting in a £44 million charge in 2012. On a managed basis non-interest income decreased by 21% to £8,450 million in 2013 principally driven by lower income from trading activities in Markets as the division managed down the scale of the balance sheet and reduced risk. This was partially offset by a £506 million improvement in Non-Core trading losses. Operating lease and rental income fell by £392 million, largely reflecting the disposal of RBS Aviation Capital in 2012.

Within other operating income, Non-Core recorded a loss of £331 million excluding rental income, primarily related to fair value adjustments associated with investment properties.

The continuing, albeit modest, strengthening of RBS's credit profile resulted in a £120 million accounting charge in relation to own credit adjustments versus £4,649 million in 2012.

Liability management exercises undertaken by the Group during 2013 resulted in a net gain of £175 million (2012 - £454 million).

The Asset Protection Scheme, which the Group exited from in 2012, was accounted for as a credit derivative and movements in the fair value of the contract were taken as non-operating items. The APS fair value charge was £44 million in 2012.

The gain on strategic disposals of £161 million primarily relates to the disposal of the Group's remaining interest in WorldPay. In 2012 the gain of £113 million primarily related to the disposal of RBS Aviation Capital.

##### Operating expenses

Operating expenses increased to £19,568 million from £17,939 million in 2012. This included PPI costs of £900 million (2012 - £1,110 million), IRHP redress and related costs of £550 million (2012 - £700 million), regulatory and legal actions of £2,394 million (2012 - £381 million), integration and restructuring costs of £656 million (2012 - £1,415 million), write-down of goodwill of £1,059 million (2012 - £18 million) and write-down of other intangible assets of £344 million (2012 - £106 million). On a managed basis, total operating expenses fell by 4% to £13,313 million, with staff costs down 7% as headcount fell by 4,300 to 114,900, principally in UK Retail, Markets and Non-Core. Markets operating expenses decreased by 11% to £2,610 million and Non-Core by 36% to £605 million,

driven by exiting staff and lower central support requirements on run-down.

To reflect current experience of Payment Protection Insurance complaints received, the Group increased its PPI provision by £900 million in 2013 compared with £1,110 million in 2012, bringing the cumulative charge taken to £3.1 billion, of which £2.2 billion had been utilised at 31 December 2013.

Following an industry-wide review in 2012 conducted in conjunction with the Financial Services Authority, a charge of £700 million was booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. In 2013, a further charge of £550 million was booked reflecting both higher volumes and anticipated redress payments, recalibration of our methodology based on experience during 2013, and additional administration charges.

Charges relating to regulatory and legal actions totalled £2,394 million compared with £381 million in 2012. These charges primarily relate to various claims and conduct related matters affecting Group companies, primarily those related to mortgage-backed securities and securities related litigation, following recent litigation settlements and regulatory decisions.

Integration and restructuring costs were £656 million compared with £1,415 million in 2012 with most of the costs relating to the Retail transformation a reduction in the size of Markets and programme costs for the EC mandated disposal of certain UK branch-based businesses.

Write-down of goodwill was £1,059 million compared with £18 million in 2012 as the International Banking division was written off in 2013. Write-down of other intangible assets, including software, of £344 million related to Markets.

The UK bank levy is based on the total chargeable equity and liabilities as reported in the balance sheet at the end of a chargeable period. The cost of the levy to the Group for 2013 was £200 million compared with £175 million in 2012.

## Business review

### Impairment losses

Impairment losses increased by 60% to £8,432 million from £5,279 million in 2012 primarily due to increased charges resulting from the establishment of RCR. Excluding the impact of RCR (£4,490 million), impairment losses fell by 25% to £3,942 million with significant improvements in Non-Core, Ulster Bank and UK Retail partially offset by increases in International Banking, US Retail & Commercial and Markets. Loan impairments represented 2.0% of gross loans and advances to customers excluding reverse repos compared with 1.2% in 2012.

Risk elements in lending at 31 December 2013 represented 9.5% of loans and advances excluding reverse repos, compared with 9.1% a year earlier. Provision coverage was 64% compared with 52% at 31 December 2012.

### Tax

The tax charge was £382 million in 2013 compared with £441 million in 2012. The tax charge for the year reflects losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), a reduction in the carrying value of the deferred tax asset in respect of UK losses and the effect of the reduction of 3% in the rate of UK corporation tax enacted in July 2013.

### Loss per share

Basic loss per ordinary and equivalent B share from continuing operations was 81.3p per share compared with 54.5p per share in 2012.

### 2012 compared with 2011

#### Operating loss

Operating loss before tax for the year was £5,277 million compared with £1,396 million in 2011.

#### Total income

Total income decreased 27% to £17,941 million in 2012, principally reflecting own credit adjustments partially offset by movements in the fair value of the Asset Protection Scheme (APS) and higher net gains on the redemption of own debt.

#### Net interest income

Net interest income decreased by 7% to £11,402 million largely reflecting lower interest-earning asset balances. Group net interest margin (NIM) increased slightly, despite very low interest rates and strong deposit competition.

#### Non-interest income

Non-interest income decreased to £6,539 million from £12,348 million in 2011. This included movements in the fair value of the Asset Protection Scheme resulting in a £44 million charge (2011 - £906 million), net gain on redemption of own debt of £454 million (2011 - £255 million) and a loss on own credit adjustments of £4,649 million (2011 - £1,914 million gain). On a managed basis, non-interest income decreased by £443 million in 2012 principally driven by lower net fees and commissions and a fall in insurance net premium income. Net fees and commissions fell largely due to weaker consumer spending volumes in the UK together with legislation changes in the US.

The Asset Protection Scheme, which the Group exited from during the year, was accounted for as a credit derivative and movements in the fair value of the contract were taken as non-operating items. The APS fair value charge was £44 million in 2012 bringing the cumulative charge for the APS to £2.5 billion.

Liability management exercises undertaken by the Group during 2012 resulted in a net gain of £454 million (2011 - £255 million).

The continuing strengthening RBS's credit profile resulted in a £4,649 million accounting charge in relation to own credit adjustments versus a gain of £1,914 million in 2011. This reflected a tightening of more than 340 basis points in the Group's credit spreads over the year.

#### Operating expenses

Operating expenses increased to £17,939 million from £17,340 million in 2011. This included PPI costs of £1,110 million (2011 - £850 million), IRHP redress and related costs of £700 million, regulatory fines of £381 million, integration and restructuring costs of £1,415 million compared with £1,016 million in 2011, and write-down of goodwill and other intangible assets of £124 million, principally as a result of exits from selective countries and lower revenue projections by Markets. On a managed basis, total operating expenses fell by 7% to £13,854 million, with staff costs down 6% as headcount fell by 8,300 to 119,200. The decline in expenses was largely driven by Non-Core run-down and lower variable compensation (particularly in Markets), including variable compensation award reductions and clawbacks following the settlements reached with UK and US authorities in relation to attempts to manipulate LIBOR. The run-off of discontinued businesses in Markets and International Banking, following the restructuring announced in January 2012, and simplification of processes and headcount reduction in UK Retail also yielded cost benefits.

To reflect current experience of Payment Protection Insurance complaints received, the Group increased its PPI provision by £1,110 million in 2012 compared with £850 million in 2011, bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion (59%) in redress had been paid by 31 December 2012.

Following an industry-wide review conducted in conjunction with the Financial Services Authority, a charge of £700 million has been booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules.

On 6 February 2013, RBS reached agreement with the Financial Services Authority, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The Group continues to co-operate with other bodies in this regard and expects it will incur some additional financial penalties.

Integration and restructuring costs of £1,415 million increased by £394 million versus £1,021 million in 2011, primarily driven by costs incurred in relation to the strategic restructuring of Markets and International Banking (M&IB) that took place during 2012.

## Business review

### Results summary continued

The UK bank levy is based on the total chargeable equity and liabilities as reported in the balance sheet at the end of a chargeable period. The cost of the levy to the Group for 2012 was £175 million compared with £300 million in 2011.

### Impairment losses

Impairment losses were £5,279 million, compared with £8,707 million in 2011, with Core impairments falling by £464 million and Non-Core by £1,694 million, mostly in the Ulster Bank and commercial real estate portfolios. There was also the non-repeat of the sovereign debt impairment in 2011. On a managed basis, impairment losses fell to £5,279 million from £7,437 million in 2011

In 2011, the Group recorded an impairment loss of £1,099 million in respect of its AFS portfolio of Greek government debt. In 2012, the vast majority of this portfolio was exchanged for Greek sovereign debt and European Financial Stability Facility notes; the Greek sovereign debt received in the exchange was sold.

Risk elements in lending represented 9.1% of gross loans and advances to customers excluding reverse repos at 31 December 2012 (2011 - 8.6%).

Provision coverage of risk elements in lending was 52% (2011 - 49%).

### Tax

The tax charge was £441 million in 2012, compared with £1,075 million in 2011. The high tax charge in the year reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), the reduction in the carrying value of deferred tax assets in Ireland in view of continuing losses, the reduction in the carrying value of deferred tax assets in Australia following the strategic changes to the Markets and International Banking businesses announced in January 2012 and the effect of the two reductions of 1% in the rate of UK corporation tax enacted in March 2012 and July 2012 on the net deferred tax balance.

### Loss per share

Basic loss per ordinary and equivalent B share from continuing operations was 54.5p per share compared with 22.7p per share in 2011.

## Business review

## Analysis of results

## Net interest income

|  | 2013    | 2012    | 2011    |
|--|---------|---------|---------|
|  | £m      | £m      | £m      |
| Interest receivable (1)  | 16,740  | 18,530  | 21,036  |
| Interest payable   | (5,759) | (7,128) | (8,733) |
| Net interest income  | 10,981  | 11,402  | 12,303  |
| Yields, spreads and margins of the banking business                | %       | %       | %       |
| Gross yield on interest-earning assets of the banking business (2) | 3.08    | 3.12    | 3.23    |
| Cost of interest-bearing liabilities of the banking business       | (1.42)  | (1.54)  | (1.68)  |
| Interest spread of the banking business (3)                        | 1.66    | 1.58    | 1.55    |
| Benefit from interest-free funds                                   | 0.36    | 0.34    | 0.34    |
| Net interest margin of the banking business (4)                    | 2.02    | 1.92    | 1.89    |
| Gross yield (2)  |         |         |         |
| - Group  | 3.08    | 3.12    | 3.23    |
| - UK   | 3.54    | 3.49    | 3.57    |
| - Overseas   | 2.33    | 2.56    | 2.77    |
| Interest spread (3)  |         |         |         |
| - Group  | 1.66    | 1.58    | 1.55    |
| - UK   | 1.99    | 1.83    | 1.82    |
| - Overseas   | 1.25    | 1.56    | 1.22    |
| Net interest margin (4)  |         |         |         |
| - Group  | 2.02    | 1.92    | 1.89    |
| - UK   | 2.21    | 2.03    | 2.04    |
| - Overseas   | 1.72    | 1.75    | 1.69    |
| The Royal Bank of Scotland plc base rate (average)                 | 0.50    | 0.50    | 0.50    |
| London inter-bank three month offered rates (average)              |         |         |         |
| - Sterling   | 0.52    | 0.82    | 0.87    |
| - Eurodollar   | 0.24    | 0.43    | 0.33    |
| - Euro   | 0.27    | 0.53    | 1.36    |

\*Restated - see page 105.

## Notes:

- (1) Interest receivable includes £798 million (2012 - £565 million; 2011 - £627 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.
- (2) Gross yield is the interest earned on average interest-earning assets of the banking book.
- (3) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
- (4) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.
- (5) The analysis into UK and overseas has been compiled on the basis of location of office.
- (6) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(7) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.



## Business review

## Average balance sheet and related interest continued

|  |                        | 2013                     |                |           | 2012                     |                |           |
|--|------------------------|--------------------------|----------------|-----------|--------------------------|----------------|-----------|
|  |                        | Average<br>balance<br>£m | Interest<br>£m | Rate<br>% | Average<br>balance<br>£m | Interest<br>£m | Rate<br>% |
| <b>Assets</b>  |                        |                          |                |           |                          |                |           |
| Loans and advances to banks                            | - UK                   | 42,466                   | 261            | 0.61      | 33,656                   | 248            | 0.74      |
|  | - Overseas             | 32,240                   | 169            | 0.52      | 40,342                   | 245            | 0.61      |
| Loans and advances to customers                        | - UK                   | 256,692                  | 11,060         | 4.31      | 277,631                  | 11,326         | 4.08      |
|  | - Overseas             | 143,104                  | 4,065          | 2.84      | 151,692                  | 4,862          | 3.21      |
| Debt securities  | - UK                   | 38,082                   | 624            | 1.64      | 49,872                   | 1,015          | 2.04      |
|  | - Overseas             | 30,792                   | 561            | 1.82      | 40,077                   | 834            | 2.08      |
| Interest-earning assets                                | - UK                   | 337,240                  | 11,945         | 3.54      | 361,159                  | 12,589         | 3.49      |
|  | - Overseas             | 206,136                  | 4,795          | 2.33      | 232,111                  | 5,941          | 2.56      |
| Total interest-earning assets                          | - banking business (1) | 543,376                  | 16,740         | 3.08      | 593,270                  | 18,530         | 3.12      |
|  | - trading business (6) | 216,211                  |                |           | 240,131                  |                |           |
| Interest-earning assets                                |                        | 759,587                  |                |           | 833,401                  |                |           |
| Non-interest-earning assets                            |                        | 467,779                  |                |           | 596,971                  |                |           |
| Total assets   |                        | 1,227,366                |                |           | 1,430,372                |                |           |
| Percentage of assets applicable to overseas operations |                        | 33.0%                    |                |           | 37.8%                    |                |           |
| <b>Liabilities</b>                                     |                        |                          |                |           |                          |                |           |
| Deposits by banks                                      | - UK                   | 7,997                    | 144            | 1.80      | 18,347                   | 216            | 1.18      |
|  | - Overseas             | 15,654                   | 262            | 1.67      | 20,129                   | 384            | 1.91      |
| Customer accounts: demand deposits                     | - UK                   | 123,707                  | 501            | 0.40      | 121,541                  | 643            | 0.53      |
|  | - Overseas             | 35,733                   | 169            | 0.47      | 35,087                   | 210            | 0.60      |
| Customer accounts: savings deposits                    | - UK                   | 93,245                   | 1,266          | 1.36      | 84,972                   | 1,479          | 1.74      |
|  | - Overseas             | 28,864                   | 101            | 0.35      | 26,989                   | 133            | 0.49      |
| Customer accounts: other time deposits                 | - UK                   | 28,566                   | 433            | 1.52      | 35,848                   | 522            | 1.46      |
|  | - Overseas             | 20,092                   | 361            | 1.80      | 23,776                   | 504            | 2.12      |
| Debt securities in issue                               | - UK                   | 44,085                   | 1,162          | 2.64      | 60,709                   | 1,681          | 2.77      |
|  | - Overseas             | 5,239                    | 145            | 2.77      | 22,294                   | 342            | 1.53      |
| Subordinated liabilities                               | - UK                   | 17,387                   | 649            | 3.73      | 15,629                   | 435            | 2.78      |
|  | - Overseas             | 5,873                    | 237            | 4.04      | 5,461                    | 380            | 6.96      |
| Internal funding of trading business                   | - UK                   | (24,041)                 | 348            | (1.45)    | (21,140)                 | 264            | (1.25)    |
|  | - Overseas             | 4,477                    | (19)           | (0.42)    | 11,992                   | (65)           | (0.54)    |

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|   |           |       |      |           |       |      |
|---|-----------|-------|------|-----------|-------|------|
| Interest-bearing liabilities - UK                           | 290,946   | 4,503 | 1.55 | 315,906   | 5,240 | 1.66 |
| - Overseas  | 115,932   | 1,256 | 1.08 | 145,728   | 1,888 | 1.30 |
| Total interest-bearing liabilities                          |           |       |      |           |       |      |
| - banking business  | 406,878   | 5,759 | 1.42 | 461,634   | 7,128 | 1.54 |
| - trading business  |           |       |      |           |       |      |
| (6)   | 223,264   |       |      | 248,647   |       |      |
| Interest-bearing liabilities                                | 630,142   |       |      | 710,281   |       |      |
| Non-interest-bearing liabilities:                           |           |       |      |           |       |      |
| Demand deposits - UK  | 55,303    |       |      | 46,420    |       |      |
| - Overseas  | 21,304    |       |      | 27,900    |       |      |
| Other liabilities   | 452,068   |       |      | 571,963   |       |      |
| Owners' equity  | 68,549    |       |      | 73,808    |       |      |
| Total liabilities and owners' equity                        | 1,227,366 |       |      | 1,430,372 |       |      |
| Percentage of liabilities applicable to overseas operations | 28.7%     |       |      | 33.9%     |       |      |

For the notes to this table refer to page 116.

## Business review

## Average balance sheet and related interest continued

|  |                        | 2011                     |                |           |
|--|------------------------|--------------------------|----------------|-----------|
|  |                        | Average<br>balance<br>£m | Interest<br>£m | Rate<br>% |
| <b>Assets</b>  |                        |                          |                |           |
| Loans and advances to banks                            | - UK                   | 29,852                   | 277            | 0.93      |
|  | - Overseas             | 41,716                   | 403            | 0.97      |
| Loans and advances to customers                        | - UK                   | 293,777                  | 11,970         | 4.07      |
|  | - Overseas             | 171,938                  | 5,857          | 3.41      |
| Debt securities  | - UK                   | 55,074                   | 1,258          | 2.28      |
|  | - Overseas             | 58,027                   | 1,271          | 2.19      |
| Interest-earning assets                                | - UK                   | 378,703                  | 13,505         | 3.57      |
|  | - Overseas             | 271,681                  | 7,531          | 2.77      |
| Total interest-earning assets                          | - banking business (1) | 650,384                  | 21,036         | 3.23      |
|  | - trading business (6) | 278,975                  |                |           |
| Interest-earning assets                                |                        | 929,359                  |                |           |
| Non-interest-earning assets                            |                        | 605,796                  |                |           |
| Total assets   |                        | 1,535,155                |                |           |
| Percentage of assets applicable to overseas operations |                        | 40.2%                    |                |           |
| <b>Liabilities</b>                                     |                        |                          |                |           |
| Deposits by banks                                      | - UK                   | 17,224                   | 242            | 1.41      |
|  | - Overseas             | 47,371                   | 740            | 1.56      |
| Customer accounts: demand deposits                     | - UK                   | 112,777                  | 666            | 0.59      |
|  | - Overseas             | 43,177                   | 483            | 1.12      |
| Customer accounts: savings deposits                    | - UK                   | 76,719                   | 1,177          | 1.53      |
|  | - Overseas             | 25,257                   | 130            | 0.51      |
| Customer accounts: other time deposits                 | - UK                   | 39,672                   | 481            | 1.21      |
|  | - Overseas             | 33,971                   | 594            | 1.75      |
| Debt securities in issue                               | - UK                   | 108,406                  | 2,606          | 2.40      |
|  | - Overseas             | 42,769                   | 765            | 1.79      |
| Subordinated liabilities                               | - UK                   | 16,874                   | 470            | 2.79      |
|  | - Overseas             | 5,677                    | 270            | 4.76      |
| Internal funding of trading business                   | - UK                   | (40,242)                 | 149            | (0.37)    |
|  | - Overseas             | (8,783)                  | (40)           | 0.46      |
| Interest-bearing liabilities                           | - UK                   | 331,430                  | 5,791          | 1.75      |

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|   |                        |           |       |      |
|---|------------------------|-----------|-------|------|
|   | - Overseas             | 189,439   | 2,942 | 1.55 |
| Total interest-bearing liabilities                          | - banking business     | 520,869   | 8,733 | 1.68 |
|   | - trading business (6) | 307,564   |       |      |
| Interest-bearing liabilities                                |                        | 828,433   |       |      |
| Non-interest-bearing liabilities:                           |                        |           |       |      |
| Demand deposits   | - UK                   | 46,495    |       |      |
|   | - Overseas             | 19,909    |       |      |
| Other liabilities   |                        | 565,279   |       |      |
| Owners' equity  |                        | 75,039    |       |      |
| Total liabilities and owners' equity                        |                        | 1,535,155 |       |      |
| Percentage of liabilities applicable to overseas operations |                        |           | 37.1% |      |

For the notes to this table refer to page 116.

## Business review

## Analysis of change in net interest income - volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

|   | 2013 over 2012                         |                    |                  |
|---|--|--------------------|------------------|
|   | Increase/(decrease) due to changes in: |                    |                  |
|   | Average volume<br>£m                   | Average rate<br>£m | Net change<br>£m |
| Interest-earning assets                           |  |                    |                  |
| Loans and advances to banks                       |  |                    |                  |
| UK  | 60                                     | (47)               | 13               |
| Overseas  | (44)                                   | (32)               | (76)             |
| Loans and advances to customers                   |  |                    |                  |
| UK  | (883)                                  | 617                | (266)            |
| Overseas  | (263)                                  | (534)              | (797)            |
| Debt securities                                   |  |                    |                  |
| UK  | (214)                                  | (177)              | (391)            |
| Overseas  | (177)                                  | (96)               | (273)            |
| Total interest receivable of the banking business |  |                    |                  |
| UK  | (1,037)                                | 393                | (644)            |
| Overseas  | (484)                                  | (662)              | (1,146)          |
|   | (1,521)                                | (269)              | (1,790)          |
| Interest-bearing liabilities                      |  |                    |                  |
| Deposits by banks                                 |  |                    |                  |
| UK  | 155                                    | (83)               | 72               |
| Overseas  | 78                                     | 44                 | 122              |
| Customer accounts: demand deposits                |  |                    |                  |
| UK  | (12)                                   | 154                | 142              |
| Overseas  | (4)                                    | 45                 | 41               |
| Customer accounts: savings deposits               |  |                    |                  |
| UK  | (133)                                  | 346                | 213              |
| Overseas  | (9)                                    | 41                 | 32               |
| Customer accounts: other time deposits            |  |                    |                  |
| UK  | 110                                    | (21)               | 89               |
| Overseas  | 72                                     | 71                 | 143              |
| Debt securities in issue                          |  |                    |                  |
| UK  | 443                                    | 76                 | 519              |
| Overseas  | 364                                    | (167)              | 197              |
| Subordinated liabilities                          |  |                    |                  |
| UK  | (53)                                   | (161)              | (214)            |
| Overseas  | (27)                                   | 170                | 143              |
| Internal funding of trading business              |  |                    |                  |
| UK  | (39)                                   | (45)               | (84)             |
| Overseas  | (34)                                   | (12)               | (46)             |
| Total interest payable of the banking business    |  |                    |                  |

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|                                 |       |       |       |
|---------------------------------|-------|-------|-------|
| UK                              | 471   | 266   | 737   |
| Overseas                        | 440   | 192   | 632   |
|                                 | 911   | 458   | 1,369 |
| Movement in net interest income |       |       |       |
| UK                              | (566) | 659   | 93    |
| Overseas                        | (44)  | (470) | (514) |
|                                 | (610) | 189   | (421) |

## Business review

## Analysis of change in net interest income - volume and rate analysis continued

|  | 2012 over 2011                         |              |            |
|--|--|--------------|------------|
|  | Increase/(decrease) due to changes in: |              |            |
|  | Average volume                         | Average rate | Net change |
|  | £m                                     | £m           | £m         |
| <b>Interest-earning assets</b>                           |  |              |            |
| <b>Loans and advances to banks</b>                       |  |              |            |
| UK   | 32                                     | (61)         | (29)       |
| Overseas   | (13)                                   | (145)        | (158)      |
| <b>Loans and advances to customers</b>                   |  |              |            |
| UK   | (673)                                  | 29           | (644)      |
| Overseas   | (664)                                  | (331)        | (995)      |
| <b>Debt securities</b>                                   |  |              |            |
| UK   | (115)                                  | (128)        | (243)      |
| Overseas   | (376)                                  | (61)         | (437)      |
| <b>Total interest receivable of the banking business</b> |  |              |            |
| UK   | (756)                                  | (160)        | (916)      |
| Overseas   | (1,053)                                | (537)        | (1,590)    |
|  | (1,809)                                | (697)        | (2,506)    |
| <b>Interest-bearing liabilities</b>                      |  |              |            |
| <b>Deposits by banks</b>                                 |  |              |            |
| UK   | (15)                                   | 41           | 26         |
| Overseas   | 495                                    | (139)        | 356        |
| <b>Customer accounts: demand deposits</b>                |  |              |            |
| UK   | (49)                                   | 72           | 23         |
| Overseas   | 78                                     | 195          | 273        |
| <b>Customer accounts: savings deposits</b>               |  |              |            |
| UK   | (133)                                  | (169)        | (302)      |
| Overseas   | (8)                                    | 5            | (3)        |
| <b>Customer accounts: other time deposits</b>            |  |              |            |
| UK   | 50                                     | (91)         | (41)       |
| Overseas   | 200                                    | (110)        | 90         |
| <b>Debt securities in issue</b>                          |  |              |            |
| UK   | 1,279                                  | (354)        | 925        |
| Overseas   | 325                                    | 98           | 423        |
| <b>Subordinated liabilities</b>                          |  |              |            |
| UK   | 33                                     | 2            | 35         |
| Overseas   | 11                                     | (121)        | (110)      |
| <b>Internal funding of trading business</b>              |  |              |            |
| UK   | 99                                     | (214)        | (115)      |
| Overseas   | 13                                     | 12           | 25         |
| <b>Total interest payable of the banking business</b>    |  |              |            |
| UK   | 1,264                                  | (713)        | 551        |
| Overseas   | 1,114                                  | (60)         | 1,054      |
|  |  |              | 231        |

|                                 |       |         |       |
|---------------------------------|-------|---------|-------|
|                                 | 2,378 | (773)   | 1,605 |
| Movement in net interest income |       |         |       |
| UK                              | 508   | (873)   | (365) |
| Overseas                        | 61    | (597)   | (536) |
|                                 | 569   | (1,470) | (901) |



## Business review

## Non-interest income

The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

|   | 2013  | 2012    | 2011   |
|---|-------|---------|--------|
|   | £m    | £m      | £m     |
| Fees and commissions receivable – statutory basis | 5,460 | 5,709   | 6,379  |
| Fees and commissions payable                      |       |         |        |
| - managed basis                                   | (942) | (833)   | (962)  |
| - RFS Holdings minority interest                  | —     | (1)     | —      |
| Statutory basis                                   | (942) | (834)   | (962)  |
| Income from trading activities                    |       |         |        |
| - managed basis                                   | 2,651 | 3,533   | 3,313  |
| - own credit adjustments                          | 35    | (1,813) | 293    |
| - Asset Protection Scheme                         | —     | (44)    | (906)  |
| - RFS Holdings minority interest                  | (1)   | (1)     | 1      |
| Statutory basis                                   | 2,685 | 1,675   | 2,701  |
| Gain on redemption of own debt – statutory basis  | 175   | 454     | 255    |
| Other operating income                            |       |         |        |
| - managed basis                                   | 1,281 | 2,259   | 2,381  |
| - own credit adjustments                          | (155) | (2,836) | 1,621  |
| - integration and restructuring costs             | —     | —       | (3)    |
| - strategic disposals                             | 161   | 113     | (25)   |
| - RFS Holdings minority interest                  | 111   | (1)     | 1      |
| Statutory basis                                   | 1,398 | (465)   | 3,975  |
| Total non-interest income – managed basis         | 8,450 | 10,668  | 11,111 |
| Total non-interest income – statutory basis       | 8,776 | 6,539   | 12,348 |

\*Restated - see page 105.

## 2013 compared with 2012

Non-interest income increased by £2,237 million to £8,776 million primarily due to the lower accounting charge for improved own credit of £120 million compared with £4,649 million in 2012.

Net fees and commissions fell by 7% principally reflecting declines in Markets, UK Corporate, International Banking and Non-Core.

The continuing strengthening of RBS's credit profile, albeit modest, resulted in a £120 million accounting charge in relation to own credit adjustment compared with £4,649 million in 2012.

Income from trading activities increased by £1,010 million to £2,685 million principally due the lower charge in relation to own credit adjustment and increase in Non-Core partially offset by a decline in Markets, where income from trading activities declined by £1,048 million as the division managed down the scale of the balance sheet and reduced risk.

The increase in other operating income predominantly reflected lower accounting charges for own credit adjustments partially offset by losses on disposal and value adjustments in Non-Core. In addition, the disposal of RBS Aviation Capital in June 2012 resulted in a £392 million reduction in operating lease income.

2012 compared with 2011

Non-interest income was down 47% at £6,539 million primarily due to the accounting charge for improved own credit of £4,649 million compared with a credit of £1,914 million in 2011, offset by a lower fair value charge of £44 million compared with £906 million in 2011 on the Asset Protection Scheme.

Net fees and commissions fell by 10% largely due to a decline in UK Retail fees, as a result of weaker consumer spending volumes, and in Markets, primarily due to the run-off in the cash equity business.

Markets trading income was sustained, despite the significant reduction in trading assets following its restructuring early in 2012.

The decrease in other operating income predominantly reflected own credit adjustments and the disposal of RBS Aviation Capital in June 2012, which resulted in lower rental income in Non-Core, partially offset by a lower fair value charge on the Asset Protection Scheme.

The continuing strengthening of RBS's credit profile resulted in a £4,649 million accounting charge in relation to own credit adjustment versus a gain of £1,914 million in 2011. This reflected a tightening of more than 340 basis points in the Group's cash market credit spreads over the year.

APS is accounted for as a derivative and the movements in fair value are recorded each quarter. The fair value charge was £44 million in 2012 versus £906 million in 2011.

## Business review

## Operating expenses

The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

|  | 2013   | 2012*  | 2011*  |
|--|--------|--------|--------|
|  | £m     | £m     | £m     |
| Staff costs  |        |        |        |
| - managed basis  | 6,882  | 7,377  | 8,072  |
| - integration and restructuring costs                      | 280    | 812    | 464    |
| - bonus tax  | —      | —      | 27     |
| - RFS Holdings minority interest                           | 1      | (1)    | (1)    |
| Statutory basis  | 7,163  | 8,188  | 8,562  |
| Premises and equipment                                     |        |        |        |
| - managed basis  | 2,233  | 2,096  | 2,246  |
| - integration and restructuring costs                      | 115    | 136    | 177    |
| Statutory basis  | 2,348  | 2,232  | 2,423  |
| Other administrative expenses                              |        |        |        |
| - managed basis  | 2,947  | 2,899  | 2,922  |
| - Payment Protection Insurance costs                       | 900    | 1,110  | 850    |
| - Interest Rate Hedging Products redress and related costs | 550    | 700    | —      |
| - regulatory and legal actions                             | 2,394  | 381    | —      |
| - integration and restructuring costs                      | 255    | 325    | 364    |
| - bank levy  | 200    | 175    | 300    |
| - RFS Holdings minority interest                           | (2)    | 3      | —      |
| Statutory basis  | 7,244  | 5,593  | 4,436  |
| Administrative expenses                                    | 16,755 | 16,013 | 15,421 |
| Depreciation and amortisation                              |        |        |        |
| - managed basis  | 1,251  | 1,482  | 1,606  |
| - amortisation of purchased intangible assets              | 153    | 178    | 222    |
| - integration and restructuring costs                      | 6      | 142    | 11     |
| Statutory basis  | 1,410  | 1,802  | 1,839  |
| Write-down of goodwill                                     | 1,059  | 18     | 80     |
| Write-down of other intangible assets                      | 344    | 106    | —      |
| Operating expenses   | 19,568 | 17,939 | 17,340 |
| Staff costs as a percentage of total income                | 36%    | 46%    | 35%    |

\*Restated - see page 105.

## 2013 compared with 2012

Operating expenses increased by £1,629 million, or 9% primarily due to higher charges resulting from regulatory and legal actions, and write-down of goodwill and other intangible assets, primarily in International Banking. These were partially offset by lower charges on Payment Protection Insurance claims, Interest Rate Hedging Products redress and

integration and restructuring costs.

Staff expenses were down by 13%. Excluding integration and restructuring costs of £280 million (2012 - £812 million), staff costs were down 7%, as staff numbers (FTEs) fell by 4,100 to 118,400, principally in UK Retail, Markets and Non-Core.

Charges of £2,394 million of regulatory and litigation provisions were recorded during the year primarily relating to mortgage-backed and other securities litigation in the US.

Write-down of goodwill and other intangible assets was £1,403 million and includes £1,059 million relating to the International Banking division following an impairment review.

Charges for PPI redress and related costs totalled £900 million, down £210 million from 2012. Of the cumulative provision of £3.1 billion, £2.2 billion had been utilised at 31 December 2013. The remaining provision of £900 million covers approximately twelve months of redress and administrative expenses.

Charges of £550 million were booked for Interest Rate Hedging Product redress and administration costs, down £150 million from 2012. The cumulative provision was £1.25 billion at 31 December 2013.

## Business review

## Operating expenses continued

## 2012 compared with 2011

Operating expenses increased by £599 million, or 3% primarily due to charges resulting from legacy conduct issues partially offset by Non-Core run-down and run-off of exited businesses in Markets and International Banking, following the restructuring announced in January 2012. Simplification of processes and headcount reduction in UK Retail also yielded cost benefits.

Staff expenses were cut by 4%. Excluding integration and restructuring costs of £812 million (2011 - £464 million), staff costs were down 9%, as headcount fell by 10,200 to 118,700.

To reflect current experience of Payment Protection Insurance complaints received, RBS increased its PPI provision by £1,110 million in 2012, bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion in redress had been paid by 31 December 2012.

On 31 January 2013, the Financial Services Authority announced the findings of its industry-wide review of the sale of Interest Rate Hedging Products to some small and medium-sized businesses that were classified as retail clients under FSA rules. As a result, RBS provided £700 million in 2012 to meet the costs of redress.

On 6 February 2013, RBS reached agreement with the Financial Services Authority, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The Group continues to co-operate with other bodies in this regard and expects it will incur some additional financial penalties.

## Integration costs

|                               | 2013 | 2012 | 2011 |
|-------------------------------|------|------|------|
|                               | £m   | £m   | £m   |
| Staff costs                   | —    | —    | 38   |
| Premises and equipment        | 1    | (2)  | 6    |
| Other administrative expenses | 1    | 2    | 51   |
| Depreciation and amortisation | —    | —    | 11   |
|                               | 2    | —    | 106  |

## Note:

(1) Integration costs in 2011 excluded a £2 million charge included within net interest income and a loss of £3 million within other operating income in respect of integration activities.

Integration costs of £106 million in 2011 primarily relate to RBS N.V. (formerly ABN AMRO) integration activity during the year, which is now largely complete.

Accruals in relation to integration costs are set out below.

|                               | At 1 January | Charge    | Utilised | At          |
|-------------------------------|--------------|-----------|----------|-------------|
|                               | 2013         | to income | during   | 31 December |
|                               | £m           | statement | the year | 2013        |
|                               |              | £m        | £m       | £m          |
| Premises and equipment        | 9            | 1         | (10)     | —           |
| Other administrative expenses | 5            | 1         | —        | 6           |



## Business review

## Restructuring costs

|                               | 2013 | 2012* | 2011* |
|-------------------------------|------|-------|-------|
|                               | £m   | £m    | £m    |
| Staff costs                   | 194  | 700   | 342   |
| Premises and equipment        | 112  | 141   | 155   |
| Other administrative expenses | 177  | 261   | 268   |
| Depreciation and amortisation | 6    | 142   | —     |
|                               | 489  | 1,244 | 765   |

\*Restated - see page 105.

## 2013 compared with 2012

Restructuring costs were £489 million compared with £1,244 million in 2012. These costs primarily relate to the Retail transformation and the reduction in the size of Markets.

## 2012 compared with 2011

Restructuring costs were £1,244 million compared with £765 million in 2011. The increase was primarily driven by costs incurred in relation to the strategic restructuring of Markets and International Banking announced in January 2012.

Accruals in relation to restructuring costs are set out below.

|                               | At<br>1 January<br>2013 | Currency<br>translation<br>adjustments | Charge<br>to income<br>statement | Utilised<br>during<br>the year | At<br>31 December<br>2013 |
|-------------------------------|-------------------------|--|----------------------------------|--------------------------------|---------------------------|
|                               | £m                      | £m                                     | £m                               | £m                             | £m                        |
| Staff costs - redundancy      | 434                     | 4                                      | 137                              | (396)                          | 179                       |
| Staff costs - other           | 111                     | 1                                      | 57                               | (125)                          | 44                        |
| Premises and equipment        | 289                     | —                                      | 112                              | (97)                           | 304                       |
| Other administrative expenses | 264                     | 1                                      | 177                              | (228)                          | 214                       |
| Depreciation and amortisation | —                       | —                                      | 6                                | (6)                            | —                         |
|                               | 1,098                   | 6                                      | 489                              | (852)                          | 741                       |

## Divestment costs

|                               | 2013 | 2012* | 2011* |
|-------------------------------|------|-------|-------|
|                               | £m   | £m    | £m    |
| Staff costs                   | 86   | 111   | 84    |
| Premises and equipment        | 2    | (2)   | 11    |
| Other administrative expenses | 77   | 62    | 50    |
|                               | 165  | 171   | 145   |

\*Restated - see page 105.

Divestment costs of £165 million in 2013 (2012 - £171 million; 2011 - £145 million) relate to preparation for the European Commission mandated divestments.

Accruals in relation to divestment costs are set out below.

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|                               | At<br>1 January<br>2013<br>£m | Charge<br>to income<br>statement<br>£m | Utilised<br>during<br>the year<br>£m | At<br>31 December<br>2013<br>£m |
|-------------------------------|-------------------------------|--|--------------------------------------|---------------------------------|
| Staff costs - redundancy      | 87                            | 34                                     | (104)                                | 17                              |
| Staff costs - other           | 46                            | 52                                     | (96)                                 | 2                               |
| Premises and equipment        | —                             | 2                                      | (2)                                  | —                               |
| Other administrative expenses | 73                            | 77                                     | (137)                                | 13                              |
|                               | 206                           | 165                                    | (339)                                | 32                              |

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## Business review

## Impairment losses

The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

|   | 2013  | 2012  | 2011  |
|---|-------|-------|-------|
|   | £m    | £m    | £m    |
| New impairment losses   | 8,688 | 5,620 | 9,234 |
| Less: recoveries of amounts previously written-off                      | (256) | (341) | (527) |
| Charge to income statement  | 8,432 | 5,279 | 8,707 |
| Comprising:   |       |       |       |
| Loan impairment losses  | 8,412 | 5,315 | 7,241 |
| Securities  |       |       |       |
| - managed basis   | 20    | (36)  | 198   |
| - sovereign debt impairment and related interest rate hedge adjustments | —     | —     | 1,268 |
| Statutory basis   | 20    | (36)  | 1,466 |
| Charge to income statement  | 8,432 | 5,279 | 8,707 |
| Of which RCR related (1)  | 4,490 | —     | —     |

## Note:

(1) Pertaining to the creation of RCR and related strategy.

RBS Capital Resolution ('RCR') was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate the run-down of these exposures over a three year period to free up capital for the bank. This revised strategy to run down high risk loans faster resulted in an increased impairment charge relating to impaired or non-performing assets transferred to RCR, reflecting adverse changes in our estimates of future cash flows. Further details about RCR are set out on pages 158 to 161.

## 2013 compared with 2012

Group loan impairment losses rose by 58% to £8,412 million reflecting the increased provisions recognised in connection with the creation of RCR. Adjusting for this, impairment losses fell by £1,393 million (26%) to £3,922 million, driven by significant improvements in Non-Core, Ulster Bank and UK Retail, partially offset by increases in International Banking, US Retail & Commercial and Markets.

Additional loan impairments arising from the RCR accelerated asset recovery strategy totalled £4,490 million, of which £3,118 million related to Non-Core, £892 million to Ulster Bank, £410 million to UK Corporate, £52 million to International Banking and £18 million to Markets.

Excluding the impact of the creation of RCR, Core Ulster Bank loan impairments fell by £482 million (35%) to £882 million, mainly as a result of continued improvement in retail mortgage debt-flow and in recovery trends. UK Retail loan impairments fell by £210 million (40%), primarily from lower default levels.

Excluding the impact of the creation of RCR, Non-Core loan impairments fell by £792 million to £1,528 million, reflecting the continued reduction in the overall portfolio.

2012 compared with 2011

Total impairment losses declined by £3,428 million to £5,279 million which included the non-repeat of a sovereign debt impairment and related interest rate hedge adjustment of £1,268 million in 2011. Within the total impairment losses, loan impairment losses declined by £1,926 million to £5,315 million, primarily driven by a £1,518 million fall in Non-Core impairments, mostly in the Ulster Bank and commercial real estate portfolios.

Core loan impairments were down £408 million, or 12%, largely due to lower default rates in UK Retail and an improved credit environment for US Retail & Commercial, which helped drive impairment reductions of £259 million and £165 million respectively. Core Ulster Bank impairments stabilised, though still at a very high level (£1,364 million in 2012 versus £1,384 million in 2011).

Loan impairments as a percentage of gross loans and advances improved by 30 basis points, principally reflecting the improved credit profile in Non-Core and the better US credit environment.

Loan impairment provisions rose to £21.3 billion, increasing coverage of risk elements in lending to 52%, compared with 49% in 2011.

## Business review

| Tax                     | 2013  | 2012* | 2011*   |
|-------------------------|-------|-------|---------|
|                         | £m    | £m    | £m      |
| Tax charge              | (382) | (441) | (1,075) |
|                         | %     | %     | %       |
| UK corporation tax rate | 23.25 | 24.50 | 26.50   |

\*Restated – see page 105.

The actual tax charge differs from the expected tax credit computed by applying the standard rate of UK corporation tax as follows:

|   | 2013  | 2012* | 2011*   |
|---|-------|-------|---------|
|   | £m    | £m    | £m      |
| Expected tax credit   | 1,916 | 1,293 | 370     |
| Sovereign debt impairment where no deferred tax asset recognised          | —     | —     | (275)   |
| Other losses in year where no deferred tax asset recognised               | (879) | (511) | (530)   |
| Foreign profits taxed at other rates                                      | (196) | (383) | (417)   |
| UK tax rate change impact   | (313) | (149) | (112)   |
| Unrecognised timing differences   | (8)   | 59    | (20)    |
| Non-deductible goodwill impairment  | (247) | —     | —       |
| Items not allowed for tax   |       |       |         |
| - losses on disposals and write-downs                                     | (20)  | (49)  | (72)    |
| - UK bank levy  | (47)  | (43)  | (80)    |
| - regulatory and legal actions  | (144) | (93)  | —       |
| - employee share schemes  | (11)  | (9)   | (113)   |
| - other disallowable items  | (202) | (246) | (285)   |
| Non-taxable items   |       |       |         |
| - gain on sale of RBS Aviation Capital                                    | —     | 26    | —       |
| - gain on sale of WorldPay (Global Merchant Services)                     | 37    | —     | 12      |
| - other non-taxable items   | 171   | 104   | 242     |
| Taxable foreign exchange movements  | (25)  | (1)   | 4       |
| Losses brought forward and utilised                                       | 36    | 2     | 2       |
| Reduction in carrying value of deferred tax asset in respect of losses in |       |       |         |
| - UK  | (701) | —     | —       |
| - Australia   | —     | (191) | —       |
| - Ireland   | —     | (203) | —       |
| Adjustments in respect of prior years                                     | 251   | (47)  | 199     |
| Actual tax charge   | (382) | (441) | (1,075) |

\*Restated - see page 105.

2013 compared with 2012

The tax charge in the year ended 31 December 2013 reflects losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), a reduction in the carrying value of the deferred tax asset in respect of UK losses and the effect of the reduction of 3% in the rate of UK corporation tax enacted in July 2013.

2012 compared with 2011

The high tax charge in 2012 reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), the reduction in the carrying value of deferred tax assets in Ireland in view of continuing losses, the reduction in the carrying value of deferred tax assets in Australia following the strategic changes to the Markets and International Banking businesses announced in January 2012, and the effect of the two reductions of 1% in the rate of UK corporation tax enacted in March 2012 and July 2012 on the net deferred tax balance.

## Business review

## Divisional performance

| Operating profit/(loss) by division                                   | 2013    | 2012*   | 2011*   |
|---|---------|---------|---------|
|   | £m      | £m      | £m      |
| UK Retail   | 1,943   | 1,891   | 2,021   |
| UK Corporate  | 1,060   | 1,796   | 1,924   |
| Wealth  | 221     | 243     | 242     |
| International Banking   | 279     | 594     | 755     |
| Ulster Bank   | (1,457) | (1,040) | (984)   |
| US Retail & Commercial  | 647     | 754     | 537     |
| Retail & Commercial   | 2,693   | 4,238   | 4,495   |
| Markets   | 620     | 1,509   | 899     |
| Central items   | (89)    | 84      | (34)    |
| Core  | 3,224   | 5,831   | 5,360   |
| Non-Core  | (5,527) | (2,879) | (4,219) |
| Operating (loss)/profit - managed basis                               | (2,303) | 2,952   | 1,141   |
| Reconciling items   |         |         |         |
| Own credit adjustments  | (120)   | (4,649) | 1,914   |
| Payment Protection Insurance costs                                    | (900)   | (1,110) | (850)   |
| Interest Rate Hedging Products redress and related costs              | (550)   | (700)   | —       |
| Regulatory and legal actions  | (2,394) | (381)   | —       |
| Sovereign debt impairment and related interest rate hedge adjustments | —       | —       | (1,268) |
| Integration and restructuring costs                                   | (656)   | (1,415) | (1,021) |
| Gain on redemption of own debt  | 175     | 454     | 255     |
| Write-down of goodwill  | (1,059) | (18)    | —       |
| Asset Protection Scheme   | —       | (44)    | (906)   |
| Amortisation of purchased intangible assets                           | (153)   | (178)   | (222)   |
| Strategic disposals   | 161     | 113     | (105)   |
| Bonus tax   | —       | —       | (27)    |
| Bank levy   | (200)   | (175)   | (300)   |
| Write-down of other intangible assets                                 | (344)   | (106)   | —       |
| RFS Holdings minority interest  | 100     | (20)    | (7)     |
| Operating loss before tax - statutory basis                           | (8,243) | (5,277) | (1,396) |

\*Restated - see page 105.

## Business review

## Divisional performance continued

|   |        |       |       |
|---|--------|-------|-------|
| Impairment losses/(recoveries) by division                            | 2013   | 2012  | 2011  |
|   | £m     | £m    | £m    |
| UK Retail   | 324    | 529   | 788   |
| UK Corporate  | 1,188  | 838   | 793   |
| Wealth  | 29     | 46    | 25    |
| International Banking   | 229    | 111   | 168   |
| Ulster Bank   | 1,774  | 1,364 | 1,384 |
| US Retail & Commercial  | 156    | 91    | 326   |
| Retail & Commercial   | 3,700  | 2,979 | 3,484 |
| Markets   | 92     | 37    | 38    |
| Central items   | 64     | 40    | (2)   |
| Core  | 3,856  | 3,056 | 3,520 |
| Non-Core  | 4,576  | 2,223 | 3,917 |
| Managed basis   | 8,432  | 5,279 | 7,437 |
| Reconciling items   |        |       |       |
| Sovereign debt impairment and related interest rate hedge adjustments | —      | —     | 1,268 |
| RFS Holdings minority interest  | —      | —     | 2     |
| Statutory basis   | 8,432  | 5,279 | 8,707 |
| Of which RCR related (1)  | 4,490  | —     | —     |
| Net interest margin by division                                       | 2013   | 2012  | 2011  |
|   | %      | %     | %     |
| UK Retail   | 3.57   | 3.58  | 3.95  |
| UK Corporate  | 3.07   | 3.06  | 3.06  |
| Wealth  | 3.56   | 3.73  | 3.23  |
| International Banking   | 1.59   | 1.64  | 1.73  |
| Ulster Bank   | 1.91   | 1.88  | 1.87  |
| US Retail & Commercial  | 2.95   | 2.97  | 3.03  |
| Retail & Commercial   | 2.94   | 2.92  | 2.96  |
| Non-Core  | (0.19) | 0.31  | 0.60  |
| Group net interest margin   | 2.02   | 1.92  | 1.89  |
| Risk-weighted assets by division                                      | 2013   | 2012  | 2011  |
|   | £bn    | £bn   | £bn   |
| UK Retail   | 43.9   | 45.7  | 48.4  |
| UK Corporate  | 86.1   | 86.3  | 79.3  |
| Wealth  | 12.0   | 12.3  | 12.9  |
| International Banking   | 49.0   | 51.9  | 43.2  |
| Ulster Bank   | 30.7   | 36.1  | 36.3  |
| US Retail & Commercial  | 56.1   | 56.5  | 59.3  |
| Retail & Commercial   | 277.8  | 288.8 | 279.4 |
| Markets   | 64.5   | 101.3 | 120.3 |

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|   |       |       |        |
|---|-------|-------|--------|
| Other   | 10.1  | 5.8   | 12.0   |
| Core  | 352.4 | 395.9 | 411.7  |
| Non-Core  | 29.2  | 60.4  | 93.3   |
| Group before benefit of Asset Protection Scheme | 381.6 | 456.3 | 505.0  |
| Benefit of Asset Protection Scheme              | —     | —     | (69.1) |
| Group before RFS Holdings minority interest     | 381.6 | 456.3 | 435.9  |
| RFS Holdings minority interest                  | 3.9   | 3.3   | 3.1    |
| Group   | 385.5 | 459.6 | 439.0  |

Note:

(1) Pertaining to the creation of RCR and related strategy.

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## Business review

## Divisional performance continued

## Employee numbers at 31 December

(full time equivalents rounded to the nearest hundred)

|                               | 2013    | 2012    | 2011    |
|-------------------------------|---------|---------|---------|
| UK Retail                     | 23,700  | 26,000  | 27,700  |
| UK Corporate                  | 13,700  | 13,300  | 13,600  |
| Wealth                        | 4,800   | 5,100   | 5,500   |
| International Banking         | 4,700   | 4,600   | 5,600   |
| Ulster Bank                   | 4,700   | 4,500   | 4,200   |
| US Retail & Commercial        | 18,500  | 18,700  | 19,500  |
| Retail & Commercial           | 70,100  | 72,200  | 76,100  |
| Markets                       | 10,300  | 11,300  | 14,000  |
| Central items                 | 7,400   | 6,800   | 6,200   |
| Core                          | 87,800  | 90,300  | 96,300  |
| Non-Core                      | 1,400   | 3,100   | 4,700   |
|                               | 89,200  | 93,400  | 101,000 |
| Business Services             | 29,200  | 29,100  | 29,800  |
| Integration and restructuring | 200     | 500     | 1,100   |
| Group                         | 118,600 | 123,000 | 131,900 |



## Business review

## UK Retail

|   | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
|   | £m      | £m      | £m      |
| Net interest income   | 3,979   | 3,990   | 4,302   |
| Net fees and commissions  | 919     | 884     | 1,066   |
| Other non-interest income   | 39      | 95      | 140     |
| Non-interest income   | 958     | 979     | 1,206   |
| Total income  | 4,937   | 4,969   | 5,508   |
| Direct expenses   |         |         |         |
| - staff   | (707)   | (811)   | (853)   |
| - other   | (562)   | (372)   | (437)   |
| Indirect expenses   | (1,401) | (1,366) | (1,409) |
| Profit before impairment losses   | 2,267   | 2,420   | 2,809   |
| Impairment losses   | (324)   | (529)   | (788)   |
| Operating profit  | 1,943   | 1,891   | 2,021   |
| Analysis of income by product   |         |         |         |
| Personal advances   | 923     | 916     | 1,089   |
| Personal deposits   | 468     | 661     | 961     |
| Mortgages   | 2,606   | 2,367   | 2,277   |
| Cards   | 838     | 863     | 950     |
| Other   | 102     | 162     | 231     |
| Total income  | 4,937   | 4,969   | 5,508   |
| Analysis of impairments by sector   |         |         |         |
| Mortgages   | 30      | 92      | 182     |
| Personal  | 180     | 307     | 437     |
| Cards   | 114     | 130     | 169     |
| Total impairment losses   | 324     | 529     | 788     |
| Loan impairment charge as % of gross customer loans and advances<br>(excluding reverse repurchase agreements) by sector |         |         |         |
| Mortgages   | —       | 0.1%    | 0.2%    |
| Personal  | 2.2%    | 3.5%    | 4.3%    |
| Cards   | 2.0%    | 2.3%    | 3.0%    |
| Total   | 0.3%    | 0.5%    | 0.7%    |
| Performance ratios  |         |         |         |
| Return on equity (1)  | 26.3%   | 24.4%   | 24.5%   |
| Net interest margin   | 3.57%   | 3.58%   | 3.95%   |
| Cost:income ratio   | 54%     | 51%     | 49%     |

For the notes to this table refer to the following page.



## Business review

## UK Retail continued

|  | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|--|-------------|-------------|-------------|
| Capital and balance sheet                    |             |             |             |
| Loans and advances to customers (gross)      |             |             |             |
| - mortgages                                  | 99.3        | 99.1        | 95.0        |
| - personal                                   | 8.1         | 8.8         | 10.1        |
| - cards                                      | 5.8         | 5.7         | 5.7         |
|  | 113.2       | 113.6       | 110.8       |
| Loan impairment provisions                   | (2.1)       | (2.6)       | (2.7)       |
| Net loans and advances to customers          | 111.1       | 111.0       | 108.1       |
| Risk elements in lending                     | 3.6         | 4.6         | 4.6         |
| Provision coverage (2)                       | 59%         | 58%         | 58%         |
| Customer deposits                            |             |             |             |
| - current accounts                           | 32.6        | 28.9        | 26.8        |
| - savings                                    | 82.3        | 78.7        | 75.1        |
| Total customer deposits                      | 114.9       | 107.6       | 101.9       |
| Assets under management (excluding deposits) | 5.8         | 6.0         | 5.5         |
| Loan:deposit ratio (excluding repos)         | 97%         | 103%        | 106%        |
| Risk-weighted assets (3)                     |             |             |             |
| - credit risk (non-counterparty)             | 36.1        | 37.9        | 41.1        |
| - operational risk                           | 7.8         | 7.8         | 7.3         |
| Total risk-weighted assets                   | 43.9        | 45.7        | 48.4        |

## Notes:

- (1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
- (2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
- (3) Divisional RWAs are based on a long-term conservative average secured mortgage probability of default methodology rather than the current lower point in time basis required for regulatory reporting.

In March 2013 UK Retail announced its strategy to become a simpler and more customer-focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Good progress has been made with £180 million of investment during 2013 through a number of initiatives directed at enhancing customer service and simplification of products and services. These have included:

- Improvements to Mobile and Digital Banking which continue to evolve in line with how customers prefer to conduct their business. One example of this is the enhancements in the mobile application allowing customers to pay their mobile phone contacts and obtain cash without using their debit card with the award winning 'Get Cash'. Investment in digital products and services continued in 2013, with 50% of eligible customers now banking online or on mobile. We currently have 5.6 million online users and 2.9 million customers using our mobile app with over 100 million transactions made in 2013. Branch counter transactions were 31 million or 11% lower across the same period. In

addition, UK Retail now has over 2.5 million active mobile users, using the service 28 times a month on average. Mobile net promoter scores continued to increase in 2013.

- During the year UK Retail invested in the introduction of a new integrated telephony system, increased training and the professional development of our staff. We spent more time on each call to support excellent customer service and to promote relevant offerings, including self service.
- During Q1 2013 mortgage advisors attended extensive training courses to help ensure customers receive the best possible outcome to meet their needs. The training affected balance growth during H1 2013; however, application volumes have rebounded quickly with the launch of competitively priced products and the 'NatYes' and 'RBYES' advertising campaigns leading to H2 2013 applications being 30% higher than H1 2013. RBS was the first bank to be ready to deliver the second phase of the UK Government's Help To Buy scheme, launched in early October 2013. Extended opening hours in branches helped to deliver more than 3,000 approvals assisting young people and families across Britain buy their home. Gross mortgage lending increased 3% year-on-year to £14.3 billion with Q4 2013 25% higher than Q4 2012.

## Business review

### UK Retail continued

- Significant focus on streamlining processes has benefited all distribution channels, with the capacity created allowing more time for staff coaching and resulting in advisors spending more time and having better conversations with customers.
- In addition, our product range has been simplified down from 56 to 46 with several products winning awards. A highlight of this UK Retail strategy is the success of the new instant saver product launched in Q4 2012, which at the end of 2013 had more than £10 billion in balances. Furthermore, nearly 800,000 customers have registered for Cashback Plus online since launch in Q3 2013 and are being rewarded for using their debit cards with selected retailers.
- A major branch refurbishment programme is under way with over one quarter completed. 350 branches now have a digital banking zone where customers can use in-branch technology to access online banking. Wi-Fi in-branch allows customers to access their account via their own devices.

During 2013 good progress has been made with FCA (Financial Conduct Authority) reportable complaints, which declined 22%. In addition, the provision relating to historic Payment Protection Insurance (PPI) mis-selling was increased by £860 million, bringing the total to £3.0 billion. The PPI expense is not included in the operating profit of UK Retail.

In 2014, UK Retail will aim to maintain a leading position in digital banking, launching new capability and customer proposition through mobile devices.

### 2013 compared with 2012

Operating profit increased by 3% to £1,943 million driven by a 39% decline in impairment losses. Net interest income was broadly stable, though investment advice income was adversely impacted following changes introduced by the Retail Distribution Review (RDR). Costs increased primarily because of a higher FSCS levy and other regulatory charges totalling £116 million in the year, conduct-related provisions of £63 million and additional technology investment of £45 million.

Mortgage balance growth was affected in H1 2013 by mortgage advisor training; however, balances recovered during H2 2013 assisted by early adoption of the second phase of the UK Government's Help To Buy scheme. Gross lending increased to £8.9 billion in H2 2013. Customer deposits increased by 7%, above the UK market average of 4% due to strong growth in both current accounts (13%) and instant access savings accounts (15%).

Net interest income was broadly flat.

- Mortgage new business margins reduced in line with market conditions; however, overall book margins improved.
- Deposit margins declined reflecting the impact of continued lower rates on current account hedges. Savings margins, however, have increased over 2013 with improved market pricing.

Non-interest income fell by 2% to £958 million due to subdued advice income post RDR.

Direct costs increased by 7% due to higher FSCS levy and other regulatory charges and conduct-related provisions of £63 million. This was partly offset by lower staff costs due to a reduction in headcount of 2,300. Indirect costs increased by 3%, largely due to investment in technology.

Impairments declined by 39% to £324 million due to lower customer defaults across all products reflecting continued improvement in asset quality.

Risk-weighted assets declined by 4% to £43.9 billion largely reflecting balance reductions across the unsecured portfolio and quality improvements.

2012 compared with 2011

Operating profit fell by 6% as a 10% decline in income was only partly offset by lower costs, down 6%, and improved impairment losses, down 33%.

Mortgage balances grew by £4.1 billion with the share of new business at 10%, ahead of our stock level of 8%. Growth as a result of FLS was starting to appear by the end of the year as mortgage applications moved through the pipeline to completion. Deposit growth of 6% was in line with the market and drove a 300 basis point improvement in the loan:deposit ratio to 103%.

Net interest income was down 7% due to weaker deposit margins and reduction in unsecured balances, partly offset by mortgage growth. Unsecured balances now represent 13% of total loans and advances to customers compared with 23% in 2008, following realignment of risk appetite and strong mortgage growth. Net interest margin declined as a result of lower rates on current account hedges and increased competition on savings rates in the early part of the year, partly offset by widening asset margins.

Non-interest income was 19% lower mainly due to:

- lower unauthorised overdraft fees as we continue to help customers manage their finances by providing mobile text alerts and further improving mobile banking functionality;
- weak consumer confidence lowering spending and associated fees on cards; and
- lower investment income as a result of weak customer demand and less advisor availability due to restructuring and retraining in preparation for regulatory changes in 2013.

Costs were down £150 million, 6%, driven by the ongoing simplification of processes across the business, lower headcount and lower FSCS levy.

Impairment losses were £259 million or 33% lower, reflecting the continued benefit of risk appetite tightening in prior years and also a smaller unsecured loan book. Impairments as a percentage of loans and advances were 50 basis points versus 70 basis points in 2011.

Risk-weighted assets continued to improve over the year as the portfolio mix adjusted, with increases in lower-risk secured mortgages, decreases in unsecured lending and further quality improvements across the book.

## Business review

| UK Corporate  | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
|   | £m      | £m      | £m      |
| Net interest income   | 2,874   | 2,974   | 3,092   |
| Net fees and commissions  | 1,310   | 1,365   | 1,375   |
| Other non-interest income   | 283     | 384     | 396     |
| Non-interest income   | 1,593   | 1,749   | 1,771   |
| Total income  | 4,467   | 4,723   | 4,863   |
| Direct expenses   |         |         |         |
| - staff   | (912)   | (940)   | (934)   |
| - other   | (442)   | (364)   | (390)   |
| Indirect expenses   | (865)   | (785)   | (822)   |
|   | (2,219) | (2,089) | (2,146) |
| Profit before impairment losses   | 2,248   | 2,634   | 2,717   |
| Impairment losses   | (1,188) | (838)   | (793)   |
| Operating profit  | 1,060   | 1,796   | 1,924   |
| Analysis of income by business  |         |         |         |
| Corporate and commercial lending  | 2,557   | 2,636   | 2,643   |
| Asset and invoice finance   | 671     | 685     | 660     |
| Corporate deposits  | 350     | 568     | 694     |
| Other   | 889     | 834     | 866     |
| Total income  | 4,467   | 4,723   | 4,863   |
| Analysis of impairments by sector   |         |         |         |
| Financial institutions  | 10      | 15      | 20      |
| Hotels and restaurants  | 53      | 52      | 59      |
| Housebuilding and construction  | 39      | 143     | 103     |
| Manufacturing   | 50      | 49      | 34      |
| Private sector education, health, social work, recreational and community services                                      | 138     | 37      | 113     |
| Property  | 439     | 252     | 170     |
| Wholesale and retail trade, repairs   | 74      | 112     | 85      |
| Asset and invoice finance   | 32      | 40      | 38      |
| Shipping  | 341     | 82      | 22      |
| Other   | 12      | 56      | 149     |
| Total impairment losses   | 1,188   | 838     | 793     |
| Of which RCR related (1)  | 410     | —       | —       |
| Loan impairment charge as % of gross customer loans and advances<br>(excluding reverse repurchase agreements) by sector |         |         |         |
| Financial institutions  | 0.2%    | 0.3%    | 0.3%    |
| Hotels and restaurants  | 1.1%    | 0.9%    | 1.0%    |
| Housebuilding and construction  | 1.3%    | 4.2%    | 2.6%    |
| Manufacturing   | 1.2%    | 1.0%    | 0.7%    |
| Private sector education, health, social work, recreational and community services                                      | 1.6%    | 0.4%    | 1.3%    |
| Property  | 2.0%    | 1.0%    | 0.6%    |
| Wholesale and retail trade, repairs   | 0.9%    | 1.3%    | 1.0%    |
| Asset and invoice finance   | 0.3%    | 0.4%    | 0.4%    |

|          |      |      |      |
|----------|------|------|------|
| Shipping | 5.2% | 1.1% | 0.3% |
| Other    | —    | 0.2% | 0.6% |
| Total    | 1.2% | 0.8% | 0.7% |

Note:

(1) Pertaining to the creation of RCR and related strategy.



## Business review

## UK Corporate continued

|  | 2013  | 2012  | 2011  |
|--|-------|-------|-------|
| Performance ratios   |       |       |       |
| Return on equity (1)   | 7.9%  | 14.5% | 15.2% |
| Net interest margin  | 3.07% | 3.06% | 3.06% |
| Cost:income ratio  | 50%   | 44%   | 44%   |
| Capital and balance sheet  | £bn   | £bn   | £bn   |
| Loans and advances to customers (gross)  |       |       |       |
| - financial institutions   | 5.5   | 5.8   | 5.8   |
| - hotels and restaurants   | 4.7   | 5.6   | 6.1   |
| - housebuilding and construction   | 2.9   | 3.4   | 3.9   |
| - manufacturing  | 4.2   | 4.7   | 4.7   |
| - private sector education, health, social work, recreational and community services | 8.5   | 8.7   | 8.7   |
| - property   | 22.0  | 24.8  | 28.2  |
| - wholesale and retail trade, repairs  | 8.2   | 8.5   | 8.7   |
| - asset and invoice finance  | 11.7  | 11.2  | 10.4  |
| - shipping   | 6.5   | 7.6   | 7.8   |
| - other  | 28.3  | 26.7  | 26.4  |
|  | 102.5 | 107.0 | 110.7 |
| Loan impairment provisions   | (2.8) | (2.4) | (2.1) |
| Net loans and advances to customers  | 99.7  | 104.6 | 108.6 |
| Total third party assets   | 105.0 | 110.2 | 114.2 |
| Risk elements in lending   | 6.2   | 5.5   | 5.0   |
| Provision coverage (2)   | 46%   | 45%   | 40%   |
| Customer deposits  | 124.7 | 127.1 | 126.3 |
| Loan:deposit ratio (excluding repos)   | 80%   | 82%   | 86%   |
| Risk-weighted assets   |       |       |       |
| - credit risk (non-counterparty)   | 77.7  | 77.7  | 71.2  |
| - operational risk   | 8.4   | 8.6   | 8.1   |
| Total risk-weighted assets   | 86.1  | 86.3  | 79.3  |

## Notes:

(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

2013 was a year in which UK Corporate underlined its commitment to support the UK economy and played an active role in the communities it operates in.

As part of this commitment the Bank appointed Sir Andrew Large to undertake a thorough and independent review of the lending standards and practices used by RBS and NatWest. UK Corporate will implement all of the Independent Lending Review's recommendations and is adopting a revised strategy and capabilities to enhance support to SMEs

and the wider UK economic recovery while maintaining sound lending practices.

As part of the division's concerted effort to support its SME customers, UK Corporate has been proactively reviewing the business needs of SME customers to understand if they could benefit from the offer of additional facilities. In 2013, over 12,000 customers were identified for additional funding under UK Corporate's 'Statements of Appetite' initiative. The initiative resulted in approximately £6 billion of new funding being offered to customers.

The division has continued to support the government-backed Funding for Lending Scheme (FLS) and as at 31 December 2013 had allocated in excess of £4.7 billion of new FLS-related lending to almost 25,000 customers, £3.1 billion of which has been drawn since the scheme was launched. Mid-sized manufacturers are being offered targeted support, with interest rates reduced by more than 1% in some cases. SME customers benefited from both lower interest rates and the removal of arrangement fees.

## Business review

### UK Corporate continued

As well as delivering a range of lending initiatives, UK Corporate continued to develop new propositions for its customers. Following a successful pilot UK Corporate launched a leading business-to-business online community platform, Bizcrowd, to support independent needs matching. By the end of 2013 Bizcrowd had over 27,000 users and is now helping to bring businesses together across the UK.

During the course of 2013 UK Corporate's Business Banking Enterprise Programme helped over 40,000 entrepreneurs through over 1,000 events. Through its combination of nationwide start-up surgeries, mobile business schools and business academies, the programme offers support and advice to aspiring entrepreneurs, new start-up businesses and established SMEs looking to grow. Combined with UK Corporate's skills-based volunteering scheme, a programme offering all employees five days to volunteer with a charitable organisation, UK Corporate continued to deliver on its on-going commitment to communities.

### 2013 compared with 2012

The business delivered a return on equity of 11.0% excluding the impact of increased impairment losses related to the creation of RCR, primarily property and shipping exposures, which reduced return on equity by 3.1%.

Net interest income was 3% lower at £2,874 million, as increased income from re-pricing initiatives was offset by the lower rate environment impacting deposit returns, the non-repeat of 2012 deferred income recognition revisions (£58 million) and reduced lending volumes, as loan repayments coupled with run-off in property and shipping sectors outpaced new lending.

Non-interest income reduced 9% to £1,593 million, primarily from lower Markets revenue share income, a decline in operating lease income (offset by an associated reduction of operating lease depreciation in expenses), lower lending fees and higher derivative close-out costs associated with impaired assets.

Expenses, increased 6% to £2,219 million, primarily as a result of remediation provisions of £68 million, an increased share of branch network costs and an uplift in investment spend. This was offset by the reduction in operating lease depreciation, a decline in Markets revenue share related costs and lower staff incentive expenditure.

Whilst full year impairments include the additional impact of increased impairment losses related to the creation of RCR (£410 million), underlying impairments improved by £60 million, or 7%, to £778 million due to lower individual and collectively assessed provisions in the SME business, partially offset by higher individual cases in the mid-to-large corporate business.

Risk-weighted assets were broadly in line with 2012 at £86.1 billion as reduced asset volumes and movements into default offset increases resulting from the implementation of risk model changes.

### 2012 compared with 2011

With economic factors continuing to suppress business confidence, 2012 saw lower income and operating profit. Nonetheless, the business delivered a return on equity of 14.5%, slightly below the prior year and comfortably ahead of the cost of capital.

Operating profit decreased by 7%, with income down 3% and increased impairments, up 6%, partially offset by a 3% decrease in costs.

Net interest income was 4% lower, reflecting a 3% fall in lending volumes as loan repayments outstripped new lending, deposit margin compression due to strong competition and the continuation of low yields on current accounts. This was partially offset by improved asset margins and a 1% increase in deposit volumes.

Non-interest income was broadly in line with 2011, with stable income from transaction services, asset finance, Markets revenue share and other lending fees.

Total costs were down 3% due to tight control over direct discretionary expenditure combined with lower indirect costs as a result of operational savings, partially offset by increased investment expenditure.

Core lending balances were up £200 million, excluding the property, housebuilding and construction sectors. The loan:deposit ratio decreased by 400 basis points, principally reflecting deposit growth and portfolio de-risking, particularly in commercial real estate. The Group took part in a number of Government initiatives, seeking responsibly to stimulate additional credit demand in the face of continued customer deleveraging and low business confidence levels.

Impairments increased by 6% with lower specific provisions, mainly in the SME business, more than offset by reduced levels of latent provision releases across the division (£44 million in 2012 versus £226 million in 2011). Impairments as a percentage of loans and advances edged up modestly to 80 basis points.

Risk-weighted assets increased by 9% as regulatory changes to capital models during H2 2012 totalling £15 billion (primarily the implementation of the market-wide slotting approach on real estate and increases to default risk weights in other models) were partly offset by a fall in funded assets.

Not reflected in operating results was UK Corporate's £350 million share of the provision for interest rate swap redress which relates to prior periods, mainly pre-2008.

## Business review

## Wealth

|  | 2013  | 2012  | 2011  |
|--|-------|-------|-------|
|  | £m    | £m    | £m    |
| Net interest income                          | 674   | 720   | 645   |
| Net fees and commissions                     | 355   | 366   | 375   |
| Other non-interest income                    | 64    | 84    | 84    |
| Non-interest income                          | 419   | 450   | 459   |
| Total income                                 | 1,093 | 1,170 | 1,104 |
| Direct expenses                              |       |       |       |
| - staff                                      | (405) | (419) | (405) |
| - other                                      | (124) | (162) | (134) |
| Indirect expenses                            | (314) | (300) | (298) |
|  | (843) | (881) | (837) |
| Profit before impairment losses              | 250   | 289   | 267   |
| Impairment losses                            | (29)  | (46)  | (25)  |
| Operating profit                             | 221   | 243   | 242   |
| Analysis of income                           |       |       |       |
| Private banking                              | 894   | 956   | 902   |
| Investments                                  | 199   | 214   | 202   |
| Total income                                 | 1,093 | 1,170 | 1,104 |
| Performance ratios                           |       |       |       |
| Return on equity (1)                         | 12.0% | 13.1% | 12.8% |
| Net interest margin                          | 3.56% | 3.73% | 3.23% |
| Cost:income ratio                            | 77%   | 75%   | 76%   |
|  | £bn   | £bn   | £bn   |
| Capital and balance sheet                    |       |       |       |
| Loans and advances to customers (gross)      |       |       |       |
| - mortgages                                  | 8.7   | 8.8   | 8.3   |
| - personal                                   | 5.6   | 5.5   | 6.9   |
| - other                                      | 2.5   | 2.8   | 1.7   |
|  | 16.8  | 17.1  | 16.9  |
| Loan impairment provisions                   | (0.1) | (0.1) | (0.1) |
| Net loans and advances to customers          | 16.7  | 17.0  | 16.8  |
| Risk elements in lending                     | 0.3   | 0.2   | 0.2   |
| Provision coverage (2)                       | 43%   | 44%   | 38%   |
| Assets under management (excluding deposits) | 29.7  | 28.9  | 30.9  |
| Customer deposits                            | 37.2  | 38.9  | 38.2  |
| Loan:deposit ratio (excluding repos)         | 45%   | 44%   | 44%   |
| Risk-weighted assets                         |       |       |       |
| - credit risk (non-counterparty)             | 10.0  | 10.3  | 10.9  |
| - market risk                                | 0.1   | 0.1   | 0.1   |

|                            |      |      |      |
|----------------------------|------|------|------|
| - operational risk         | 1.9  | 1.9  | 1.9  |
| Total risk-weighted assets | 12.0 | 12.3 | 12.9 |

Notes:

- (1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
- (2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

## Business review

### Wealth continued

2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review (RDR). Clients welcomed Coutts' new fully compliant advice-led model where Coutts requires its advisers to achieve the more stringent Level 6 rating, in excess of the FCA's minimum Level 4 requirement. Coutts has received a number of industry accolades for its levels of service, such as 'UK Private Bank of the Year' (The Banker Global Private Banking Awards). Total assets under advice grew to approximately £3 billion over the year.

Following the deposit re-pricing strategy implemented in the second half of 2013 deposit margins have significantly improved. Lending volumes have remained resilient despite pay-downs in line with best-advice policy under RDR. In addition, a new international trust strategy was announced, strengthening the client offering by positioning it as a market-leading, client-centric trust business. This was achieved by the creation of a centre of excellence in Jersey, accompanied by withdrawal from the Cayman Islands and restructuring of the Geneva trust business.

Work continued on streamlining client-facing processes and driving increased benefits from the division's global technology platform, including significant enhancements to Coutts' online and digital client channels. A streamlining of the London property footprint from 11 buildings to 2 was also concluded, alongside further office rationalisation in the International business.

### 2013 compared with 2012

Operating profit was 9% lower at £221 million, driven by lower income partially offset by a decrease in expenses and impairment losses.

Income declined by 7% to £1,093 million, with the reduction in net interest income reflecting the lower spread earned on deposits as a result of lower Group funding requirements.

Non-interest income fell by 7% to £419 million due to the disposal of the Latin American, Caribbean and African businesses for a profit of £15 million in H1 2012 together with a decline in fee income in the International business.

Expenses were 4% lower at £843 million as a result of reduced headcount, tight discretionary cost management and the non-recurrence of two regulatory fines totalling £26 million incurred during 2012. This was partially offset by a one-off UK tax treaty charge in the International business.

Client assets and liabilities managed by the division declined by 2%, with a £1.7 billion reduction in deposits following re-pricing initiatives in the UK in line with the wider Group funding strategy. Assets under management increased by 3% due to positive market movements. Lending was 2% lower, reflecting increased levels of repayments in the UK.

Impairments were £17 million lower at £29 million, largely reflecting a small number of specific impairments.

### 2012 compared with 2011

Operating profit increased by £1 million to £243 million driven by higher income partially offset by increased expenses and impairment losses.

Total income increased by £66 million, with net interest income up £75 million, largely driven by improvements in margins and strong divisional treasury income, particularly during H1 2012.

Non-interest income fell by 2% as the gain from the disposal of the Latin American, Caribbean and African businesses was more than offset by a decline in fee income in the UK and lower investment volumes, driven by continued economic uncertainty.

Expenses were £44 million or 5% higher at £881 million, with significant investment in change programmes, including the development of new products and services capability and the implementation of RDR in the UK.

Expenses also increased as a result of client redress following a past business review into the sale of the ALICO Enhanced Variable Rate Fund announced in November 2011 and a Financial Services Authority fine of £8.75 million relating to Anti Money Laundering control processes.

Client assets and liabilities fell by 1% with a £2 billion decrease in assets under management, primarily reflecting low margin client outflows of £1.4 billion and the impact of client transfers following the disposal of the Latin American, Caribbean and African businesses. This fall was partially offset by increases in lending and deposit volumes.

Impairment losses were £46 million, up £21 million, largely reflecting a small number of large specific impairments.



## Business review

|   |         |         |         |
|---|---------|---------|---------|
| International Banking   | 2013    | 2012    | 2011    |
|   | £m      | £m      | £m      |
| Net interest income from banking activities   | 713     | 922     | 1,199   |
| Funding costs of rental assets  | —       | (9)     | (42)    |
| Net interest income   | 713     | 913     | 1,157   |
| Non-interest income   | 1,135   | 1,209   | 1,398   |
| Total income  | 1,848   | 2,122   | 2,555   |
| Direct expenses   |         |         |         |
| - staff   | (530)   | (580)   | (710)   |
| - other   | (171)   | (164)   | (228)   |
| Indirect expenses   | (639)   | (673)   | (694)   |
|   | (1,340) | (1,417) | (1,632) |
| Profit before impairment losses   | 508     | 705     | 923     |
| Impairment losses   | (229)   | (111)   | (168)   |
| Operating profit  | 279     | 594     | 755     |
| Of which:   |         |         |         |
| Ongoing businesses  | 279     | 602     | 773     |
| Run-off businesses  | —       | (8)     | (18)    |
| Analysis of income by product   |         |         |         |
| Cash management   | 738     | 943     | 940     |
| Trade finance   | 295     | 291     | 275     |
| Loan portfolio  | 814     | 865     | 1,265   |
| Ongoing businesses  | 1,847   | 2,099   | 2,480   |
| Run-off businesses  | 1       | 23      | 75      |
| Total income  | 1,848   | 2,122   | 2,555   |
| Analysis of impairments/(recoveries) by sector  |         |         |         |
| Manufacturing and infrastructure  | 147     | 42      | 254     |
| Property and construction   | 15      | 7       | 17      |
| Transport and storage   | 55      | (3)     | 11      |
| Telecommunications, media and technology  | (7)     | 12      | —       |
| Banks and financial institutions  | (15)    | 43      | (42)    |
| Other   | 34      | 10      | (72)    |
| Total impairment losses   | 229     | 111     | 168     |
| Of which RCR related (1)  | 52      | —       | —       |
| Loan impairment charge as % of gross customer loans and advances<br>(excluding reverse repurchase agreements) | 0.6%    | 0.3%    | 0.3%    |
| Performance ratios (ongoing businesses)   |         |         |         |
| Return on equity (2)  | 3.9%    | 9.1%    | 11.5%   |
| Net interest margin   | 1.59%   | 1.64%   | 1.73%   |
| Cost:income ratio   | 73%     | 66%     | 62%     |

Notes:

- (1) Pertaining to the creation of RCR and related strategy.
- (2) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for the ongoing businesses.

## Business review

## International Banking continued

|   | 2013  | 2012  | 2011  |
|---|-------|-------|-------|
|   | £bn   | £bn   | £bn   |
| Capital and balance sheet                                       |       |       |       |
| Loans and advances to customers (gross) (1)                     | 36.0  | 42.2  | 57.7  |
| Loan impairment provisions                                      | (0.3) | (0.4) | (0.8) |
| Net loans and advances to customers                             | 35.7  | 41.8  | 56.9  |
| Loans and advances to banks                                     | 8.0   | 4.8   | 3.4   |
| Securities  | 2.4   | 2.6   | 6.0   |
| Cash and eligible bills   | 0.3   | 0.5   | 0.3   |
| Other   | 2.1   | 3.3   | 3.3   |
| Total third party assets (excluding derivatives mark-to-market) | 48.5  | 53.0  | 69.9  |
| Risk elements in lending  | 0.5   | 0.4   | 1.6   |
| Provision coverage (2)  | 69%   | 93%   | 52%   |
| Customer deposits (excluding repos)                             | 39.3  | 46.2  | 45.1  |
| Bank deposits (excluding repos)                                 | 6.5   | 5.6   | 11.4  |
| Loan:deposit ratio (excluding repos and conduits)               | 91%   | 91%   | 126%  |
| Risk-weighted assets  |       |       |       |
| - Credit risk (non-counterparty)                                | 44.3  | 46.7  | 38.9  |
| - Operational risk  | 4.7   | 5.2   | 4.3   |
| Total risk-weighted assets                                      | 49.0  | 51.9  | 43.2  |
|   | £m    | £m    | £m    |
| Run-off businesses (3)  |       |       |       |
| Total income  | 1     | 23    | 75    |
| Direct expenses   | (1)   | (31)  | (93)  |
| Operating loss  | —     | (8)   | (18)  |

## Notes:

- (1) Excludes disposal groups.  
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.  
(3) Run-off businesses consist of the exited corporate finance businesses.

International Banking provides for the needs of its customers through its offering of debt financing, risk management and transaction services across its network. Business conditions remain challenging as themes of low interest rates and margin compression continue. International Banking remained focused on cost discipline throughout 2013 and continued to strengthen its balance sheet. Despite credit model uplifts, risk-weighted assets reduced 6% year on year.

The strength of the division's efforts in serving its customers' needs is reflected in recent external industry awards and recognition, including:

- Best Trade Finance Bank, UK, and Best Supply Chain Finance Provider, Western Europe - Global Finance. Global Trade Review magazine's 'Leaders in Trade' award for Best Bank for Documentary Processing 2013, making this the 4th consecutive win for the bank.

- A good performance in the Euromoney 2013 Cash Management Survey, particularly in Europe, ranking #1 in the Netherlands, #2 in the UK and #2 in Western Europe. International Banking improved on last year's performance in APAC, achieving a #8 ranking, and retained a #9 ranking in North America and a #6 ranking globally.
- Received the 'Most Innovative Investment Bank for Loans' award at The Banker Investment Banking Awards 2013 providing a further indication that RBS is putting customers at the heart of its business.
- Best Debt House, UK - Euromoney.

## Business review

### International Banking continued

#### 2013 compared with 2012

Operating profit, decreased by £315 million as lower income and higher impairments, including £52 million in relation to the accelerated asset recovery strategy associated with RCR, were only partially offset by lower costs.

Income was 13% lower:

- Cash management was 22% lower reflecting a decline in three-month LIBOR rates as well as increased funding costs of liquidity buffer requirements.
- Loan portfolio decreased by 6%, in line with a smaller balance sheet.

Expenses were down £77 million, or 5%, reflecting continued emphasis on cost control and timely run-off of discontinued business.

Impairment losses were £118 million higher than in 2012, including two large single-name provisions and £52 million in relation to the impact of the accelerated RCR asset recovery strategy.

Third party assets were down 8% due to reductions in the loan portfolio following increased levels of customer repayments partially offset by an increase in Asia trade volume.

Customer deposits declined by 15% in line with a change in Group funding strategy.

Risk-weighted assets decreased by 6% primarily as a result of management action to mitigate credit model increases and a smaller balance sheet.

Return on equity was 4% or 5% excluding the impact of the accelerated RCR asset recovery strategy compared with 9% in 2012.

#### 2012 compared with 2011

Operating profit decreased by £161 million as a decline in income was only partially mitigated by lower expenses and impairment losses.

Income was 17% lower:

- Loan portfolio decreased by 32%, mainly due to a strategic reduction in assets, in order to allocate capital more efficiently, and the effect of portfolio credit hedging and lower corporate appetite for risk management activities.
- Cash management was broadly in line with the previous year. Deposit margins declined following reductions in both three month LIBOR and five year fixed rates across Europe; however, this was offset by lower liquidity costs due to the strategic initiative to reduce short-term bank deposits.
- Trade finance increased by 6% as a result of increased activity, particularly in Asia.
- The restructuring in 2012 led to a reduction in activities undertaken in the division, which contributed to a decline in income.

Expenses declined by £215 million, reflecting planned restructuring initiatives following the formation of the International Banking division. Savings were achieved through headcount reduction, run-off of discontinued businesses and a resulting decrease in infrastructure support costs. Revenue-linked expenses also fell in line with the decrease in income.

Impairment losses decreased by £57 million with the non-repeat of a single name impairment.

Third party assets declined by 24%, with targeted reductions in the lending portfolio following a strategic reduction in assets.

Customer deposits increased by 2%. Successful efforts to rebuild customer confidence following the Moody's credit rating downgrade and the Group technology incident in June 2012 outweighed economic pressures. This, coupled with the managed reduction in loans and advances to customers, improved the loan:deposit ratio to 91%.

Bank deposits were down 51%, mainly as a result of lower short-term balances, reflecting a strategic initiative to reduce liquidity outflow risk.

Risk-weighted assets increased by 20%, reflecting the impact of regulatory uplifts partially offset by successful mitigation through balance sheet reduction. Risk-weighted asset intensity in the loan book has increased significantly given the uplifts, which will result in strategic adjustments going forward.

## Business review

## Ulster Bank

|   | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
|   | £m      | £m      | £m      |
| Net interest income   | 631     | 649     | 736     |
| Net fees and commissions  | 141     | 145     | 142     |
| Other non-interest income   | 99      | 51      | 69      |
| Non-interest income   | 240     | 196     | 211     |
| Total income  | 871     | 845     | 947     |
| Direct expenses   |         |         |         |
| - staff   | (239)   | (214)   | (225)   |
| - other   | (63)    | (49)    | (67)    |
| Indirect expenses   | (252)   | (258)   | (255)   |
|   | (554)   | (521)   | (547)   |
| Profit before impairment losses   | 317     | 324     | 400     |
| Impairment losses   | (1,774) | (1,364) | (1,384) |
| Operating loss  | (1,457) | (1,040) | (984)   |
| Analysis of income by business  |         |         |         |
| Corporate   | 315     | 360     | 435     |
| Retail  | 408     | 360     | 428     |
| Other   | 148     | 125     | 84      |
| Total income  | 871     | 845     | 947     |
| Analysis of impairments by sector   |         |         |         |
| Mortgages   | 235     | 646     | 570     |
| Commercial real estate  |         |         |         |
| - investment  | 593     | 221     | 225     |
| - development   | 153     | 55      | 99      |
| Other corporate   | 771     | 389     | 434     |
| Other lending   | 22      | 53      | 56      |
| Total impairment losses   | 1,774   | 1,364   | 1,384   |
| Of which RCR related (1)  | 892     | —       | —       |
| Loan impairment charge as % of gross customer loans and advances<br>(excluding reverse repurchase agreements) by sector |         |         |         |
| Mortgages   | 1.2%    | 3.4%    | 2.9%    |
| Commercial real estate  |         |         |         |
| - investment  | 17.4%   | 6.1%    | 5.8%    |
| - development   | 21.9%   | 7.9%    | 11.0%   |
| Other corporate   | 10.9%   | 5.0%    | 5.6%    |
| Other lending   | 1.8%    | 4.1%    | 3.5%    |
| Total   | 5.6%    | 4.2%    | 4.1%    |
| Performance ratios  |         |         |         |
| Return on equity (2)  | (32.4%) | (21.8%) | (22.8%) |
| Net interest margin   | 1.91%   | 1.88%   | 1.87%   |

|                   |     |     |     |
|-------------------|-----|-----|-----|
| Cost:income ratio | 64% | 62% | 58% |
|-------------------|-----|-----|-----|

Notes:

- (1) Pertaining to the creation of RCR and related strategy.
- (2) Divisional return on equity is based on divisional operating loss after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).



## Business review

## Ulster Bank continued

|   | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---|-------------|-------------|-------------|
| Capital and balance sheet               |             |             |             |
| Loans and advances to customers (gross) |             |             |             |
| - mortgages                             | 19.0        | 19.2        | 20.0        |
| - commercial real estate                |             |             |             |
| - investment                            | 3.4         | 3.6         | 3.9         |
| - development                           | 0.7         | 0.7         | 0.9         |
| - other corporate                       | 7.1         | 7.8         | 7.7         |
| - other lending                         | 1.2         | 1.3         | 1.6         |
|   | 31.4        | 32.6        | 34.1        |
| Loan impairment provisions              | (5.4)       | (3.9)       | (2.7)       |
| Net loans and advances to customers     | 26.0        | 28.7        | 31.4        |
| Risk elements in lending                |             |             |             |
| - mortgages                             | 3.2         | 3.1         | 2.2         |
| - commercial real estate                |             |             |             |
| - investment                            | 2.3         | 1.6         | 1.0         |
| - development                           | 0.5         | 0.4         | 0.3         |
| - other corporate                       | 2.3         | 2.2         | 1.8         |
| - other lending                         | 0.2         | 0.2         | 0.2         |
| Total risk elements in lending          | 8.5         | 7.5         | 5.5         |
| Provision coverage (1)                  | 64%         | 52%         | 50%         |
| Customer deposits                       | 21.7        | 22.1        | 21.8        |
| Loan:deposit ratio (excluding repos)    | 120%        | 130%        | 143%        |
| Risk-weighted assets                    |             |             |             |
| - credit risk                           |             |             |             |
| - non-counterparty                      | 28.2        | 33.6        | 33.6        |
| - counterparty                          | 0.3         | 0.6         | 0.6         |
| - market risk                           | 0.5         | 0.2         | 0.3         |
| - operational risk                      | 1.7         | 1.7         | 1.8         |
| Total risk-weighted assets              | 30.7        | 36.1        | 36.3        |
| Spot exchange rate - €/£                | 1.201       | 1.227       | 1.196       |

## Note:

(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. The creation of RCR resulted in additional charges of £911 million in Ulster Bank's results in Q4 2013.

Operating performance for 2013, excluding the impact of the creation of RCR, improved by £494 million or 48% versus prior year primarily reflecting higher income and a 64% reduction in mortgage impairment losses driven by

enhanced collections effectiveness, the development of programmes to assist customers in financial difficulty and a modest improvement in economic conditions.

Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers. The bank made considerable progress during 2013 in its commitment to building a really good bank that serves customers well.

## Business review

### Ulster Bank continued

#### Simplifying Banking

Ulster Bank delivered a number of improvements for personal and business customers in 2013:

- The launch of initiatives such as “Get Cash”, “Pay Your Contacts” and “Emergency Cash” provided a new range of simple and convenient services for customers to access their cash and make payments online and via mobile.
- Further development of online and mobile banking for business customers focused on providing an efficient and effective day-to-day banking service. Enhancements during 2013 included a speedy and simplified account application process; registration for Anytime Banking via telephone; ability to manage personal and business accounts together and access to extended transaction history.
- The efficiency and effectiveness of Ulster Bank’s digital offering was evidenced by a 55% increase in mobile app registrations and more than 100 million transactions were carried out via digital channels during 2013. Over 315,000 customers regularly use mobile app banking services and 640,000 customers make regular use of online Anytime banking services.

#### Supporting Enterprise and the Community:

- Supporting entrepreneurship and the growth of small businesses in the local community is a long term commitment of Ulster Bank. Highlights in 2013 included:
  - The Community Impact Fund and Business Woman Can initiative which facilitated women in local communities to set up their own business. The bank also supported a number of projects in schools across the island of Ireland through its MoneySense programme.
  - Ulster Bank’s dedicated SME teams offer professional support and a range of products to help customers meet their banking challenges and grow their business. The agri-specialist team has introduced a number of initiatives during 2013 to support the farming sector.
  - The ‘One Week in June’ initiative raised £430,000 for a number of Irish charities through a series of fundraising events involving both customers and staff.
  - In partnership with Concern Worldwide and Disasters Emergency Committee, Ulster Bank ATMs, branches and online banking facilitated donations to the Philippines Typhoon emergency appeals.

#### Helping Customers out of Financial Difficulty:

- Ulster Bank is committed to working with all customers in financial difficulty to find a solution. The Bank continued to invest in its Problem Debt Management Unit and further developed a range of solutions to make it easier for customers to enter into arrangements. As a consequence, the number of mortgage customers in arrears of 90 days or more has decreased every month since March 2013.

#### 2013 compared with 2012

Excluding the impact of the creation of RCR, operating result improved by £494 million or 48% primarily due to a higher income and lower impairment losses on the mortgage portfolio.

Total income increased by £26 million or 3% to £871 million primarily reflecting hedging gains on the mortgage portfolio. Net interest margin for 2013 increased by 3 basis points to 1.91% although net interest income was £18 million lower at £631 million, largely driven by lower interest-earning assets and a higher cost of funding.

Total expenses increased by £33 million or 6% to £554 million driven by the costs of mandatory change programmes such as the Single Euro Payment Area, £18 million, an investment of £10 million in programmes to support customers in financial difficulty and an accelerated depreciation charge of £12 million.

Impairment losses, excluding the impact of RCR, were £482 million, 35% lower. This was predominantly due to a sharp reduction in losses on the mortgage portfolio which reduced by £411 million or 64% due to a decline in arrears levels driven by an improved collections performance and the development of programmes to assist customers in financial difficulty, coupled with stabilising residential property prices.

The loan:deposit ratio reduced from 130% to 120% during 2013 reflecting continued customer deleveraging and low levels of demand for new lending. Retail and SME deposit balances increased by 2% during 2013, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.

Risk-weighted assets decreased by 15% reflecting a smaller performing loan book and stabilising credit metrics.

2012 compared with 2011

Operating loss increased by £56 million primarily reflecting a reduction in income driven by lower interest earning asset volumes.

Total expenses fell by £26 million, reflecting the benefits of cost saving initiatives.

Impairment losses remained elevated, as weak underlying credit metrics prevailed. Falling asset values throughout most of 2012 and high levels of unemployment coupled with weak domestic demand continued to depress the property market. The impairment charge for 2012 was driven by a combination of new defaulting customers and deteriorating security values. Risk elements in lending increased by £2 billion during the year reflecting continued difficult conditions in both the commercial and residential property sectors.

The loan to deposit ratio improved from 143% to 130%, driven by a combination of deposit growth and a decrease in the loan book. The loan book decreased by 1% as a result of movements in foreign exchange rates offset by natural amortisation and limited new lending due to low levels of market demand. Retail and SME deposits increased by 8%; however, this was partly offset by outflows of wholesale balances driven by market volatility and the impact of a rating downgrade in the second half of 2011.

## Business review

|  |         |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|---------|
| US Retail & Commercial   | 2013    | 2012    | 2011    | 2013    | 2012    | 2011    |
|  | US\$m   | US\$m   | US\$m   | £m      | £m      | £m      |
| Net interest income  | 2,998   | 3,062   | 3,015   | 1,916   | 1,932   | 1,879   |
| Net fees and commissions   | 1,190   | 1,253   | 1,368   | 761     | 791     | 853     |
| Other non-interest income  | 489     | 584     | 479     | 312     | 368     | 299     |
| Non-interest income  | 1,679   | 1,837   | 1,847   | 1,073   | 1,159   | 1,152   |
| Total income   | 4,677   | 4,899   | 4,862   | 2,989   | 3,091   | 3,031   |
| Direct expenses  |         |         |         |         |         |         |
| - staff  | (1,667) | (1,605) | (1,620) | (1,065) | (1,013) | (1,010) |
| - other  | (1,521) | (1,609) | (1,674) | (972)   | (1,014) | (1,044) |
| - litigation settlement  | —       | (138)   | —       | —       | (88)    | —       |
| Indirect expenses  | (233)   | (206)   | (184)   | (149)   | (131)   | (114)   |
|  | (3,421) | (3,558) | (3,478) | (2,186) | (2,246) | (2,168) |
| Profit before impairment losses  | 1,256   | 1,341   | 1,384   | 803     | 845     | 863     |
| Impairment losses  | (244)   | (145)   | (524)   | (156)   | (91)    | (326)   |
| Operating profit   | 1,012   | 1,196   | 860     | 647     | 754     | 537     |
| Average exchange rate - US\$/£   |         |         |         | 1.565   | 1.585   | 1.604   |
| Analysis of income by product  |         |         |         |         |         |         |
| Mortgages and home equity  | 716     | 856     | 744     | 458     | 540     | 463     |
| Personal lending and cards   | 643     | 637     | 700     | 411     | 402     | 436     |
| Retail deposits  | 1,194   | 1,348   | 1,465   | 763     | 852     | 914     |
| Commercial lending   | 1,062   | 965     | 936     | 679     | 609     | 584     |
| Commercial deposits  | 631     | 689     | 656     | 403     | 434     | 410     |
| Other  | 431     | 404     | 361     | 275     | 254     | 224     |
| Total income   | 4,677   | 4,899   | 4,862   | 2,989   | 3,091   | 3,031   |
| Analysis of impairments by sector  |         |         |         |         |         |         |
| Residential mortgages  | 44      | (2)     | 44      | 28      | (1)     | 28      |
| Home equity  | 101     | 150     | 165     | 65      | 95      | 103     |
| Corporate and commercial   | (36)    | (120)   | 88      | (23)    | (77)    | 55      |
| Other consumer   | 127     | 104     | 101     | 81      | 65      | 61      |
| Securities   | 8       | 13      | 126     | 5       | 9       | 79      |
| Total impairment losses  | 244     | 145     | 524     | 156     | 91      | 326     |
| Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector |         |         |         |         |         |         |
| Residential mortgages  | 0.5%    | —       | 0.5%    | 0.5%    | —       | 0.5%    |
| Home equity  | 0.5%    | 0.7%    | 0.7%    | 0.5%    | 0.7%    | 0.7%    |
| Corporate and commercial   | (0.1%)  | (0.3%)  | 0.2%    | (0.1%)  | (0.3%)  | 0.2%    |
| Other consumer   | 0.9%    | 0.8%    | 0.8%    | 0.9%    | 0.8%    | 0.8%    |
| Total  | 0.3%    | 0.2%    | 0.5%    | 0.3%    | 0.2%    | 0.5%    |

## Performance ratios

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|                      |       |       |       |       |       |       |
|----------------------|-------|-------|-------|-------|-------|-------|
| Return on equity (1) | 7.2%  | 8.3%  | 6.3%  | 7.2%  | 8.3%  | 6.3%  |
| Net interest margin  | 2.95% | 2.97% | 3.03% | 2.95% | 2.97% | 3.03% |
| Cost:income ratio    | 73%   | 73%   | 72%   | 73%   | 73%   | 72%   |

Note:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

## Business review

## US Retail &amp; Commercial continued

|   | 2013<br>US\$bn | 2012<br>US\$bn | 2011<br>US\$bn | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---|----------------|----------------|----------------|-------------|-------------|-------------|
| Capital and balance sheet               |                |                |                |             |             |             |
| Loans and advances to customers (gross) |                |                |                |             |             |             |
| - residential mortgages                 | 9.6            | 9.4            | 9.4            | 5.8         | 5.8         | 6.1         |
| - home equity                           | 20.1           | 21.5           | 23.1           | 12.1        | 13.3        | 14.9        |
| - corporate and commercial              | 39.8           | 38.5           | 35.3           | 24.1        | 23.8        | 22.9        |
| - other consumer                        | 14.1           | 13.5           | 12.0           | 8.6         | 8.4         | 7.7         |
|   | 83.6           | 82.9           | 79.8           | 50.6        | 51.3        | 51.6        |
| Loan impairment provisions              | (0.4)          | (0.5)          | (0.7)          | (0.3)       | (0.3)       | (0.5)       |
| Net loans and advances to customers     | 83.2           | 82.4           | 79.1           | 50.3        | 51.0        | 51.1        |
| Total third party assets                | 118.7          | 117.7          | 117.8          | 71.7        | 72.8        | 76.1        |
| Investment securities                   | 21.3           | 19.5           | 23.5           | 12.9        | 12.0        | 15.2        |
| Risk elements in lending                |                |                |                |             |             |             |
| - retail                                | 1.5            | 1.3            | 1.0            | 0.9         | 0.8         | 0.6         |
| - commercial                            | 0.2            | 0.6            | 0.6            | 0.1         | 0.3         | 0.4         |
| Total risk elements in lending          | 1.7            | 1.9            | 1.6            | 1.0         | 1.1         | 1.0         |
| Provision coverage (1)                  | 26%            | 25%            | 45%            | 26%         | 25%         | 45%         |
| Customer deposits (excluding repos)     | 91.1           | 95.6           | 92.8           | 55.1        | 59.2        | 60.0        |
| Bank deposits (excluding repos)         | 3.3            | 2.9            | 8.0            | 2.0         | 1.8         | 5.2         |
| Loan:deposit ratio (excluding repos)    | 91%            | 86%            | 85%            | 91%         | 86%         | 85%         |
| Risk-weighted assets                    |                |                |                |             |             |             |
| - credit risk                           |                |                |                |             |             |             |
| - non-counterparty                      | 83.8           | 82.0           | 83.0           | 50.7        | 50.8        | 53.6        |
| - counterparty                          | 0.8            | 1.4            | 1.5            | 0.5         | 0.8         | 1.0         |
| - operational risk                      | 8.2            | 7.9            | 7.3            | 4.9         | 4.9         | 4.7         |
|   | 92.8           | 91.3           | 91.8           | 56.1        | 56.5        | 59.3        |
| Spot exchange rate - US\$/£             |                |                |                | 1.654       | 1.616       | 1.548       |

## Note:

(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

## Business review

### US Retail & Commercial continued

On 1 November 2013, RBS announced plans to accelerate its previously announced partial initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. RBS intends to fully divest its position in RBSCFG by the end of 2016, leaving it as a standalone regional bank, owned by public shareholders.

RBSCFG has commenced a number of actions in 2013 aimed at improving financial performance. RBSCFG continued to drive profitable growth in its core business by focusing on the customer and delivering a differentiated experience. In addition, RBSCFG has launched a series of initiatives aimed at narrowing the performance gap with competitors, including selectively expanding lending areas where RBSCFG has proven capabilities (such as Mid-Corporate, Specialty Verticals) and selective expansion of risk appetite (moving from super-prime to prime in certain products).

RBSCFG has also launched transformational initiatives in 2013 including:

- A special initiative called Project ‘TOP’, ‘Tapping Our Potential’. The project intends to improve the overall effectiveness and efficiency of the franchise by utilising ideas generated by our colleagues.
- On 7 January 2014, RBSCFG announced the sale of its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, the lead bank of U.S. Bancorp. RBSCFG will maintain a presence in Chicago through its commercial business lines and several national consumer business lines not included in the sale(1). The sale, expected to close in mid-2014 (subject to regulatory approval), includes 94 Charter One branches in the Chicago area, \$5.3 billion in local deposits and \$1.1 billion in locally originated loans for a deposit premium of approximately \$315 million, or 6%. The proceeds will be reinvested in the remaining franchise, where we have stronger market positions and better long-term growth prospects.

Moreover, RBSCFG continued to grow its core franchise by consistently delivering a differentiated customer experience and leveraging its strong market presence (top 5 deposit market share in 8 of its top 10 Metropolitan Statistical Areas).

In 2013, Consumer Banking continued to improve customer convenience, address the shift in customer preference, and expand its distribution presence. Consumer Banking installed more than 900 intelligent deposit machines (enhanced ATMs), improved the web account opening process, simplified online banking log-in, and released a new mobile application optimised for the iPad. Consumer Banking also implemented a new branch image capture system throughout the network that automates teller processing and offers secure paperless transactions, debit card identification and clear receipts that provide on-the-spot balance availability.

In recognition of the customer experience it offers, Money magazine named Citizens Bank one of the “Best Banks in America” in 2013. In addition to a “robust presence” defined by its many branches and ATMs, Money recognised RBSCFG’s extended branch hours that include seven-day-a-week supermarket branches. Money also noted that RBSCFG’s convenience options also extend to its mobile banking apps for Android and iPhone, which are generating positive customer feedback in the industry. An August report issued by Xtreme Labs noted that “Citizens Bank is the only bank with the highest rated apps on both Android (4.5 stars) and iOS (4.5 stars) platforms”.

The Small Business Banking and Commercial Enterprise Banking divisions were integrated into one consolidated Business Banking division within Consumer Banking, targeting companies with up to \$25 million in annual sales. The consolidation will enhance the customer experience, transform sales and service, and align products and processes.



Commercial Banking remained focused on growing and deepening relationships by providing thought leadership and improved product capabilities to clients. Commercial and Industry loan growth was 8.5% compared with the same time period a year ago, which was 1.3% higher than the market<sup>(2)</sup>. The strong results are partially due to the launch of several growth initiatives, which includes expanding our MidCorporate business nationally, as well as growing our Franchise Finance, Lender Finance and other key industry verticals.

Corporate Finance & Capital Markets continued to take market share from both regional competitors and large money centre banks. Commercial Banking moved up in the Overall Middle Market Bookrunner league table from an unranked position in 2009 to #6 by origination volume and #8 by number of transactions in Q4 2013.

Furthermore, the strategic alliance with Oppenheimer allowed Commercial bankers to deliver M&A ideas and solutions that are helping us provide comprehensive solutions to our clients. This alliance won the Barlow Research Associates' Monarch Innovation Award for "Most Innovative Product". The award highlights RBSCFG's commitment to making it easier for middle market companies to develop financial strategies that encompass both commercial banking and investment banking products and services.

As a result of our ongoing focus on providing thought leadership to our clients, our most recent client survey (Q3 2013) showed significant improvement in Middle Market customer satisfaction metrics over the same period a year ago. Net Promoter score increased from 36 to 50, which is well above the peer average of 42. "Proactively Provides Advice and Solutions" score was up from 62% to 85% and lead relationships as a percent of total relationships improved from 51% to 58%. Both metrics are strong indicators of our Commercial bankers' thought leadership capabilities.

Notes:

(1) RBSCFG will continue to operate several businesses in the Chicago market, including the consumer businesses lines of mortgage lending, Education Finance and Auto Finance. RBS Citizens, the bank's commercial banking division, will continue a diverse range of commercial banking operations in Chicago including Asset-Based Lending, Asset Finance, Equipment Leasing, Commercial Real Estate, Treasury Solutions, Capital Markets, Sponsor Finance, Franchise Finance and the majority of its corporate banking business.

(2) Source: SNL Financial. Based on most recent regulatory data as of Q3 2013. Market includes all US banks required to file regulatory reports.

## Business review

### US Retail & Commercial continued

2013 compared with 2012

Operating profit of £647 million (\$1,012 million) was down £107 million (\$184 million), or 14%. The operating environment and market conditions remained challenging, with intense competition for loans. An extended period of low short-term rates limited net interest margin expansion and the rise in long-term rates dramatically slowed mortgage refinance volumes.

Net interest income was down 1% at £1,916 million (\$2,998 million) due to a smaller investment portfolio, consumer loan run-off and the effect of prevailing economic conditions on asset yields partially offset by the benefit of interest rate swaps, commercial loan growth and favourable funding costs.

Average loans and advances were flat, with commercial loan growth of 5% despite competition for lending opportunities offset by run-off of long-term fixed-rate consumer products.

Average customer deposits were flat, with planned run-off of high priced time deposits and lower wholesale deposits offset by growth achieved in checking and money market balances. Consumer checking balances grew by 3% while small business checking balances grew by 7% over the year.

Excluding the £47 million (\$75 million) gross gain on the sale of Visa B shares in 2012, non-interest income was down £39 million (\$83 million), or 4% at £1,073 million (\$1,679 million), reflecting lower mortgage banking fees as refinancing volumes have slowed, and lower deposit fees. This was partially offset by higher securities gains and commercial banking fee income.

Excluding the £88 million (\$138 million) litigation settlement in 2012 relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010 and the £8 million (\$13 million) litigation reserve associated with the sale of Visa B shares, total expenses of £2,186 million (\$3,421 million) were broadly in line with prior year. This largely reflects a mortgage servicing rights impairment recapture driven by the increase in long-term rates offset by the cost of regulatory compliance and new technology investments and a one-off £21 million (\$33 million) pension gain in 2012.

Impairment losses increased by £65 million (\$99 million) to £156 million (\$244 million) for the year and represented 0.3% of loans and advances to customers.

2012 compared with 2011

US Retail & Commercial posted an operating profit of £754 million (\$1,196 million), up £217 million (\$336 million), or 40%, from 2011. Excluding the £88 million (\$138 million) litigation settlement in Q1 2012 and the £39 million (\$62 million) net gain on the sale of Visa B shares in Q2 2012, operating profit was up £266 million (\$412 million), or 50%, largely reflecting lower impairment losses due to an improved credit environment.

Net interest income was up £53 million (\$47 million), or 3%, driven by targeted commercial loan growth, deposit pricing discipline and lower funding costs. This was partially offset by consumer loan run-off and lower asset yields reflecting prevailing economic conditions.

Non-interest income was up £7 million. In US dollar terms non-interest income was down \$10 million, or 1%, reflecting a decline in debit card fees as a result of the Durbin Amendment legislation and lower securities gains and deposit fees. This was largely offset by strong mortgage banking fees of £69 million (\$109 million), up 71%, and the £47 million (\$75 million) gross gain on the sale of Visa B shares.

Gross loans and advances to customers were down £0.3 billion. In US dollar terms loans and advances to customers were up \$3.1 billion, or 4%, due to strong growth in commercial loan volumes.

Customer deposits decreased by 1% as a result of movements in foreign exchange rates partially offset by strong growth achieved in checking balances. Consumer checking balances fell by 1% while small business checking balances grew by 4% over the year.

Excluding the £88 million (\$138 million) litigation settlement, relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010, and the £8 million (\$13 million) litigation reserve associated with the sale of Visa B shares, and a one-off £21 million (\$33 million) pension gain in Q4 2012, total expenses were down 1%, reflecting lower loan collection costs and the elimination of the Everyday Points rewards programme for consumer debit card customers, partially offset by higher operational losses.

During the year, RBS Citizens offered former employees a one-time opportunity to receive the value of future pension benefits as a single lump sum payment. The transaction allowed RBS Citizens to partially de-risk its pension plan and future liability under the plan. A strong participant take-up rate of 60% enabled RBS Citizens to reduce its pension liability by 17% and recognise a £21 million (\$33 million) accounting gain.

Impairment losses were down £235 million (\$379 million), or 72%, reflecting an improved credit environment and lower impairments on securities. Loan impairments improved by £168 million (\$266 million) driven primarily by commercial loan impairments. Impairments as a percentage of loans and advances fell to 20 basis points.

## Business review

| Markets                             | 2013    | 2012    | 2011    |
|-------------------------------------|---------|---------|---------|
|                                     | £m      | £m      | £m      |
| Net interest income                 | 157     | 111     | 67      |
| Net fees and commissions receivable | 75      | 128     | 371     |
| Income from trading activities      | 3,057   | 4,105   | 3,846   |
| Other operating income              | 33      | 139     | 131     |
| Non-interest income                 | 3,165   | 4,372   | 4,348   |
| Total income                        | 3,322   | 4,483   | 4,415   |
| Direct expenses                     |         |         |         |
| - staff                             | (1,177) | (1,453) | (1,959) |
| - other                             | (723)   | (722)   | (748)   |
| Indirect expenses                   | (710)   | (762)   | (771)   |
|                                     | (2,610) | (2,937) | (3,478) |
| Profit before impairment losses     | 712     | 1,546   | 937     |
| Impairment losses (1)               | (92)    | (37)    | (38)    |
| Operating profit                    | 620     | 1,509   | 899     |
| Of which:                           |         |         |         |
| Ongoing businesses (2)              | 655     | 1,431   | 523     |
| Run-off and recovery businesses     | (35)    | 78      | 376     |
| Analysis of income by product       |         |         |         |
| Rates                               | 1,053   | 1,922   | 1,459   |
| Currencies                          | 1,000   | 775     | 1,129   |
| Asset-backed products (ABP)         | 943     | 1,322   | 1,221   |
| Credit markets                      | 699     | 735     | 461     |
| Total income ongoing businesses     | 3,695   | 4,754   | 4,270   |
| Inter-divisional revenue share      | (612)   | (708)   | (828)   |
| Run-off and recovery businesses     | 239     | 437     | 973     |
| Total income                        | 3,322   | 4,483   | 4,415   |
| Memo - fixed income and currencies  |         |         |         |
| Total income ongoing businesses     | 3,695   | 4,754   | 4,270   |
| Less: primary credit markets        | (561)   | (574)   | (683)   |
| Total fixed income and currencies   | 3,134   | 4,180   | 3,587   |
| Performance ratios                  |         |         |         |
| Return on equity (3)                | 5.0%    | 9.6%    | 5.9%    |
| Cost:income ratio                   | 79%     | 66%     | 79%     |
| Compensation ratio (4)              | 35%     | 32%     | 44%     |

## Notes:

(1) Includes £18 million pertaining to the creation of RCR and related strategy.

(2) The ongoing businesses include the Rates, Currencies, Asset backed products and credit markets areas.

(3) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for the ongoing businesses.

(4) Compensation ratio is based on staff costs as a percentage of total income.



## Business review

## Markets continued

|   | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---|-------------|-------------|-------------|
| Capital and balance sheet                                       |             |             |             |
| Loans and advances to customers (gross)                         | 25.4        | 29.8        | 31.5        |
| Loan impairment provisions                                      | (0.2)       | (0.2)       | (0.2)       |
| Net loans and advances to customers                             | 25.2        | 29.6        | 31.3        |
| Net loans and advances to banks                                 | 12.5        | 16.6        | 29.9        |
| Reverse repos   | 76.2        | 103.8       | 100.5       |
| Securities  | 69.8        | 92.4        | 108.4       |
| Cash and eligible bills   | 20.3        | 30.2        | 28.1        |
| Other   | 8.8         | 11.9        | 15.7        |
| Total third party assets (excluding derivatives mark-to-market) | 212.8       | 284.5       | 313.9       |
| Net derivative assets (after netting)                           | 15.5        | 21.9        | 37.0        |
| Provision coverage (1)  | 85%         | 77%         | 75%         |
| Customer deposits (excluding repos)                             | 21.5        | 26.3        | 36.8        |
| Bank deposits (excluding repos)                                 | 23.8        | 45.4        | 48.2        |
| Risk-weighted assets  |             |             |             |
| - credit risk   |             |             |             |
| - non-counterparty  | 10.8        | 14.0        | 16.7        |
| - counterparty  | 17.5        | 34.7        | 39.9        |
| - market risk   | 26.4        | 36.9        | 50.6        |
| - operational risk  | 9.8         | 15.7        | 13.1        |
| Total risk-weighted assets                                      | 64.5        | 101.3       | 120.3       |
| Income statement (ongoing business)                             | £m          | £m          | £m          |
| Total income  | 3,094       | 4,076       | 3,507       |
| Direct expenses   | (1,750)     | (1,902)     | (2,220)     |
| Indirect expenses   | (682)       | (753)       | (762)       |
| Impairment (losses)/recoveries                                  | (7)         | 10          | (2)         |
| Operating profit  | 655         | 1,431       | 523         |
| Performance ratios (ongoing business)                           |             |             |             |
| Return on equity (2)  | 6.8%        | 11.5%       | 4.3%        |
| Cost:income ratio   | 79%         | 65%         | 85%         |
| Compensation ratio (3)  | 35%         | 31%         | 46%         |
| Balance sheet (ongoing businesses)                              | £bn         | £bn         | £bn         |
| Total third party assets (excluding derivatives mark-to-market) | 198.8       | 259.3       | 278.6       |
| Risk-weighted assets  | 52.1        | 79.1        | 95.5        |

## Notes:

(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

(2)

Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for ongoing businesses.

- (3) Compensation ratio is based on staff costs as a percentage of total income.

## Business review

### Markets continued

In 2013, Markets launched and executed a strategic repositioning of the business, aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths in fixed income products. The division met or exceeded all internal targets for reducing controllable costs, risk weighted assets and balance sheet, while meeting revenue and operating profit expectations. Controls were enhanced, trading was integrated into four financial hubs, the front-to-back operating model was simplified and an agreement was reached for the sale of the Investor Products and Equity Derivatives business. Market share in the four core product areas (Rates, Currencies, Asset Backed Products and Credit) remained broadly stable with high profile client transactions executed across the globe. As a result of the strategic repositioning, Markets ended 2013 better positioned for the changing regulatory and external environment.

Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment. Client activity was limited by the uncertainty that surrounded the much anticipated tapering of the Federal Reserve's programme of quantitative easing. This contrasted with 2012 when markets were boosted by the European Central Bank's Long Term Refinancing Operation. Nevertheless, Markets' core businesses remained resilient and continued to produce positive results. Currencies income increased significantly year on year and Corporate Debt Capital Markets reaffirmed its leading position in the GBP market.

### 2013 compared with 2012

Operating profit fell by £889 million with income falling by 26%, partly offset by significant cost reductions. The de-risking of Markets resulted in a 36% reduction in risk-weighted assets.

Rates actively repositioned the business during 2013, lowering the balance sheet and reducing risk. This, combined with a weak trading performance in H1 2013, resulted in subdued returns.

Currencies income increased as the franchise remained resilient and FX Options benefited from opportunities in volatile FX and emerging markets.

Asset Backed Products continued to perform well, although income was affected by investor concerns regarding tapering of the Federal Reserve's programme of quantitative easing and a reduction in the balance sheet and risk resources deployed by the business.

Credit Markets reflected the previous year's de-risking of credit trading and witnessed a modest reduction in Debt Capital Markets income, although the business executed a number of significant transactions and retained its leading position in corporate GBP issuance.

Costs fell by 11%, reflecting a reduction in headcount of 1,000 – split evenly between the front and back-office - and tightly controlled discretionary expenses, although this was offset by a higher level of legal costs, primarily related to legacy issues in the US Asset Backed Products business.

The increase in impairments was driven predominantly by provisions against a single exposure in 2013.

Reducing risk and refocusing the division on core fixed income and currencies products drove a substantial reduction in both balance sheet and risk capital. Third party assets were £72 billion lower than 31 December 2012 and risk-weighted assets, at £65 billion, were down £37 billion.

### 2012 compared with 2011



Operating profit increased by 68% reflecting 2% growth in income and 20% decrease in direct expenses, most notably through a reduction in staff costs.

Rates benefited from a strong trading performance, while losses incurred in managing counterparty exposures during the third quarter of 2011 were not repeated during 2012. Revenues for the year were up 32% to £1.9 billion.

Currencies volumes were weak across the industry, although the Spot FX business minimised the impact on revenue. Options income was limited by further Eurozone uncertainty.

Asset Backed Products continued to perform strongly as markets were sustained throughout the year by investors' search for yield. Revenues for the year were £1.3 billion, up 8% from a strong performance of £1.22 billion in 2011.

A 59% increase in Credit Markets revenue to £735 million was driven by Flow Credit which, as a result of improved risk management and more benign market conditions, recorded good profitability compared with a loss in 2011. This was partially offset by weaker earnings from credit origination.

The division focused on controlling costs throughout 2012, driving total expenses down by 16%. Lower staff expenses, down 26%, reflect lower headcount and lower levels of variable compensation, including reductions and clawbacks following the Group's LIBOR settlements reached on 6 February 2013, with the compensation ratio falling from 44% to 32%. Headcount reductions totalled 2,700 in the year, including that resulting from the exit of businesses announced in January. Other expenses fell by 3% as rigorous controls on discretionary expenditure and the exiting of product areas continued to take effect, partially offset by higher legal expenses.

The reduction in third party assets reflected management action to optimise and de-risk the balance sheet, consistent with previously disclosed medium-term objectives.

The division reduced risk-weighted assets, successfully focusing on lowering risk and enhancing models whilst managing the requirement for greater prudence in the regulatory environment.

Not reflected in Markets operating results in 2012 were the following items: £381 million for regulatory fines; £350 million for its share of the provision for interest rate swap redress; and approximately £700 million in restructuring costs associated with the strategic changes that took place during 2012.

## Business review

|                             |      |      |      |
|-----------------------------|------|------|------|
| Central items               | 2013 | 2012 | 2011 |
|                             | £m   | £m   | £m   |
| Central items not allocated | (89) | 84   | (34) |

Funding and operating costs have been allocated to operating divisions, based on direct service usage, requirement for market funding and other appropriate drivers where services span more than one division.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

## 2013 compared with 2012

Central items not allocated, represented a debit of £89 million in 2013 compared with a credit of £84 million in 2012, a reduction of £173 million.

This has been principally driven by higher unallocated Treasury and funding costs, £175 million higher, including volatile items under IFRS and lower gains on Treasury available-for-sale securities, down £156 million from £880 million in 2012 to £724 million in 2013.

Central items included various legacy litigation and conduct provisions totalling £127 million for 2013, a reduction of £33 million compared with 2012, and a property-related impairment of £65 million which have been offset by the non-repeat of £175 million costs incurred in 2012 in relation to the technology incident and credits totalling £80 million recognised in relation to the Group's share of profit from its stake in Saudi Hollandi, which was held as a disposal group in 2012.

## 2012 compared with 2011

Central items not allocated represented a credit of £84 million compared with a debit of £34 million in 2011.

Significant central costs included the Group technology incident cost of £175 million, a £160 million provision for various litigation and legacy conduct issues, as well as unallocated Treasury costs of circa £390 million. VAT recoveries of £85 million and Group Pension fund adjustment of circa £50 million in 2011 were not repeated.

Offsetting these costs, profits on Group Treasury available-for-sale bond disposals totalled £880 million compared with £516 million in 2011, as active management of the liquid assets portfolio as well as favourable market conditions enabled the Group to crystallise gains on some holdings.

## Business review

| Non-Core  | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
|   | £m      | £m      | £m      |
| Net interest income   | (61)    | 346     | 828     |
| Funding costs of rental assets  | (38)    | (102)   | (215)   |
| Net interest income   | (99)    | 244     | 613     |
| Net fees and commissions  | 55      | 105     | 54      |
| Loss from trading activities  | (148)   | (654)   | (721)   |
| Other operating income  |         |         |         |
| - rental income   | 177     | 510     | 953     |
| - other (1)   | (331)   | 83      | 75      |
| Non-interest income   | (247)   | 44      | 361     |
| Total income  | (346)   | 288     | 974     |
| Direct expenses   |         |         |         |
| - staff   | (203)   | (276)   | (376)   |
| - operating lease depreciation  | (76)    | (246)   | (347)   |
| - other   | (128)   | (164)   | (240)   |
| Indirect expenses   | (198)   | (258)   | (313)   |
|   | (605)   | (944)   | (1,276) |
| Loss before impairment losses   | (951)   | (656)   | (302)   |
| Impairment losses   | (4,576) | (2,223) | (3,917) |
| Operating loss  | (5,527) | (2,879) | (4,219) |
| Analysis of (loss)/income by business   |         |         |         |
| Banking & portfolios  | (496)   | 40      | 1,251   |
| International businesses  | 51      | 250     | 411     |
| Markets   | 99      | (2)     | (688)   |
| Total income  | (346)   | 288     | 974     |
| Loss from trading activities  |         |         |         |
| Monoline exposures  | (46)    | (205)   | (670)   |
| Credit derivative product companies   | (5)     | (205)   | (85)    |
| Asset-backed products (2)   | 103     | 101     | 29      |
| Other credit exotics  | 32      | (28)    | (175)   |
| Equities  | 2       | (2)     | (11)    |
| Banking book hedges   | 3       | (38)    | (1)     |
| Other   | (237)   | (277)   | 192     |
|   | (148)   | (654)   | (721)   |
| Impairment losses   |         |         |         |
| Banking & portfolios  | 4,646   | 2,346   | 3,831   |
| International businesses  | 1       | 56      | 82      |
| Markets   | (71)    | (179)   | 4       |
| Total impairment losses   | 4,576   | 2,223   | 3,917   |
| Of which RCR related (3)  | 3,118   | —       | —       |
| Loan impairment charge as % of gross customer loans and advances<br>(excluding reverse repurchase agreements) (4) |         |         |         |

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|                          |       |      |        |
|--------------------------|-------|------|--------|
| Banking & portfolios     | 12.9% | 4.2% | 4.9%   |
| International businesses | 0.5%  | 5.1% | 3.7%   |
| Markets                  | —     | —    | (3.0%) |
| Total                    | 12.8% | 4.2% | 4.8%   |

Notes:

- (1) Includes losses on disposals of £221 million for 2013 (2012 - £14 million; 2011 - £127 million).
- (2) Asset-backed products include super asset backed structures and other asset-backed products.
- (3) Pertaining to the creation of RCR and related strategy.
- (4) Includes disposal groups.

## Business review

## Non-Core continued

|  | 2013    | 2012   | 2011   |
|--|---------|--------|--------|
| Performance ratio                                |         |        |        |
| Net interest margin                              | (0.19%) | 0.31%  | 0.60%  |
|  | £bn     | £bn    | £bn    |
| Capital and balance sheet                        |         |        |        |
| Loans and advances to customers (gross) (1)      | 35.6    | 55.4   | 79.4   |
| Loan impairment provisions                       | (13.8)  | (11.2) | (11.5) |
| Net loans and advances to customers              | 21.8    | 44.2   | 67.9   |
| Total third party assets (excluding derivatives) | 28.0    | 57.4   | 92.5   |
| Total third party assets (including derivatives) | 31.2    | 63.4   | 103.6  |
| Risk elements in lending (1)                     | 19.0    | 21.4   | 24.0   |
| Provision coverage (2)                           | 73%     | 52%    | 48%    |
| Customer deposits (1)                            | 2.2     | 2.7    | 3.5    |
| Risk-weighted assets                             |         |        |        |
| - credit risk                                    |         |        |        |
| - non-counterparty                               | 21.0    | 45.1   | 65.6   |
| - counterparty                                   | 3.7     | 11.5   | 20.2   |
| - market risk                                    | 3.3     | 5.4    | 13.0   |
| - operational risk                               | 1.2     | (1.6)  | (5.5)  |
| Total risk-weighted assets                       | 29.2    | 60.4   | 93.3   |
| Gross customer loans and advances                |         |        |        |
| Banking & portfolios                             | 35.4    | 54.5   | 77.3   |
| International businesses                         | 0.2     | 0.9    | 2.0    |
| Markets  | —       | —      | 0.1    |
|  | 35.6    | 55.4   | 79.4   |
| Risk-weighted assets                             |         |        |        |
| Banking & portfolios                             | 26.2    | 53.3   | 64.8   |
| International businesses                         | 0.7     | 2.4    | 4.1    |
| Markets  | 2.3     | 4.7    | 24.4   |
|  | 29.2    | 60.4   | 93.3   |
| Third party assets (excluding derivatives)       |         |        |        |
| Banking & portfolios                             | 25.9    | 51.1   | 80.1   |
| International businesses                         | 0.3     | 1.2    | 2.9    |
| Markets  | 1.8     | 5.1    | 9.5    |
|  | 28.0    | 57.4   | 92.5   |

For the notes to this table refer to the following page.



## Business review

## Non-Core continued

|  | 31       |                       |            |             | Foreign  |          | 31   |
|--|----------|-----------------------|------------|-------------|----------|----------|------|
|  | December | Disposals/            | Drawings/  | Impairments | exchange | December |      |
|  | 2012     | Run-off restructuring | roll overs |             |          | 2013     |      |
|  | £bn      | £bn                   | £bn        | £bn         | £bn      | £bn      | £bn  |
| Third party assets (excluding derivatives) |          |                       |            |             |          |          |      |
| Commercial real estate                     | 22.1     | (5.3)                 | (2.3)      | 0.2         | (4.1)    | 0.3      | 10.9 |
| Corporate                                  | 25.5     | (8.2)                 | (4.6)      | 0.8         | (0.3)    | (0.2)    | 13.0 |
| SME  | 1.0      | (0.5)                 | (0.2)      | —           | —        | —        | 0.3  |
| Retail                                     | 3.2      | (0.6)                 | (0.6)      | —           | (0.2)    | —        | 1.8  |
| Other                                      | 0.5      | (0.3)                 | —          | —           | —        | —        | 0.2  |
| Markets                                    | 5.1      | (0.3)                 | (3.0)      | —           | —        | —        | 1.8  |
| Total (3)                                  | 57.4     | (15.2)                | (10.7)     | 1.0         | (4.6)    | 0.1      | 28.0 |

## Notes:

- (1) Excludes disposal groups.
- (2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
- (3) Disposals of £0.8 billion have been signed as at 31 December 2013 but are pending completion (2012 and 2011 - £0.2 billion).

|   | 2013 | 2012 | 2011 |
|---|------|------|------|
|   | £bn  | £bn  | £bn  |
| Commercial real estate third party assets |      |      |      |
| UK (excluding NI)                         | 4.7  | 8.9  | 11.4 |
| Ireland (ROI and NI)                      | 2.3  | 5.8  | 7.7  |
| Spain                                     | 0.8  | 1.4  | 1.8  |
| Rest of Europe                            | 2.8  | 4.9  | 7.9  |
| USA                                       | 0.3  | 0.9  | 2.2  |
| RoW                                       | —    | 0.2  | 0.5  |
| Total (excluding derivatives)             | 10.9 | 22.1 | 31.5 |

## Business review

## Non-Core continued

|   | 2013  | 2012 | 2011  |
|---|-------|------|-------|
|   | £m    | £m   | £m    |
| Impairment losses by donating division and sector |       |      |       |
| UK Retail   |       |      |       |
| Mortgages   | —     | —    | 5     |
| Personal  | (1)   | 4    | (27)  |
| Total UK Retail                                   | (1)   | 4    | (22)  |
| UK Corporate                                      |       |      |       |
| Manufacturing and infrastructure                  | 60    | 19   | 76    |
| Property and construction                         | 228   | 88   | 224   |
| Transport   | 40    | 16   | 52    |
| Financial institutions                            | (8)   | (38) | 5     |
| Lombard   | (4)   | 48   | 75    |
| Other   | 40    | 107  | 96    |
| Total UK Corporate                                | 356   | 240  | 528   |
| Ulster Bank                                       |       |      |       |
| Mortgages   |       |      |       |
| Commercial real estate                            |       |      |       |
| - investment                                      | 837   | 288  | 609   |
| - development                                     | 1,836 | 611  | 1,552 |
| Other corporate                                   | 345   | 77   | 173   |
| Other EMEA  | 9     | 7    | 15    |
| Total Ulster Bank                                 | 3,027 | 983  | 2,349 |
| US Retail & Commercial                            |       |      |       |
| Auto and consumer                                 | 55    | 49   | 58    |
| Cards   | —     | 1    | (9)   |
| SBO/home equity                                   | 83    | 130  | 201   |
| Residential mortgages                             | 12    | 21   | 16    |
| Commercial real estate                            | 9     | (12) | 40    |
| Commercial and other                              | (3)   | (12) | (3)   |
| Total US Retail & Commercial                      | 156   | 177  | 303   |
| International Banking                             |       |      |       |
| Manufacturing and infrastructure                  | (42)  | 3    | 57    |
| Property and construction                         | 835   | 623  | 752   |
| Transport   | 26    | 199  | (3)   |
| Telecoms, media and technology                    | 24    | 32   | 68    |
| Banking and financial institutions                | (49)  | (58) | (98)  |
| Other   | 245   | 18   | (19)  |
| Total International Banking                       | 1,039 | 817  | 757   |
| Other   |       |      |       |
| Wealth  | (1)   | 1    | 1     |



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|                          |       |       |       |
|--------------------------|-------|-------|-------|
| Central items            | —     | 1     | 1     |
| Total Other              | (1)   | 2     | 2     |
| Total impairment losses  | 4,576 | 2,223 | 3,917 |
| Of which RCR related (1) | 3,118 | —     | —     |

Note:

(1) Pertaining to the creation of RCR and related strategy.

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## Business review

## Non-Core continued

| Gross loans and advances to customers (excluding reverse repurchase agreements) by donating division and sector | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---|-------------|-------------|-------------|
| UK Retail   |             |             |             |
| Mortgages   | —           | —           | 1.4         |
| Personal  | —           | —           | 0.1         |
| Total UK Retail   | —           | —           | 1.5         |
| UK Corporate  |             |             |             |
| Manufacturing and infrastructure  | —           | 0.1         | 0.1         |
| Property and construction   | 1.7         | 3.6         | 5.9         |
| Transport   | 2.7         | 3.8         | 4.5         |
| Financial institutions  | —           | 0.2         | 0.6         |
| Lombard   | 0.2         | 0.4         | 1.0         |
| Other   | 1.2         | 4.2         | 7.5         |
| Total UK Corporate  | 5.8         | 12.3        | 19.6        |
| Ulster Bank   |             |             |             |
| Commercial real estate  |             |             |             |
| - investment  | 3.2         | 3.4         | 3.9         |
| - development   | 6.9         | 7.6         | 8.5         |
| Other corporate   | 1.5         | 1.6         | 1.6         |
| Other EMEA  | —           | 0.3         | 0.4         |
| Total Ulster Bank   | 11.6        | 12.9        | 14.4        |
| US Retail & Commercial  |             |             |             |
| Auto and consumer   | 0.2         | 0.6         | 0.8         |
| Cards   | —           | —           | 0.1         |
| SBO/home equity   | 1.5         | 2.0         | 2.5         |
| Residential mortgages   | 0.3         | 0.4         | 0.6         |
| Commercial real estate  | 0.2         | 0.4         | 1.0         |
| Commercial and other  | 0.1         | 0.1         | 0.4         |
| Total US Retail & Commercial  | 2.3         | 3.5         | 5.4         |
| Markets   |             |             |             |
| Manufacturing and infrastructure  | 1.4         | 3.9         | 6.6         |
| Property and construction   | 7.5         | 12.3        | 15.3        |
| Transport   | 1.4         | 1.7         | 3.2         |
| Telecoms, media and technology  | 0.8         | 0.4         | 0.7         |
| Banking and financial institutions  | 2.9         | 4.7         | 5.6         |
| Other   | 1.9         | 3.7         | 7.0         |
| Total Markets   | 15.9        | 26.7        | 38.4        |
| Other   |             |             |             |
| Wealth  | —           | —           | 0.2         |
| Central items   | —           | —           | (0.2)       |

|   |      |      |      |
|---|------|------|------|
| Total Other   | —    | —    | —    |
| Gross loans and advances to customers (excluding reverse repurchase agreements) | 35.6 | 55.4 | 79.3 |

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## Business review

### Non-Core continued

Non-Core has successfully achieved and surpassed its five year Strategic Plan target, reducing third party assets from the opening £258 billion position to end 2013 significantly below the original c.£40 billion target at £28 billion. Over the life of Non-Core this represents an overall reduction of £230 billion, or 89%. This was achieved through a mixture of disposals, run-off and impairments. By the end of 2013, the Non-Core funded balance sheet was c.4% of the Group's funded balance sheet compared with 21% when the division was created. RWAs have reduced from £171 billion to £29 billion, or 83%, over the life of Non-Core.

Third party assets were reduced by £29 billion, or 51%, during the year. Approximately £3.1 billion of the reduction was due to increased impairments as a result of the change in the future run-down/disposal plan for the remaining Non-Core assets under the transition to RCR.

2013 is the final reporting period for the Non-Core division. Approximately £12 billion of assets which were managed by Non-Core are to be returned to the relevant Core divisions, with the remaining assets transferring to RCR from 1 January 2014.

### 2013 compared with 2012

Third party assets declined by £29 billion, or 51%, reflecting run-off of £15 billion, disposals of £11 billion and impairments of £5 billion, of which £3.1 billion is driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans.

Risk-weighted assets were £31 billion lower, driven by disposals and run-off.

Operating loss of £5,527 million was £2,648 million higher than 2012, principally due to a £2,353 million increase in impairments. This was predominantly due to £3,118 million of 2013 impairments related to the creation of RCR, most significantly with £2,299 million in Ulster Bank and £742 million in International Banking, driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans, which has led to increased impairment losses on the non-performing assets.

Operating loss before impairment losses was £295 million higher with a reduction in net interest income of £343 million, £207 million additional disposal losses and £104 million further fair value writedowns offset by £506 million lower losses from trading activities.

The reduction in net interest income of £343 million was driven by a 31% fall in interest earning assets driven by run-off and disposals.

Headcount declined by 1,700, or 55% to 1,400 of which 1,000 relates to operations in India and Romania, reflecting divestment activity and run-off.

### 2012 compared with 2011

Third party assets declined by £35 billion, or 38%, largely reflecting disposals of £18 billion and run-off of £16 billion. The disposal of RBS Aviation Capital in Q2 2012 contributed c.£5 billion of this reduction.

Risk-weighted assets were £33 billion lower, principally driven by disposals, run-off and restructuring of existing positions.

An operating loss of £2,879 million was £1,340 million lower than 2011, principally due to lower impairments and expenses, partially offset by lower net interest income following run-off and disposals.

Impairment losses fell by £1,694 million to £2,223 million, with £1,366 million of this reduction from the Ulster Bank portfolio and £269 million from the real estate portfolio.

Income declined by £686 million as continued divestment and run-off reduced net interest income. Rental income was lower following the disposal of RBS Aviation Capital in Q2 2012.

Expenses were £332 million lower, driven by reduced headcount and lower operating lease depreciation, principally following the disposal of RBS Aviation Capital.

Headcount declined by 29% to 2,900 reflecting the divestment activity and run-off across the business.

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## Business review

### RBS Capital Resolution

#### Background

In June 2013, in response to a recommendation by the Parliamentary Commission on Banking Standards, the UK Government announced it would review the case for an external 'bad bank', based on three objectives as originally outlined by the Chancellor:

- accelerating the return of RBS to the private sector;
- supporting the British economy; and
- best value for the taxpayer.

Following this announcement, RBS worked closely with HM Treasury ('HMT') and its advisers to identify a pool of assets with particularly high long-term capital intensity, credit risk, low returns and/or potential stress loss in varying scenarios. The balance of this identified pool was £47 billion as at 30 June 2013. The pool was forecast to be c.£38 billion of assets as at 31 December 2013, which together with derivatives were forecast to attract c.£116 billion of RWA equivalents(1).

HMT published its report on 1 November 2013. The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified. It also concluded that "RBS's existing provisions and levels of capital deducted suggested that projected future losses are appropriately covered".

As a result, and in line with its new strategic direction set out on 1 November 2013, RBS announced the creation of RBS Capital Resolution ('RCR') to separate and wind down RBS's high capital intensive assets. RCR will bring assets under common management and was established with the following principles:

- removing risk from the balance sheet in an efficient, expedient and economic manner;
- reducing the volatile outcomes in stressed environments; and
- accelerating the release of capital through management and exit of the portfolio.

The RCR division created with effect from 1 January 2014 is of a similar size to the ex Non-Core division, but the assets were selected on a different basis and no direct comparisons should be drawn. RCR assets were selected on the basis of long term capital intensity whereas the Non-Core assets were selected based on five strategic tests.

Going forward, as part of its external reporting, the Group will provide comprehensive and transparent disclosures on the progress of RCR, including funding and capital employed and released. Furthermore, a Board Oversight Committee ('BOC') has been set up reporting directly to the Group Board, to report on adherence to asset management principles and recommend changes to strategy where appropriate. The BOC comprises a quorum of any two of the Chairman of the Group Board, the Senior Independent Director, the Chair of the Group Audit Committee and the Chair of the Board Risk Committee.

While there are inevitable uncertain market and execution risks associated with running down such assets, it is RBS's aspiration, subject to shareholder value, to remove most of these assets and capital from the balance sheet in three years. RCR will target a reduction in funded assets to c.£23 billion by the end of 2014; to between £15 billion and £11 billion by the end of 2015 and to less than £6 billion by the end of 2016. RCR is expected to be Common Equity Tier 1 ('CET1') accretive over its life and is neutral for shareholder value, taking into account future regulatory capital requirements.

The RCR pool of assets was forecast to be c.£38 billion and c.£116 billion RWAE at its inception on 1 January 2014 based on 30 June 2013 data. Since this forecast was made:

- £4.6 billion of impairments and other adjustments were recorded in respect of non-performing and other assets as a result of the change in realisation strategy noted above, with capital impact of £37 billion RWAE. The increased impairments relate to certain of the impaired or non-performing assets transferred to RCR, and reflect the revised holding strategy which has led to adverse changes in our estimates of future cash flows.
- there were materially higher levels of disposal activity and recoveries (£5 billion) in Non-Core than had been forecast based on 30 June 2013 data, with a capital impact of £14 billion reduction in RWAE.

In aggregate, these two factors reduced the opening funded assets by £9 billion to £29 billion and RWAE by £51 billion to £65 billion. This reduction in funded assets in the second half of the year, particularly the disposals, has also resulted in a corresponding decrease in the Group's funding requirements.

At 1 January 2014, 48% of the portfolio's funded assets are from Non-Core (excluding Ulster Bank), 17% from Ulster Bank (Core and Non-Core) and the remainder are from UK Corporate, International Banking and Markets.

£12 billion of assets with RWAE of £11 billion managed by Non-Core have been returned to the relevant Core divisions because they did not meet the risk and capital criteria for RCR.

RCR commenced on 1 January 2014 and its first results will be reported separately in the Group's first quarter 2014 results.

Note:

(1)RWA equivalent (RWAE) is an internal metric that measures the equity capital employed in divisions. RWAE converts both performing and non-performing exposures into a consistent capital measure, being the sum of the regulatory RWAs and the regulatory capital deductions, the latter converted to RWAE by applying a multiplier. The Group applies a CET 1 ratio of 10%, consistent with that used for divisional return on equity measure; this results in an FLB3 RWAE conversion multiplier of 10.

## Business review

## RBS Capital Resolution continued

## Roll forward of funded assets

|                                   | Note | £bn   |
|-----------------------------------|------|-------|
| Estimated balance at 30 June 2013 |      | 46.8  |
| Disposals                         | (a)  | (6.0) |
| Run-off                           | (b)  | (4.8) |
| Impairments                       | (c)  | (5.2) |
| Other                             | (d)  | (1.9) |
| Balance at 31 December 2013       |      | 28.9  |

## Notes

- (a) disposals in the second half of the year, predominantly in Non-Core.
- (b) represents repayments and amortisations, partially offset by draw down of facilities across the portfolios.
- (c) includes all impairments in the second half of 2013, predominately in Non-Core, and reflects increased impairments relating to the creation of RCR and the related strategy.
- (d) other includes fair value adjustments, foreign exchange movements (£1.2 billion) and finalisation of the asset pool.

## Roll forward of FLB3 RW Ae

|                                   | Note | £bn    |
|-----------------------------------|------|--------|
| Estimated balance at 30 June 2013 |      | 136.8  |
| Disposals                         | (a)  | (11.9) |
| Run-off                           | (b)  | (10.9) |
| Impairments                       | (c)  | (45.1) |
| Other                             | (d)  | (3.9)  |
| Balance at 31 December 2013       |      | 65.0   |

## Notes:

- (a) includes all aspects relating to disposals including associated removal of deductions from regulatory capital.
- (b) represents RW Ae on repayments and amortisations, partially offset by draw down of facilities across the portfolios.
- (c) RW Ae impairment charge.
- (d) other includes fair value adjustments; changes to inputs for RWA calculation (including LGD, PD, and slotting category); the implementation of a new RWA model or modification of an existing model approved by the PRA, foreign exchange movements and finalisation of the asset pool.

The £18 billion decrease in funded assets in the second half of the year resulted in a significantly higher reduction of £72 billion in RW Ae. This was due to:

- impairments of £5 billion recognised in the second half of 2013 resulted in a lower capital deduction for the excess of expected loss over provisions. Allowing for a restriction in provisions allowable against expected losses, the benefit was £4.5 billion or £45 billion of RW Ae.
- disposals of £6 billion resulting in RW Ae of £12 billion
- run-off of £5 billion with a corresponding RW Ae of £11 billion

Capital deductions comprised expected losses less impairment provisions (31 December 2013 - £1,774 million; 30 June 2013 - £6,047 million) and allocation of defined pension fund deficit (31 December 2013 - £58 million; 30 June 2013 - £38 million).



Additional details are set out on the following pages.

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## Business review

## RBS Capital Resolution continued

The impact of the revised strategy on key metrics of the Group are set out below.

|                          | Group<br>£bn | RCR<br>£bn | Rest of<br>the<br>Group<br>£bn |
|--------------------------|--------------|------------|--------------------------------|
| Funded assets            |              |            |                                |
| Non-Core                 | 28.0         | 16.2       | 11.8                           |
| Ulster Bank              | 28.0         | 2.5        | 25.5                           |
| UK Corporate             | 105.0        | 5.3        | 99.7                           |
| International Banking    | 48.5         | 2.2        | 46.3                           |
| Markets                  | 212.8        | 2.7        | 210.1                          |
| Other divisions          | 317.5        | —          | 317.5                          |
|                          | 739.8        | 28.9       | 710.9                          |
| Risk elements in lending | £m           | £m         | £m                             |
| Non-Core                 | 19.0         | 17.2       | 1.7                            |
| Ulster Bank              | 8.5          | 3.8        | 4.7                            |
| UK Corporate             | 6.2          | 2.3        | 3.9                            |
| International Banking    | 0.5          | 0.5        | —                              |
| Markets                  | 0.3          | 0.3        | —                              |
| Other divisions          | 4.9          | —          | 4.9                            |
|                          | 39.4         | 24.2       | 15.2                           |
| Impairment provision     | £m           | £m         | £m                             |
| Non-Core                 | 13.8         | 13.0       | 0.8                            |
| Ulster Bank              | 5.4          | 2.2        | 3.2                            |
| UK Corporate             | 2.8          | 0.9        | 1.9                            |
| International Banking    | 0.3          | 0.2        | 0.1                            |
| Markets                  | 0.3          | 0.3        | —                              |
| Other divisions          | 2.6          | —          | 2.6                            |
|                          | 25.2         | 16.6       | 8.6                            |

## Business review

## RBS Capital Resolution continued

Estimated funded assets (third party assets excluding derivatives or TPA) and RWAE of RCR

Analysis of the funded assets and RWAE of RCR at 31 December 2013 and the related position at 30 June 2013 (the starting point for the identification of the portfolios of RCR), are set out below.

|               | Non-performing (1) |      |         |     |         | Performing (1) |      |      |      |         | Total   |       |       |       |       |         |
|---------------|--------------------|------|---------|-----|---------|----------------|------|------|------|---------|---------|-------|-------|-------|-------|---------|
|               | Gross              | Net  | Capital |     |         | Gross          | Net  | RWAE |      |         | Capital | Gross | Net   | Total |       |         |
|               | TPA                | TPA  | RWAE    | RWA | deducts | TPA            | TPA  | RWAE | RWA  | deducts | (2)     | TPA   | TPA   | RWAE  | RWA   | deducts |
| 31            |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| December      |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| 2013          | £bn                | £bn  | £bn     | £bn | £m      | £bn            | £bn  | £bn  | £bn  | £m      | £bn     | £bn   | £bn   | £bn   | £m    |         |
| Non-Core      | 18.4               | 5.8  | 4.7     | 0.5 | 413     | 10.8           | 10.4 | 21.5 | 23.2 | (170)   | 29.2    | 16.2  | 26.2  | 23.7  | 243   |         |
| Core          |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Ulster Bank   | 3.9                | 1.8  | 6.3     | 0.2 | 610     | 0.8            | 0.7  | 1.9  | 1.9  | 3       | 4.7     | 2.5   | 8.2   | 2.1   | 613   |         |
| UK            |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Corporate     | 2.3                | 1.6  | 3.5     | —   | 353     | 3.9            | 3.7  | 8.0  | 8.0  | —       | 6.2     | 5.3   | 11.5  | 8.0   | 353   |         |
| International |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Banking       | 0.5                | 0.4  | 1.8     | —   | 178     | 1.9            | 1.8  | 4.5  | 4.3  | 23      | 2.4     | 2.2   | 6.3   | 4.3   | 201   |         |
| Markets       | 0.4                | 0.1  | 0.9     | —   | 91      | 2.6            | 2.6  | 11.9 | 8.6  | 331     | 3.0     | 2.7   | 12.8  | 8.6   | 422   |         |
| Total Core    | 7.1                | 3.9  | 12.5    | 0.2 | 1,232   | 9.2            | 8.8  | 26.3 | 22.8 | 357     | 16.3    | 12.7  | 38.8  | 23.0  | 1,589 |         |
| Total RCR     | 25.5               | 9.7  | 17.2    | 0.7 | 1,645   | 20.0           | 19.2 | 47.8 | 46.0 | 187     | 45.5    | 28.9  | 65.0  | 46.7  | 1,832 |         |
| 30 June 2013  |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Non-Core      | 22.3               | 11.8 | 39.4    | 2.2 | 3,716   | 17.9           | 17.9 | 31.6 | 38.4 | (666)   | 40.2    | 29.7  | 71.0  | 40.6  | 3,050 |         |
| Core          |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Ulster Bank   | 5.1                | 2.8  | 12.9    | 0.8 | 1,207   | 1.4            | 1.4  | 5.2  | 3.8  | 149     | 6.5     | 4.2   | 18.1  | 4.6   | 1,356 |         |
| UK Corporate  | 2.9                | 2.5  | 7.9     | —   | 762     | 4.6            | 4.6  | 12.3 | 9.6  | 265     | 7.5     | 7.1   | 19.9  | 9.6   | 1,027 |         |
| International |                    |      |         |     |         |                |      |      |      |         |         |       |       |       |       |         |
| Banking       | 0.9                | 0.6  | 3.2     | —   | 323     | 2.4            | 2.4  | 4.8  | 4.2  | 59      | 3.3     | 3.0   | 8.0   | 4.2   | 382   |         |
| Markets       | —                  | —    | —       | —   | —       | 2.8            | 2.8  | 19.8 | 17.1 | 270     | 2.8     | 2.8   | 19.8  | 17.1  | 270   |         |
| Total Core    | 8.9                | 5.9  | 23.7    | 0.8 | 2,292   | 11.2           | 11.2 | 42.1 | 34.7 | 743     | 20.1    | 17.1  | 65.8  | 35.5  | 3,035 |         |
| Total RCR     | 31.2               | 17.7 | 63.1    | 3.0 | 6,008   | 29.1           | 29.1 | 73.7 | 73.1 | 77      | 60.3    | 46.8  | 136.8 | 76.1  | 6,085 |         |

## Notes

(1) Performing assets are those with an internal asset quality (AQ) of 1-9; and non-performing assets are in AQ 10 with a probability of default being 100%.

(2) The negative capital deductions are a result of the latent loss provisions held in respect of the performing portfolio.

## Business review

## Consolidated balance sheet at 31 December 2013

|   | 2013<br>£m       | 2012*<br>£m      | 2011*<br>£m      |
|---|------------------|------------------|------------------|
| <b>Assets</b>                                     |                  |                  |                  |
| Cash and balances at central banks                | 82,659           | 79,290           | 79,269           |
| Net loans and advances to banks                   | 27,555           | 29,168           | 43,870           |
| Reverse repurchase agreements and stock borrowing | 26,516           | 34,783           | 39,440           |
| Loans and advances to banks                       | 54,071           | 63,951           | 83,310           |
| Net loans and advances to customers               | 390,825          | 430,088          | 454,112          |
| Reverse repurchase agreements and stock borrowing | 49,897           | 70,047           | 61,494           |
| Loans and advances to customers                   | 440,722          | 500,135          | 515,606          |
| Debt securities subject to repurchase agreements  | 55,554           | 91,173           | 79,480           |
| Other debt securities                             | 58,045           | 66,265           | 129,600          |
| Debt securities                                   | 113,599          | 157,438          | 209,080          |
| Equity shares                                     | 8,811            | 15,232           | 15,183           |
| Settlement balances                               | 5,591            | 5,741            | 7,771            |
| Derivatives                                       | 288,039          | 441,903          | 529,618          |
| Intangible assets                                 | 12,368           | 13,545           | 14,858           |
| Property, plant and equipment                     | 7,909            | 9,784            | 11,868           |
| Deferred tax                                      | 3,478            | 3,443            | 3,878            |
| Prepayments, accrued income and other assets      | 7,614            | 7,820            | 10,976           |
| Assets of disposal groups                         | 3,017            | 14,013           | 25,450           |
| <b>Total assets</b>                               | <b>1,027,878</b> | <b>1,312,295</b> | <b>1,506,867</b> |
| <b>Liabilities</b>                                |                  |                  |                  |
| Bank deposits                                     | 35,329           | 57,073           | 69,113           |
| Repurchase agreements and stock lending           | 28,650           | 44,332           | 39,691           |
| Deposits by banks                                 | 63,979           | 101,405          | 108,804          |
| Customers deposits                                | 414,396          | 433,239          | 414,143          |
| Repurchase agreements and stock lending           | 56,484           | 88,040           | 88,812           |
| Customer accounts                                 | 470,880          | 521,279          | 502,955          |
| Debt securities in issue                          | 67,819           | 94,592           | 162,621          |
| Settlement balances                               | 5,313            | 5,878            | 7,477            |
| Short positions                                   | 28,022           | 27,591           | 41,039           |
| Derivatives                                       | 285,526          | 434,333          | 523,983          |
| Accruals, deferred income and other liabilities   | 16,017           | 14,801           | 23,204           |
| Retirement benefit liabilities                    | 3,210            | 3,884            | 2,239            |
| Deferred tax                                      | 507              | 1,141            | 1,945            |
| Insurance liabilities                             | —                | —                | 6,233            |
| Subordinated liabilities                          | 24,012           | 26,773           | 26,319           |
| Liabilities of disposal groups                    | 3,378            | 10,170           | 23,995           |
| <b>Total liabilities</b>                          | <b>968,663</b>   | <b>1,241,847</b> | <b>1,430,814</b> |
| Non-controlling interests                         | 473              | 1,770            | 686              |
| Owners' equity                                    | 58,742           | 68,678           | 75,367           |
| <b>Total equity</b>                               | <b>59,215</b>    | <b>70,448</b>    | <b>76,053</b>    |
| <b>Total liabilities and equity</b>               | <b>1,027,878</b> | <b>1,312,295</b> | <b>1,506,867</b> |

\*Restated - see page 105.

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## Business review

Commentary on consolidated balance sheet

2013 compared with 2012

Total assets of £1,027.9 billion at 31 December 2013 were down £284.4 billion, 22%, compared with 31 December 2012. This was driven by the downsizing of the Markets business, primarily reflected in decreases in loans to banks and customers, debt securities and derivatives balances, and a further decrease in loans and advances to banks and customers due to Non-Core disposals and run off.

Loans and advances to banks decreased by £9.9 billion, 15%, to £54.1 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £8.3 billion, 24%, to £26.5 billion, bank placings declined £1.6 billion, 6%, to £27.6 billion.

Loans and advances to customers declined £59.4 billion, 12%, to £440.7 billion. Within this, reverse repurchase agreements were down £20.1 billion, 29%, to £49.9 billion. Customer lending decreased by £39.3 billion, 9%, to £390.8 billion, or £35.2 billion to £416.0 billion before impairments. This reflected reductions in Non-Core of £19.9 billion, along with declines in International Banking, £6.2 billion, UK Corporate, £4.5 billion, Markets, £4.3 billion, Ulster Bank, £1.9 billion, UK Retail, £0.4 billion, Wealth, £0.3 billion, and US Retail & Commercial, £0.2 billion which included the impact of £0.7 billion of customer loans being transferred to assets of disposal groups at 31 December 2013. These decreases were partially offset by the effect of exchange rate and other movements, £2.5 billion.

Debt securities were down £43.8 billion, 28%, to £113.6 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds.

Equity shares decreased by £6.4 billion, 42%, to £8.8 billion due to the targeted run-down of Markets' equities business.

Movements in the value of derivative assets, down £153.9 billion, 35%, to £288.0 billion, and liabilities, down £148.8 billion, 34% to £285.5 billion, primarily reflects upward shifts in major yield curves which resulted in significant mark-to-market decreases on interest rate contracts.

Property, plant and equipment decreased by £1.9 billion, 19%, to £7.9 billion driven largely by the disposal of Non-Core assets.

Intangible assets decreased by £1.2 billion, 9%, to £12.4 billion primarily as a result of the write-down of goodwill relating to the International Banking division at 31 December 2013.

The decrease in assets and liabilities of disposal groups, down £11.0 billion, 78%, to £3.0 billion, and £6.8 billion, 67%, to £3.4 billion respectively, primarily reflects the deconsolidation of Direct Line Group following the further sale of shares and ceding of control in 2013. The remaining interest, classified as an associate, is included in assets of disposal groups at 31 December 2013. In addition, disposal groups include loans and deposits in Illinois branches for sale in US Retail & Commercial.

Deposits by banks decreased £37.4 billion, 37%, to £64.0 billion, with decreases in inter-bank deposits, down £21.7 billion, 38%, to £35.3 billion and repurchase agreements and stock lending ('repos'), down £15.7 billion, 35%, to £28.7 billion, as a result of the Group's lower funding requirements and reduced derivative cash collateral.

Customer accounts decreased £50.4 billion, 10%, to £470.9 billion. Within this, repos decreased £31.6 billion, 36%, to £56.5 billion. Excluding repos, customer deposits were down £18.8 billion, 4%, at £414.4 billion, primarily reflecting decreases in International Banking, £6.9 billion, Markets, £4.8 billion, UK Corporate, £2.4 billion, Wealth, £1.7

billion, Ulster Bank, £0.7 billion, US Retail & Commercial, £5.9 billion, which included the impact of £3.2 billion of customer deposits being transferred to liabilities of disposal groups at 31 December 2013, and the effect of exchange rate and other movements of £3.4 billion. These decreases were partially offset by increases in UK Retail, £7.3 billion.

Debt securities in issue decreased £26.8 billion, 28%, to £67.8 billion due to lower funding requirements as a result of the reduction in the overall size of the balance sheet, with most of the reduction in medium term notes in issue.

Retirement benefit liabilities decreased by £0.7 billion, 17%, to £3.2 billion with net actuarial gains of £0.5 billion arising from improved asset returns and higher discount rates partly offset by an increase in the assumed inflation rate. Additional employer contributions of £0.4 billion to the Group's Main scheme also reduced retirement benefit liabilities.

Subordinated liabilities decreased by £2.8 billion, 10% to £24.0 billion, primarily as a result of the net decrease in dated loan capital with redemptions of £3.4 billion and the effects of exchange and other movements of £1.2 billion being partially offset by issuances of £1.8 billion.

Minority interests decreased by £1.3 billion, 73%, to £0.5 billion, predominantly due to the deconsolidation of Direct Line Group following the further sale of shares and ceding of control in 2013.

Owner's equity decreased by £9.9 billion, 14%, to £58.7 billion, driven by the £9.0 billion attributable loss for the year together with movements in cash flow hedging reserves, £1.7 billion and foreign exchange reserves, £0.2 billion. Partially offsetting these reductions were share issuances of £0.4 billion, the termination of the contingent capital facility, £0.3 billion, the recognition of actuarial gains in respect of the Group's defined benefit pension schemes, net of tax, £0.2 billion and other reserve movements, £0.1 billion.

## Business review

Commentary on consolidated balance sheet continued

2012 compared with 2011

Total assets of £1,312.3 billion at 31 December 2012 were down £194.6 billion, 13%, compared with 31 December 2011. This was principally driven by a decrease in loans and advances to banks and customers led by Non-Core disposals and run off, decreases in debt securities and the continuing reduction in the mark-to-market value of derivatives.

Loans and advances to banks decreased by £19.4 billion, 23%, to £64.0 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £4.7 billion, 12%, to £34.8 billion, bank placings declined £14.7 billion, 34%, to £29.2 billion.

Loans and advances to customers declined £15.5 billion, 3%, to £500.1 billion. Within this, reverse repurchase agreements were up £8.6 billion, 14%, to £70.0 billion. Customer lending decreased by £24.0 billion, 5%, to £430.1 billion, or £22.6 billion to £451.2 billion before impairments. This reflected reductions in Non-Core of £22.6 billion, along with declines in International Banking, £14.3 billion, UK Corporate, £2.9 billion, Markets, £1.0 billion and Ulster Bank, £0.7 billion, together with the effect of exchange rate and other movements, £4.7 billion. These were partially offset by the transfer from disposal groups of £18.9 billion of customer balances relating to the UK branch-based businesses, together with underlying growth in UK Retail, £2.6 billion, US Retail & Commercial, £1.9 billion and Wealth, £0.2 billion.

Debt securities were down £51.6 billion, 25%, to £157.4 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds.

Settlement balance assets and liabilities decreased £2.0 billion to £5.7 billion and £1.6 billion to £5.9 billion respectively reflecting the overall reduction in the size of the balance sheet.

Movements in the value of derivative assets, down £87.7 billion, 17%, to £441.9 billion, and liabilities, down £89.7 billion, 17%, to £434.3 billion, primarily reflect decreases in interest rate and credit derivative contracts, together with the effect of currency movements, with Sterling strengthening against both the US dollar and the Euro.

Intangible assets decreased £1.3 billion, 9%, to £13.5 billion, primarily as a result of write-down of the Direct Line Group goodwill, £0.4 billion, and the transfer of the remaining £0.5 billion of goodwill together with £0.2 billion of other intangible assets to assets of disposal groups at 31 December 2012.

Property, plant and equipment decreased by £2.1 billion, 18%, to £9.8 billion driven largely by the disposal of investment property in Non-Core.

The decrease in assets and liabilities of disposal groups, down £11.4 billion, 45%, to £14.0 billion, and £13.8 billion, 58%, to £10.2 billion respectively, primarily reflects the removal of the UK branch-based businesses from disposal groups following Santander's withdrawal from the purchase, together with the disposal of RBS Aviation Capital in the second quarter. These were partly offset by the transfer to disposal groups of Direct Line Group at 31 December 2012.

Deposits by banks decreased £7.4 billion, 7%, to £101.4 billion, with a decrease in inter-bank deposits, down £12.0 billion, 17%, to £57.1 billion. This was partly offset by an increase in repurchase agreements and stock lending ('repos'), up £4.6 billion, 12%, to £44.3 billion, improving the Group's mix of secured and unsecured funding.

Customer accounts increased £18.3 billion, 4%, to £521.3 billion. Within this, repos decreased £0.8 billion, 1%, to £88.0 billion. Excluding repos, customer deposits were up £19.1 billion, 5%, at £433.2 billion, primarily reflecting the transfer from disposal groups of £21.5 billion of customer accounts relating to the UK branch-based businesses



together with underlying increases in UK Retail, £6.0 billion, International Banking, £2.0 billion, US Retail & Commercial, £1.8 billion, UK Corporate, £0.8 billion, Ulster Bank, £0.7 billion and Wealth, £0.7 billion. This was partially offset by decreases in Markets, £9.7 billion, and Non-Core, £0.9 billion, together with exchange and other movements £3.8 billion.

Debt securities in issue decreased £68.0 billion, 42%, to £94.6 billion reflecting the maturity of the remaining notes issued under the UK Government's Credit Guarantee Scheme, £21.3 billion, the repurchase of bonds and medium term notes as a result of the liability management exercise completed in September 2012, £4.4 billion, and the continuing reduction of commercial paper and medium term notes in issue in line with the Group's strategy.

Short positions were down £13.4 billion, 33%, to £27.6 billion mirroring decreases in debt securities.

Retirement benefit liabilities increased by £1.6 billion, 73%, to £3.9 billion with net actuarial losses of £2.3 billion on the Group's defined benefit pension schemes, primarily arising from significant reductions in the real discount rates in the Sterling, Euro and US dollar currency zones. These were partially offset by the £0.6 billion excess of employer contributions paid over the current year pension charge.

Insurance liabilities of £6.2 billion relating to Direct Line Group were transferred to liabilities of disposal groups at 31 December 2012.

Subordinated liabilities increased by £0.5 billion, 2% to £26.8 billion, primarily as a result of the net increase in dated loan capital. Issuances of £1.4 billion and redemptions of £0.3 billion were partly offset by a net decrease of £0.6 billion arising from the liability management exercise completed in March 2012, which consisted of redemptions of £3.4 billion offset by the issuance of £2.8 billion new loan capital.

Non-controlling interests increased by £1.1 billion, 158%, to £1.8 billion, predominantly due to the sale of 34.7% of the Group's investment in Direct Line Group during the fourth quarter.

Owner's equity decreased by £6.7 billion, 9%, to £68.7 billion, driven by the £6.1 billion attributable loss for the period together with movements in foreign exchange reserves, £0.9 billion, the recognition of actuarial losses in respect of the Group's defined benefit pension schemes, net of tax, £1.8 billion, and other reserve movements of £0.2 billion. Partially offsetting these reductions were gains in available-for-sale reserves, £0.6 billion, and cash flow hedging reserves, £0.8 billion, share capital and reserve movements in respect of employee share schemes, £0.8 billion and other share issuances of £1.0 billion.

## Business review

| Cash flow   | 2013     | 2012*    | 2011*   |
|---|----------|----------|---------|
|   | £m       | £m       | £m      |
| Net cash flows from operating activities                      | (30,631) | (45,113) | 3,325   |
| Net cash flows from investing activities                      | 21,183   | 27,175   | 14      |
| Net cash flows from financing activities                      | (2,728)  | 2,017    | (1,741) |
| Effects of exchange rate changes on cash and cash equivalents | 512      | (3,893)  | (1,473) |
| Net (decrease)/increase in cash and cash equivalents          | (11,664) | (19,814) | 125     |

\*Restated - see page 105.

## 2013

The major factors contributing to the net cash outflow from operating activities of £30,631 million were the decrease of £28,780 million in operating assets and liabilities, the net operating loss before tax of £8,066 million from continuing and discontinued operations, loans and advances written-off net of recoveries of £4,090 million and other provisions utilised of £2,066 million. These were partially offset by provisions for impairment losses of £8,432 million and other provisions charged net of releases £4,422 million.

Net cash inflows from investing activities of £21,183 million related to the net inflows from sales of securities of £19,211 million, the sale of property, plant and equipment of £1,448 million and net divestments of business interests and intangible assets of £1,150 million offset by net cash outflows from the purchase of property, plant and equipment of £626 million.

Net cash outflows from financing activities of £2,728 million relate primarily to the repayment of subordinated liabilities of £3,500 million and interest paid on subordinated liabilities of £958 million partly offset by the issue of subordinated liabilities of £1,796 million.

## 2012

The major factors contributing to the net cash outflow from operating activities of £45,113 million were the decrease of £48,736 million in operating assets and liabilities, the net operating loss before tax of £5,388 million from continuing and discontinued operations, loans and advances written off net of recoveries of £3,925 million and other non-cash items of £1,491 million. These were partially offset by the elimination of foreign exchange differences of £7,140 million, provisions for impairment losses of £5,283 million and depreciation and amortisation of £1,854 million.

Net cash inflows from investing activities of £27,175 million related to the net inflows from sales of securities of £26,092 million, the sale of property, plant and equipment of £2,215 million and divestments in business interests and intangible assets of £352 million offset by net cash outflows from the purchase of property, plant and equipment of £1,484 million.

Net cash inflows from financing activities of £2,017 million relate primarily to the issue of subordinated liabilities of £2,093 million and proceeds of non-controlling interests issued of £889 million partly offset by interest paid on subordinated liabilities of £746 million and dividends paid of £301 million.

## 2011

The major factors contributing to the net cash inflow from operating activities of £3,325 million were the elimination of foreign exchange differences of £2,702 million, depreciation and amortisation of £1,875 million and inflow from

other items of £3,106 million, partially offset by the net operating loss before tax of £914 million from continuing and discontinued operations and the decrease of £3,444 million in operating assets and liabilities.

Net cash inflows from investing activities of £14 million related to the net inflows from sales of securities of £3,074 million, and sale of property, plant and equipment of £1,840 million offset by net cash outflows from investments in business interests and intangible assets of £1,428 million and from the purchase of property, plant and equipment of £3,472 million.

Net cash outflows from financing activities of £1,741 million relate primarily to interest on subordinated liabilities of £714 million, repayment of subordinated liabilities of £627 million and redemption of non-controlling interests of £382 million.

## Business review

## Capital resources

The following table analyses the Group's regulatory capital resources on a fully consolidated basis at 31 December as monitored by the Prudential Regulation Authority (PRA) for regulatory purposes.

|                                | 2013    | 2012    | 2011     | 2010      | 2009      |
|--------------------------------|---------|---------|----------|-----------|-----------|
|                                | £m      | £m      | £m       | £m        | £m        |
| Capital base                   |         |         |          |           |           |
| Tier 1 capital                 | 50,626  | 57,135  | 56,990   | 60,124    | 76,421    |
| Tier 2 capital                 | 13,305  | 12,152  | 8,546    | 9,897     | 15,389    |
|                                | 63,931  | 69,287  | 65,536   | 70,021    | 91,810    |
| Less: supervisory deductions   | (272)   | (2,487) | (4,828)  | (4,732)   | (4,565)   |
| Total regulatory capital       | 63,659  | 66,800  | 60,708   | 65,289    | 87,245    |
| Risk-weighted assets           |         |         |          |           |           |
| Credit risk                    |         |         |          |           |           |
| - non-counterparty             | 291,100 | 323,200 | 344,300  | 385,900   | 513,200   |
| - counterparty                 | 22,300  | 48,000  | 61,900   | 68,100    | 56,500    |
| Market risk                    | 30,300  | 42,600  | 64,000   | 80,000    | 65,000    |
| Operational risk               | 41,800  | 45,800  | 37,900   | 37,100    | 33,900    |
|                                | 385,500 | 459,600 | 508,100  | 571,100   | 668,600   |
| Asset Protection Scheme relief | —       | —       | (69,100) | (105,600) | (127,600) |
|                                | 385,500 | 459,600 | 439,000  | 465,500   | 541,000   |
| Risk asset ratios              | %       | %       | %        | %         | %         |
| Core Tier 1                    | 10.9    | 10.3    | 10.6     | 10.7      | 11.0      |
| Tier 1                         | 13.1    | 12.4    | 13.0     | 12.9      | 14.1      |
| Total                          | 16.5    | 14.5    | 13.8     | 14.0      | 16.1      |

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the PRA. The PRA uses risk asset ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. At 31 December 2013, the Group's total RAR was 16.5% (2012 - 14.5%) and the Tier 1 RAR was 13.1% (2012 - 12.4%). For further information refer to Risk and Balance sheet management: Capital management on pages 187 to 203.

## Business review

## Analysis of balance sheet pre and post disposal groups

In accordance with IFRS 5 assets and liabilities of disposal groups are presented as a single line on the face of the balance sheet. As allowed by IFRS, disposal groups are included within risk measures in the Risk and balance sheet management section.

|  | 2013                |                           |                                | 2012                |                           |                                | 2011                |                           |                                |
|--|---------------------|---------------------------|--------------------------------|---------------------|---------------------------|--------------------------------|---------------------|---------------------------|--------------------------------|
|  | Balance sheet<br>£m | Disposal groups (1)<br>£m | Gross of disposal groups<br>£m | Balance sheet<br>£m | Disposal groups (2)<br>£m | Gross of disposal groups<br>£m | Balance sheet<br>£m | Disposal groups (3)<br>£m | Gross of disposal groups<br>£m |
| <b>Assets</b>                                |                     |                           |                                |                     |                           |                                |                     |                           |                                |
| Cash and balances at central banks           | 82,659              | 2                         | 82,661                         | 79,290              | 18                        | 79,308                         | 79,269              | 127                       | 79,396                         |
| Net loans and advances to banks              | 27,555              | 22                        | 27,577                         | 29,168              | 2,112                     | 31,280                         | 43,870              | 87                        | 43,957                         |
| Reverse repos                                | 26,516              | 41                        | 26,557                         | 34,783              | —                         | 34,783                         | 39,440              | —                         | 39,440                         |
| Loans and advances to banks                  | 54,071              | 63                        | 54,134                         | 63,951              | 2,112                     | 66,063                         | 83,310              | 87                        | 83,397                         |
| Net loans and advances to customers          | 390,825             | 1,765                     | 392,590                        | 430,088             | 1,863                     | 431,951                        | 454,112             | 19,405                    | 473,517                        |
| Reverse repos                                | 49,897              | —                         | 49,897                         | 70,047              | —                         | 70,047                         | 61,494              | —                         | 61,494                         |
| Loans and advances to customers              | 440,722             | 1,765                     | 442,487                        | 500,135             | 1,863                     | 501,998                        | 515,606             | 19,405                    | 535,011                        |
| Debt securities                              | 113,599             | 24                        | 113,623                        | 157,438             | 7,186                     | 164,624                        | 209,080             | —                         | 209,080                        |
| Equity shares                                | 8,811               | —                         | 8,811                          | 15,232              | 5                         | 15,237                         | 15,183              | 5                         | 15,188                         |
| Settlement balances                          | 5,591               | —                         | 5,591                          | 5,741               | —                         | 5,741                          | 7,771               | 14                        | 7,785                          |
| Derivatives                                  | 288,039             | 1                         | 288,040                        | 441,903             | 15                        | 441,918                        | 529,618             | 439                       | 530,057                        |
| Intangible assets                            | 12,368              | 30                        | 12,398                         | 13,545              | 750                       | 14,295                         | 14,858              | 15                        | 14,873                         |
| Property, plant and equipment                | 7,909               | 32                        | 7,941                          | 9,784               | 223                       | 10,007                         | 11,868              | 4,749                     | 16,617                         |
| Deferred tax                                 | 3,478               | 1                         | 3,479                          | 3,443               | —                         | 3,443                          | 3,878               | —                         | 3,878                          |
| Other financial assets                       | —                   | —                         | —                              | —                   | 924                       | 924                            | 1,309               | —                         | 1,309                          |
| Prepayments, accrued income and other assets | 7,614               | 936                       | 8,550                          | 7,820               | 742                       | 8,562                          | 9,667               | 456                       | 10,123                         |
| Assets of disposal groups                    | 3,017               | (2,854)                   | 163                            | 14,013              | (13,838)                  | 175                            | 25,450              | (25,297)                  | 153                            |
| <b>Total assets</b>                          | <b>1,027,878</b>    | <b>—</b>                  | <b>1,027,878</b>               | <b>1,312,295</b>    | <b>—</b>                  | <b>1,312,295</b>               | <b>1,506,867</b>    | <b>—</b>                  | <b>1,506,867</b>               |
| <b>Liabilities</b>                           |                     |                           |                                |                     |                           |                                |                     |                           |                                |
| Bank deposits                                | 35,329              | —                         | 35,329                         | 57,073              | 1                         | 57,074                         | 69,113              | 1                         | 69,114                         |
| Repos  | 28,650              | —                         | 28,650                         | 44,332              | —                         | 44,332                         | 39,691              | —                         | 39,691                         |

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|   |         |         |         |           |          |           |           |          |           |
|---|---------|---------|---------|-----------|----------|-----------|-----------|----------|-----------|
| Deposits by banks                               | 63,979  | —       | 63,979  | 101,405   | 1        | 101,406   | 108,804   | 1        | 108,805   |
| Customer deposits                               | 414,396 | 3,273   | 417,669 | 433,239   | 753      | 433,992   | 414,143   | 22,610   | 436,753   |
| Repos   | 56,484  | —       | 56,484  | 88,040    | —        | 88,040    | 88,812    | —        | 88,812    |
| Customer accounts                               | 470,880 | 3,273   | 474,153 | 521,279   | 753      | 522,032   | 502,955   | 22,610   | 525,565   |
| Debt securities in issue                        | 67,819  | —       | 67,819  | 94,592    | —        | 94,592    | 162,621   | —        | 162,621   |
| Settlement balances                             | 5,313   | —       | 5,313   | 5,878     | —        | 5,878     | 7,477     | 8        | 7,485     |
| Short positions                                 | 28,022  | —       | 28,022  | 27,591    | —        | 27,591    | 41,039    | —        | 41,039    |
| Derivatives                                     | 285,526 | 1       | 285,527 | 434,333   | 7        | 434,340   | 523,983   | 126      | 524,109   |
| Accruals, deferred income and other liabilities | 16,017  | 101     | 16,118  | 14,801    | 2,679    | 17,480    | 23,204    | 1,233    | 24,437    |
| Retirement benefit liabilities                  | 3,210   | 1       | 3,211   | 3,884     | —        | 3,884     | 2,239     | —        | 2,239     |
| Deferred tax                                    | 507     | —       | 507     | 1,141     | —        | 1,141     | 1,945     | —        | 1,945     |
| Insurance liabilities                           | —       | —       | —       | —         | 6,193    | 6,193     | 6,233     | —        | 6,233     |
| Subordinated liabilities                        | 24,012  | —       | 24,012  | 26,773    | 529      | 27,302    | 26,319    | —        | 26,319    |
| Liabilities of disposal groups                  | 3,378   | (3,376) | 2       | 10,170    | (10,162) | 8         | 23,995    | (23,978) | 17        |
| Total liabilities                               | 968,663 | —       | 968,663 | 1,241,847 | —        | 1,241,847 | 1,430,814 | —        | 1,430,814 |

For the notes to this table refer to the following page.

## Business review

## Analysis of balance sheet pre and post disposal groups continued

|   | 2013                |                              |                                | 2012                |                              |                                | 2011                |                              |                                |
|---|---------------------|------------------------------|--------------------------------|---------------------|------------------------------|--------------------------------|---------------------|------------------------------|--------------------------------|
|   | Balance sheet<br>£m | Disposal groups<br>(1)<br>£m | Gross of disposal groups<br>£m | Balance sheet<br>£m | Disposal groups<br>(2)<br>£m | Gross of disposal groups<br>£m | Balance sheet<br>£m | Disposal groups<br>(3)<br>£m | Gross of disposal groups<br>£m |
| Selected financial data                   |                     |                              |                                |                     |                              |                                |                     |                              |                                |
| Gross loans and advances to customers     | 415,978             | 1,774                        | 417,752                        | 451,224             | 1,875                        | 453,099                        | 473,872             | 20,196                       | 494,068                        |
| Customer loan impairment provisions       | (25,153)            | (9)                          | (25,162)                       | (21,136)            | (12)                         | (21,148)                       | (19,760)            | (791)                        | (20,551)                       |
| Net loans and advances to customers (4)   | 390,825             | 1,765                        | 392,590                        | 430,088             | 1,863                        | 431,951                        | 454,112             | 19,405                       | 473,517                        |
| Gross loans and advances to banks         | 27,618              | 22                           | 27,640                         | 29,282              | 2,112                        | 31,394                         | 43,993              | 87                           | 44,080                         |
| Bank loan impairment provisions           | (63)                | —                            | (63)                           | (114)               | —                            | (114)                          | (123)               | —                            | (123)                          |
| Net loans and advances to banks (4)       | 27,555              | 22                           | 27,577                         | 29,168              | 2,112                        | 31,280                         | 43,870              | 87                           | 43,957                         |
| Total loan impairment provisions          | (25,216)            | (9)                          | (25,225)                       | (21,250)            | (12)                         | (21,262)                       | (19,883)            | (791)                        | (20,674)                       |
| Customer REIL                             | 39,322              | —                            | 39,322                         | 40,993              | 13                           | 41,006                         | 40,708              | 1,549                        | 42,257                         |
| Bank REIL                                 | 70                  | —                            | 70                             | 134                 | —                            | 134                            | 137                 | —                            | 137                            |
| REIL                                      | 39,392              | —                            | 39,392                         | 41,127              | 13                           | 41,140                         | 40,845              | 1,549                        | 42,394                         |
| Gross unrealised gains on debt securities | 1,541               | —                            | 1,541                          |                     |                              |                                |                     |                              |                                |