



Annual Results 2014
Fixed Income Investor Conference Call
Held at the offices of the Company
280 Bishopsgate London EC2N 4RB
on Thursday 26th February 2015

FORWARD-LOOKING STATEMENTS

This transcript includes certain statements regarding our assumptions, projections, expectations, intentions or beliefs about future events. These statements constitute “forward-looking statements” for purposes of the Private Securities Litigation Reform Act of 1995. We caution that these statements may and often do vary materially from actual results. Accordingly, we cannot assure you that actual results will not differ materially from those expressed or implied by the forward-looking statements. You should read the section entitled “Forward-Looking Statements” in our Annual Results announcement published on 26th February 2015.

Operator: Good afternoon, ladies and gentlemen. Today's conference will be hosted by Ewen Stevenson, Chief Financial Officer; and John Cummins, Treasurer. Please go ahead, Ewen.

Ewen Stevenson: Thanks. Good morning or good afternoon, everyone. I was planning to speak for 10 or 15 minutes and then just open it up for Q&A for John and I. We're very positive on what we announced today, very positive on the delivery we achieved in 2014, despite the attributable loss we reported. As you will have seen, an attributable loss of about GBP3.5 billion. It does include a fair value adjustment for Citizens of GBP4 billion, and the first payment of the Dividend Access Share of GBP320 million.

I think we've done what we said we'd do back in February last year, in terms of achievement of 2014 targets. The core Tier 1 ratio is up 40 basis points on the quarter, up 260 basis points in the year to 11.2 percent. The leverage ratio is up a further 30 basis points in the quarter, up 80 basis points in the year to 4.2 percent. And TNAV was down a P to 387, but up about 24p on the year or 6.6 percent.

We said we'd take out GBP1 billion of cost and we took out GBP1.1 billion of cost. We said we'd make our systems more resilient. We spent about GBP0.75 billion in the last couple of years achieving that. Regulator's now very happy, I think. And we said we'd streamline the structure from seven divisions into three businesses, which we did the middle of last year.

I think when you look at our business, I think it's important to really – we've tried to focus that message with people today to think about is really is – actually today, it's a very good core bank in the U.K. and Ireland, which is about half our balance sheet. And another half of our balance sheet which remains subject to material restructuring.

In our core business in U.K. and Ireland, customer metrics improving. We've still got a long way to go to get to our customer objectives. But across most customer categories, our Net Promoter Scores are improving. Our U.K. Personal and Business bank is doing very well. Last year, income was up 4 percent, costs were down 3 percent, operating profit was up 77 percent. We

had mortgage growth in that business of 4 percent versus 2 percent for the market, and a return on equity of 19 percent.

Our Commercial bank also doing well, income up 2 percent, costs down 2 percent, operating profits up over 140 percent, or over GBP0.75 billion. The loan growth was a net 1 percent. Within that, we've got a significant part of the commercial portfolio, which is still legacy and pre-crisis, which is shrinking. So the overall growth rate in the core books was good. And an ROE of 12.6 percent.

In Ireland, with Ulster Bank, we had our first operating profit since 2008, and a GBP2.1 billion shift from a large operating loss in 2013. It was underpinned by high impairment losses of around GBP365 million, which helped underpin an ROE of 16 percent.

The U.K. and Private Banking returned to operating profits, had about a GBP200 million turnaround in its profitability from a small loss in 2013.

And we also put in some disclosure today on our International Private banking business, which as you know is for sale at the moment. You can see, when you look at that disclosure, that it's a business that's losing money. If you back that out of the rest of the private banking activities, the core remaining banking activities are very nice, very healthy ROE business.

I think our problem child, so to speak, is our CIB franchise, our Commercial and Institutional Bank. It really is producing unsatisfactory returns. Had a non-operating loss last year of GBP892 million, including a significant loss in Q4. I would say the business did a very good job last year on reducing RWAs. RWAs in CIB were down GBP40 billion last year or 27 percent. Costs were down 22 percent and headcount was down 20 percent.

As part of this restructuring last year of our CIB business, we've now effectively exited our U.S. asset-backed business. We started last year with GBP19 billion of RWAs in the business. That's now down to four billion. Making problems smaller is good, but doesn't solve the problem. So we are

taking clear action with this announcement to address the core returns issue we have in that business.

I think in addition to CIB, we've also delivered on strategic de-risking and repositioning across the bank. RCR, our bad bank, RWA equivalents are down 58 percent; funded assets are down 48 percent last year. We're now confident that we can effectively complete the RCR exit or rundown a year early, by the end of this year.

As you know in the third quarter, we sold a 9 billion European mortgage-backed portfolio. That helped us reduce stress capital risk by GBP1 billion. We took CFG public in third quarter last year. We are targeting a partial de-consolidation of that business during 2015. That requires us, from an accounting point of view, to sell down to 35 percent. We currently own about 70.5 percent. If we get down to 30.5 percent, that will increase our core Tier 1 ratio by around 160 basis points.

We completed strategic reviews of Ulster and Coutts. We convinced ourselves with Ulster, as we saw with the results today, that we had a business that was capable of producing cost of capital returns. And on Coutts, we came to a bifurcated answer. We like the domestic business. The international business losing money. We expect to complete the sale by the end of Q2.

Our risk elements in lending are down 28 percent year on year, down to 6.6 percent of gross loans. If you back out the RCR component of risk elements in lending, our core loan books improved by 16 percent, and have 3.3 percent risk elements in lending to gross loans. Our leverage exposure fell below GBP1 trillion for the first time since 2007, and helped boost our leverage ratios by 30 basis points, that I talked about earlier in the fourth quarter.

I think all of what I've just talked about for 2014 gives us the confidence now to accelerate our strategy for this year, and out to 2018, 2019. Really three core components. We think we can grow core U.K. loan business at or above U.K. GDP. When we look across Commercial, that means, I think, that we're going to maintain share. And I think when we look at Personal Banking,

particularly in mortgages, we think we can continue to gain share. Last year, we had 10 percent flow share versus 8 percent stock share.

There's also a whole slew of other portfolios that sit in our core businesses, such as, half of our Irish business today is a tracker mortgage portfolio that was put on from 2003 to 2007. It's risk weighting of close to 100 percent, returns of close to zero, probably an average maturity of about another 20 years to run. We're now going to start focusing on those portfolios and seeing whether we can accelerate the wind-down, provided we can do it in a value-acceptable way.

We're also announcing today a fairly radical restructuring of our Corporate and Institutional Bank's international network, really taking it back to its core sustainable strengths. And when we look at what those core sustainable strengths are – when you look in the U.K., with large corporates, we're number one or two in most product segments. And from that kernel of expertise, we've built very strong specialist sector strengths into certain parts of Europe, in certain industrial lines like energy, transportation, and infrastructure.

And on the market side, we're number one or two in most sterling product. And from that, have built a decent global franchise, both firmly based around our strength in sterling. But today that collection of businesses that I just talked about is effectively one-third of the capital that we've currently got allocated. So we're going to take the Corporate and Institutional Bank back to an end-state of about GBP35 billion to GBP40 billion of RWAs. That compares to about GBP107 billion of RWAs at the end of the fourth quarter.

We're going to exit out of 25 countries, back down to around 13. We're going to reduce our product offering by half. We're going to exit out of about half of our desks in markets. We think the cost for this – we think the additional restructuring and asset wind-down costs are going to be about GBP2.5 billion to GBP3.5 billion pretax.

I think the way to think about that is, we currently have GBP107 billion of RWAs in the business. We're going to take it down to GBP35 billion to

GBP40 billion. So call that about GBP70 billion of RWA release over the next couple of years, at a 13 percent core Tier 1 ratio. I think that gives you – we have about GBP9 billion of capital that we'll release out of that business in the coming years, which will more than fund, we think, the cost of wind-down.

I would also note that, and I've been here for nine months, but this is a franchise that has got exceptional experience because of its legacy, in winding down non-core and legacy asset pools. Across pools, across geographies. Started out with non-core when it was formed in 2009 in RCR and our U.S. asset-backed experience. So we've got a high-degree of confidence about our degree to execute this restructuring.

On financial guidance, we set out new targets for 2015 today. We said we were going to reduce costs by a further GBP800 million. We said we're going to take RWAs down from a year-end Q4 total of GBP356 billion, down to below GBP300 billion. I think we are signaling that we expect 2015 to be a tough year financially.

I think with CIB, we can see that CIB's revenues, given what we've announced today, will fall faster than our ability to take out costs this year. We do expect higher conduct and litigation costs, particularly around potential settlements we're going to have to make for U.S. RMBS settlements. And we do think restructuring costs will be higher again this year, given the scale of the restructuring we're proposing for CIB, together with the ongoing core bank transformation.

On the RWA reduction, out of the investment bank, there's really three core – sorry, across the bank, there's really three core components in this. Firstly, in RCR, in order to get to that end-state during this year, that will imply another GBP12 billion or GBP13 billion of RWAs come out of RCR. In relation to Citizens, to get to, as I mentioned earlier, to get to about a 35 percent share holding this year involves the release of about GBP42 billion of RWAs, or about 160 basis points of additional capital.

And with CIB, we've committed to get out at least GBP25 billion of RWAs this year. You would have seen earlier this morning in the U.S. and earlier this morning in the U.K., that we announced the sale to Mizuho of \$36.5 billion of U.S. and Canadian loan commitments, including \$3.2 billion of drawn assets. When that transaction closes in the next couple of months, that will create around an additional 15 basis points of core Tier 1, and it will release about GBP5 billion of RWAs.

We've also committed to raising GBP2 billion of AT1. We have provided some additional disclosure today on our capital buffers, our Pillar 2A buffers. Our MDA trigger on the back of that is at 10.5 percent.

We've told the market that we're going to raise our Core Tier 1 target from a previous target of 12 percent-plus to 13 percent. We're not backing off when we think we're going to get there. We think we will get to 13 percent Core Tier 1 by next year. And we've also made some pretty clear commitments around that, that once we get to 13 percent, we intend to engage with the PRA about managing our capital base. So as you think about our buffers, effectively we're signaling that we're going to run at about a 2.5 percent buffer above our MDA trigger of 10.5 percent.

So on my to-do list for 2015; get Citizens de-consolidated. We think we need to do tranches to do that. Lock-up comes off on the 23rd of March. We're pretty confident that we're able to do that.

RCR continues to go very well. Again, we've got a high-degree of confidence about our ability to complete that wind-down. There will be a small stub of long-dated assets at the end, which we intend to then fold in, together with the management team, into CIB's legacy business and run it as a collective wind-off.

We're going to go out and raise AT1. I think you'll see us coming to the market for the first tranche of that before summer. Take the costs out by GBP800 million. Really make some good progress on CIB.

Continuing on with the announcement that we made today to Mizuho, which represents about 20 percent of the RWAs that we said we'd take out. Coutts

International, I've talked about. I think we'd also like, frankly, to be through the hump of our conduct and litigation. A the big issue there is obviously U.S. RMBS. We've still got ongoing FX discussions going. We took another GBP320 million, or \$500 million, today as a reserve for ongoing likely FX settlements.

And we continue to have a few longer-dated programs. Williams & Glyn, our challenger bank, we have to separate out next year. That continues on track. We started a whole bunch of work on ICB, and we've got the ongoing work, the core bank transformation.

So in conclusion, very happy with what we did last year. We think it does provide us with a much better platform to now accelerate our strategy for this year onwards. We think we're much better-placed financially to withstand outstanding litigation and conduct issues. We're not over-confident, but we're confident in our ability to execute our accelerated restructuring plan. And we're making a pretty unambiguous set of statements around our desire to return surplus capital as and when we think we'll get there in 2016.

So with that, I'll stop and open up for questions.

Operator: Thank you, Ewen.

Ladies and gentlemen, if you would like to ask a question please press the star key followed by the digit one your telephone keypad. We will pause for a moment to give everyone the opportunity to signal for questions.

Thank you. First question today comes from the line of Lee Street from Citigroup. Please go ahead, sir.

Lee Street: Thanks for the call, and thanks for all the additional disclosure. Just looking at slide 32, as you said on the call, you're guiding for 2.5 percent management buffer. I was just trying to understand how the ring-fenced buffer fits into that, given you have about 80 percent of the bank in the ring-fence. If I was to factor that in, I guess that would consume a fair bit of the management buffer. So I was just looking for any comments there.

Second question is the – from listening to you on the call and looking at materials, it sounds like you're in a bit of a hurry to get AT1 issued, talking about doing it before summer. I was just wondering why that is, given I thought you would probably wait to hit your 13 percent first, and get your settlements to the U.S. authorities in place before doing it; probably just to get a better price.

And then finally, just wondering about TLAC. You've given some good guidance there in terms of what you're thinking. As it relates to Moody's, if they were to downgrade your senior wholesale rating to a higher rating, I'm just wondering if that would actually change your approach to TLAC? Would you look the to do some more in equity maybe? Or would that just have no impact, and you just bear the additional cost? There are my questions, thank you.

John Cummins: OK. Starting with the last one first. If Moody's do move us – and obviously people are aware of the reduction in state sovereign ratings, which are going to be coming at some stage – then it wouldn't change our – we've got a conservative view in terms of the issuance per annum - it wouldn't change it in terms of having to see if we'd be split-rated if it were to happen. And then we'd have to see what the market demands for it would be.

On the actual AT1 issuance, I wouldn't say we're in massive hurry. But also, I'd say we do – we have given a commitment to issue 2GBP this year. And Ewen said we'll do it before the summer. We just want to get the timing right. We don't think saying by the summer would be in too much of a rush.

Ewen Stevenson: Yes, I'd almost turn it around. We've been waiting for some time to issue, and we felt last year that our core capital ratios were not in the place we needed them to be, in order to issue. I think now we've got them up to where they are at 11.2 percent core capital, with continuing capital build. I think we feel comfortable now that we're operating at a level where we can go out and issue.

And your question on where will we be in 2019 – good question. I would like to be able to give you a good answer to it. But some of it is, we don't know

today. Because we know the PRA has given indicative guidance of where, for example, they think the D-SIB will be. We think in terms of what we announced, 1.5 percent G-SIB buffer should continue to moderate. If not, we'd be delighted at some point to not become a G-SIB. Equally, I think pragmatically, we can see that D-SIB buffers are likely to offer us no real relief, in terms of our domestic capital structure.

Lee Street: OK. If I could just turn that around. Would it be fair to say, even if your requirements were not, you'd probably still be looking at a 250-basis point management buffer? Obviously I appreciate things can go up and down as you flag it. Is that kind of what you are saying, is, almost no matter where we shake out, it's probably going to be a 2.5 percent management buffer?

John Cummins: I wouldn't stick just to one number. I'd say, we want to have a comfortable buffer as things move. And obviously we've given guidance we're going to be a far more robust, stabler, operating earnings, franchise and bank. But obviously I wouldn't want to give an hostage to fortune by giving a number which are always going to be there in the future; these are dynamic buffers. But we want to manage to give enough comfort to AT1 investors that we will their interests at heart, as well as managing the overall bank.

Lee Street: OK, that's clear. Thank you very much for the answers.

Operator: Thank you. Your next question today comes from the line of Paul Sena from Societe Generale. Please go ahead.

Paul Sena: Hi. Thank you also for the call and taking my questions. I've got two questions. The first is on Tier 2, you say you want to get up to something around 3 percent of risk-weighted assets. By my back-of-the-envelope calculation, you're at about there, if you take risk weighted assets down to 300. Does that mean that you're pretty much done on Tier 2, and we shouldn't expect anything any time soon? That was your previous guidance. I just want to make sure that, that's still the case.

And then my second question relates to slide 37, where very helpfully, actually, you give an idea of what your structure is going to look like post ring-fencing. But one of the questions I have – and you might want to clarify

if I'm going the wrong direction. But right now, you got most of your debt is at RBS PLC level, with controlling risk-weighted assets of something like GBP350 billion. The end-state, you're asking creditors to be exposed to essentially a CIB business with risk-weighted assets of GBP25 billion, which will be what RBS PLC comprises of.

So I'm just trying to understand how you're going to go about protecting bondholder interests in that process. Or is that going to be just a massive liability management exercise where you're going to take people out?

John Cummins: No. The answer to the second question ...

Paul Sena: I can't quite hear you there, John.

John Cummins: I said – the second question first. We've got about GBP76 billion of total debt outstanding. And post 2019, GBP4.3 billion of senior and GBP1.7 billion of sub-debt will be in that entity. So it's a relatively small part – about 8 percent of the total debt will be in a non-ringfenced bank. And obviously what we said is, from a single point of entry, we'll be issuing out of the Holdco. We've already issued GBP7 billion out of the Holdco, going forward, we've already done. So we would expect over time ...

And on LMEs, I can't give any guidance as to what we do in LME. It could be something which is looked at at the time in any particular security. This has been driven by obviously the regulatory authorities and the Parliament. We have to do this. But the actual impact for people in terms of their process is very much a small number of the overall outstanding right now.

Paul Sena: Could you repeat the number percent, please, John?

John Cummins: Sure. Total debt, GBP76 billion currently. Post 2019, we expect to see GBP4.3 billion of senior debt still outstanding, and GBP1.7 billion of sub-debt still outstanding in RBS PLC. And the point I would make is that, despite what you read in the media, the non-ringfenced bank and the ring-fenced bank are both expected to be in positions where they would have strong capital ratios. And that they would be – there isn't one which is more riskier than the other, in terms of resolution. And obviously all the debt issuance that the

investors will have in the future will be coming out of the Holdco that we answered in the previous conversation.

Paul Sena: So do you imagine that the ratings will be relatively similar? Or at least unchanged at the ...

John Cummins: I've been at this job seven years and I can assure you I've given up some time ago trying to predict rating agencies. And they're on the call. And they're lovely people. I can't ...

Ewen Stevenson: No, I think as another way to answer it, this, I think, is a story in terms of where it gets us in the next couple of years, is what I think is a very credit-friendly story. We're creating a much smaller, much cleaner bank, with much lower earnings volatility, with very good capital generation. Actually, we've got that bank today, but it's only about half of our bank. And we've got the other half of our balance sheet that needs to be restructured.

I think people are naturally concerned about execution risks. As I think I pointed out, when you run the numbers on those, it produces large sums of excess capital and excess capital build-up, given the extent of the restructuring. And that gives us a lot of capital comfort. In fact, it produces a lot of surplus capital, and hence, the message to equity investors today that we intend to get the capital back to them as when we can.

I also think, in terms of the execution risk, people should bear in mind really what I said earlier in terms of the exceptional experience that we've got in this bank to do these types of restructurings. Which goes from having been the biggest bank in the world to not trying to be the biggest bank in the world in the last seven or eight years.

John Cummins: And that means we shouldn't – we're not trying to forecast anything. We're just trying to execute the plan, and then we'll see what happens.

Paul Sena: OK, thanks. And the second question, the Tier 2?

John Cummins: Well, tier 2 the present plan we think – we are comfortable though obviously we're still waiting for some more granular guidance. We'd have to see what,

kind of, the view is from regulators as they get more information on some of these more detailed issues on TLAC.

Ewen Stevenson: And we're going to manage our existing Tier 2 securities, I think, for value. And if it makes sense to leave them, we'll leave them. If it makes sense to buy them back, we'll buy them back. But we're not wedded to a fixed position on how we manage those securities.

Paul Sena: Thanks.

Operator: Thank you. And your next question today comes from the line of Tom Jenkins from Jefferies. Please go ahead.

Tom Jenkins: Hello, folks. Thank you very much indeed for the call. Just one question, given you've answered a few of them already. The one I had left was on RBS NV. It may be my idiocy, but I didn't see any numbers this morning. So if you could give us a total asset, total risk-weighted assets and Core Tier 1 ratio for RBS NV, if that number is available.

And then also just if you could give us some thoughts, I'd appreciate it. We're a little way out from resolution or final, final state on RBS NV, but just wondering what you're thinking of doing with the outstanding sub-debt? And, in RBS NV, are you allowed to novate or transfer it across to the group without bondholder consent? Or would you think to somehow retire that prior to revoking the license in several years time? I'm just wondering if you could give a little color around that. Thank you.

John Cummins: It is in run-down, but it does remain a regulated entity in its own right by the DNB. And during this period RBS N.V. does need to retain funding and capital needs – you had already mentioned, we reduced down the liquidity buffer to help us on the stress capital numbers. But the process centers, progress and execution negotiations and the Dutch national regulator. We can't really give further information at the present time.

We'll make sure you see the numbers when they come out.

- Tom Jenkins: All right, thanks. Just a little follow-up on that. I know you obviously can't give guidance on regulated entity, but in terms of a legal standpoint, I know you obviously transferred some debt, the senior debt from N.V. to the Group. Are you able to do that with the sub-debt without bondholder consent? Or would you have to get bondholder consent, or are you able to sort of move it around as you see fit?
- John Cummins: I'm afraid you're not going to get a very geeky answer, which is, it really depends on the nature of the bond documentation and Dutch law. Because some of these bonds are quite long-dated, and some of them are done under different types of documentation. So I can't give a definitive answer to that. We could do it all without bonds potentially. It just really depends on the bond documentation operating at hybrid debt at that time. I'm sorry, I can't be more helpful.
- Tom Jenkins: All right, no worries. Thanks very much, anyway. Cheers, then.
- Operator: Next question today comes from the line of Edward Kalu. Please go ahead.
- Edward Kalu: Hi. I would like to know how you view your legacy Tier 1 stock. Given a lot of it has already lost its grandfathering value. And how you think going forward – what would you do with this legacy Tier 1 stack?
- John Cummins: OK, on legacy Tier 1, obviously each time we have a call then, we look and see – not just from an external point of view in terms of the value to us of debt versus capital value – but also amortisation value. And also some of the internal workings that we have to do in terms of internal swaps. I'm afraid it's on a call-by-call basis, in terms of legacy positions. But we will make those decisions as and when they come due.
- Edward Kalu: Thank you.
- Operator: Thank you. Your next question today comes from the line of Robert Smalley from UBS. Please go ahead.
- Robert Smalley: Hi, thanks very much for taking my questions, and doing this call in U.S. time as well. Just to clarify a couple of answers. First, so on the G-SIB buffer,

you're not building in any relief from 1.5 to 1 with the idea that a D-SIB buffer may end up actually being the same. So it will be six of one, half-a-dozen of the other?

Ewen Stevenson: Yes, it could even be worse. We don't know that today.

Robert Smalley: OK. Another point that I wasn't sure got answered. On Tier 2 issuance, you're close to or around done for 2015, with no real sub-debt issuance need for this year?

John Cummins: Yes, for this year. But obviously, we do reserve the right to – as things change with our regulators - may revisit with them. But at the moment, we're comfortable with our Tier 2 position on our main focus is on our TLAC issuance, and on the AT1 issuance, which we already talked about. The main focus issuance-wise from the Group this year will be the TLAC and the AT1 – of GBP2 billion.

Robert Smalley: Right, OK. Thank you for the clarity on those two. In terms of go-forward issuance, senior potentially subordinated, what's the view on issuing in U.S. dollars versus euros or sterling, given that you're contracting the business here, and the overwhelming majority of the business is going to be denominated in different currencies?

John Cummins: I think we'd still look to try and find the most efficient market for us for the different maturities that we're looking for. And obviously, though we are contracting part of our U.S. dollar business, we would still want to have a presence and a curve in all the three major currencies, as we currently do now, if it gets best execution.

So although geographically, we may be reducing our footprint with the de-consolidation of Citizens and reduction of activities, we're still going to have it broker dealer in the US. It's still the world's largest capital market. We want to be present in it.

Robert Smalley: Thank you, and last question. I think there's been a lack of clarity around resolution strategy and what the Bank of England has said or not said with regard to subordinated debt at the bank level versus the holding company

level. I know we're talking single point of entry, but there has been some things written by some commentators saying that Opco level sub-debt may get bailed in first before Holdco. Or, some others have said potentially both at the same time. Can you give us any clarity on that? Have you had any discussions with the bank that might provide any clarity?

John Cummins: Well, I wouldn't pin it down to the bank. But I'd say, obviously you've got to follow the waterfall in terms of Operating Company resolution matters. And at the same time, my understanding from the bank is, the vision is that you have to see single points of entry, hybrid debt, internally down to the operating companies. And so that would be another form of support as well.

But I think obviously this is quite a complex area. Andrew Gracie at the bank has done some quite good speeches. And I know they've done some investor round tables. I'm sure it would be good if you could follow up with Andrew, hear it straight from the horse's mouth.

Robert Smalley: OK, that's great. Thank you.

Operator: Thank you. Next question today comes from the line of Corinne Cunningham from Autonomous. Please go ahead.

Corinne Cunningham: Hello, there. I had some questions around coupon payment ability. What's the PRA actually looking for before you can pay clean Tier 1 coupons? And by that I mean, I understand for 2015 you're going to have to issue equity again to cover the coupons. What is the PRA actually looking for before you can actually pay coupons in cash?

Ewen Stevenson: I don't think they've been precise on that – but from our perspective. If you look at it from their perspective, we think the 13 percent Core Tier 1 target that we're now targeting is the right number. We're currently at 11.2, so we're 180 basis points away from operating within risk appetite for Core Tier 1. So I think they and we feel more comfortable with the strategy we've got this year, and we'll revisit it next year.

But I think you can certainly see, some time over the next two years that we're going to be in a very different place. I think certainly by the time we get to

our 13 percent Core Tier 1 target. There's no need at that point, particularly if we're through the very uncertain settlements we might have to do in relation to the Department of Justice and others on U.S. RMBS. That there's no reason why we wouldn't continue with the current strategy.

Corinne Cunningham: So if you hit your 13 percent, even if you were loss-making, you said you would be able to pay coupons in cash by that point?

Ewen Stevenson: I think it depends very much on our capital plan at that point. But again, if you think about what we set out today, half of our business is capital-accretive, self-financing, et cetera. Half of our business is effectively self-financing through wind-down. So even if it's losing money, it's still creating capital.

Corinne Cunningham: OK. And if I just think this through a little bit further, if you're going to issue AT1s this year, but you're not able to pay those coupons in cash, so you'll be issuing equity to pay coupons on the stuff that's already outstanding. Including all the prefs, and then a new slug of AT1s. So you're actually becoming – you're diluting equity shareholders by issuing AT1 debt. Would it not make sense to do some kind of an exchange to minimize that dilution effect?

John Cummins: On the point of exchanges, we made the point before, we don't intend to make comments on it, given this is done on a case-by-case basis. Again, I've seen it suggested before. And I said, at the moment we're still focused on AT1 issuance. So I take the point about issuance and coupon payments. But as Ewen said, further along in the not too distant future, we will be in a very different capital position from – even a year ago, we were starting with an 8. Now, 11.2. And that just means it's a stronger position for us to manage this capital stack.

Corinne Cunningham: OK, thanks very much.

Operator: Thank you. Your next question today comes from the line of James Hyde from Comerica. Please go ahead.

James Hyde: Hi. Thanks for doing this. And also thanks for giving some color on the ring-fence versus the non-ring-fence for the first time, in terms of some numbers. I wanted to have a question on that, with a follow-on to Tom's question and Paul Sena's question. It's about LMEs and the whole issue of over-funding.

So you have GBP195 billion targeted rundown of what you call third-party assets, according to slide 28. You've got GBP75 billion of debt in bond form. And you've got GBP63 billion-odd of repos, customer into bank. So clearly, there's got to be something left over, a lot of cash there.

And also on the point that John made about GBP4.3 billion senior at the RBS non-ring-fence, and GBP1.7 billion sub, unless I misheard that. If I do an RBS-level, Opco-level DDIS, I get to GBP20 billion-odd left beyond 2019 maturities. All of this spells that you've got to do some significant LME.

Now the question part of it is, does it have to wait until you revisit with the PRA on your capital level once you get to 13 percent? Because obviously if you buy over par, you create a loss. Is that holding up quite substantial LME? Or have I got my math wrong about the GBP20 billion left over from RBS Opco beyond 2019?

John Cummins: Well, we do have maturities and, as I said, on LME, we've done quite substantial LMEs in the past. We don't rule out doing them in the future, but we don't make any comments about them. Because obviously, doing LMEs above par destroys value, destroys capital. And actually, we're doing all this work to make sure we grow our capital base.

And as I said, in terms of the maturity family of products, the hybrids, on our senior debt – that will – as we get to be a smaller bank, that will actually enable us to meet some of our targets. We also do go to issue the TLAC on a concerted [basis] in terms of 16 percent to 20 percent. So we have to issue TLAC out of the Holdco to meet the new CRDIV compliance. I can't give too much clarity on potential LME because it's not something we comment upon.

Richard O'Connor: Jim, have you missed the fact that surplus capital will be going back to shareholders by then, if we get it right?

James Hyde: Well, yes, but we're talking really mega billions here as well. So I've got that. But how about this issue of not being able to do it until you have this sit-down with the PRA once you get to 13 percent?

John Cummins: If you look at the record, we've done LMEs far before we had 13 percent. I've think we've done four of five of them. But obviously when you manage your capital structure, there are various knowledge actions that actually agree with the PRA. And at the moment, we're very focused on building our Core Tier 1 by going through the actions Ewen mentioned in his opening comments.

Richard O'Connor: Jim, having you factored in loan growth as well, in those calculations.

James Hyde: Yes, hopefully, yes. Just quickly – so is there going to be – in your assumptions, what's the debt at the ring-fence bank – unsecured debt?

John Cummins: Well, the debt going forward, there is probably some working debt at the ring-fence bank. The majority of our debt outstanding, public long-term debt, will be out of the holding company.

Ross Aucutt: James, you're comment around DDIS and the maturities beyond that – I think you need to obviously take that with a bit of a grain of salt. Because there's quite a lot of structured notes in there that have different callability profiles. Obviously, from a ring-fence bank perspective, you're going to get a lot of the debt, as John said, coming through from the Holdco, being through as internal TLAC. And you'll see the maturities of our public debt currently is fairly short-dated.

James Hyde: OK. Well, thank you very much.

Operator: Thank you. Our next question today comes from the line of Kagna Sensenopoli from HSBC. Please go ahead.

Kagna Sensenopoli: Hi. Thanks very much for the call. So I have two questions, if I may. The first one is about the slide 38. So your target for Tier 2 is 3 percent. On an end-point basis, given your current RWA target of GBP300 million, you have about 3 percent Tier 2. So is it fair to assume that this GBP3 billion to GBP5 billion in annual issues in the slide will likely be Holdco Senior?

John Cummins: Yes.

Kagna Sensenopoli: OK. And the second question is about slide 37, about the ring-fence bank. So when the ring-fence bank starts operating in 2019, how should we think about existing that was issued by the RBS bank PLC? Are there going to be the obligations of the ring-fence bank? Or will some part of it go to the non-ring-fence bank? Again, the same question about LME to the Holdco. How should we think about existing debt that was issued by the RBS bank PLC at that point in time?

John Cummins: There will be a small stub that I have mentioned that will be outstanding post-2019. And before that, the maturing debt that comes along will be issued out of the Holdco.

Kagna Sensenopoli: OK. And just small amounts of debt that will be ring-fence bank obligation?

John Cummins: Yes. It's going to be the non-ring-fence bank obligation.

Kagna Sensenopoli: It's going to be the non-ring-fence bank obligation?

Ewen Stevenson: Yes, the RBS PLC will be the non-ring-fence bank obligation.

Kagna Sensenopoli: OK, thanks.

Operator: Thank you. Next question today comes from the line of Simon Morgan from Moore Capital. Please go ahead, sir.

Simon Morgan: Hi, good afternoon. I've got just a couple questions. I think one for John and one for Ewen. Could you – one of the topics on the equity call was volume expansion. And you've said that you expect to grow volumes with U.K. GDP. There was very little discussion about NIM expansion trajectory for repricing assets away from paying less on deposits. So I was wondering if you could give something of a commentary there?

Secondly, in connection with that, could you just give us an update on the contribution of the structural hedge to the net interest margin? And the impact of the roll-off profile obviously then? A lower for-longer-rate environment.

And then lastly – I think this is a John question. You mentioned that you're – on the equity call again – you intend to expand your loan deposit ratio from 95 to now to about 105, 110. Given the roll-off of risk-weighted assets, that's going to come down naturally, and then you may be addressing deposits separately. But does that imply then that from a senior debt issuance perspective, a funding perspective away from TLAC rollover, we should anticipate that volumes are going to continue to be progressively lighter? Thank you.

Ewen Stevenson: On NIM – I'm not going to sit and forecast NIM for you. I think we give you enough disclosure that you can look at the elements of what our NIM is. And as I think I said in the call earlier with equity analysts, I think you do need to do a bit of work to look at the individual businesses and how the profile of those individual businesses is changing as an overall – in terms of the overall mix to the group. But I'm not going to sit and forecast NIM.

Richard O'Connor: Simon, the benefits of the hedge, a product hedge – and it could hedge on pages 54, 55 of appendix 1, Capital & Risk Management so its on the Web site. And it gives you the rest of the full details. Basically, the hedge income was stable in 2014, but with a slight dip in incremental yield. But the disclosure is there and its self-explanatory.

John Cummins: And then on the TLAC, we've given the guidance on the TLAC. Although the assumption is the range we discussed. But obviously breaking it and the regulator can change some of their views on superequivalence. So we don't expect to have to issue more than the TLAC we've already given guidance...

Simon Morgan: I'm sorry, there was some distortion in front of the microphone on the response to the last question. Could you repeat on that, please?

John Cummins: On the TLAC, we said we've used a conservative assumption of 20 percent. And we expect that to be GBP3 billion to GBP5 billion, in that range, per annum, from the Holdco.

Simon Morgan: OK, thank you. My question actually was more on the funding. Because of the expansion of your loan to the – the intended expansion of loan to deposit, should we expect a contraction in senior funding as a consequence?

Ewen Stevenson: Yes.

Simon Morgan: Not TLAC, I guess. Correct, OK. Thank you for that clarity.

Operator: Thank you. Have a further question from the line of Lee Street from Citigroup. Please go ahead, sir.

Lee Street: Hello. Just a couple of quick ones from me. On your Pillar 2A, obviously you have disclosed what it is, could you just give us any clarity on what that might relate to. As I understand it, it's supposedly like quantifiable risk that will not qualify the capture of requirements just so we get an order of how and when that may go away?

Secondly, on your Holdco Senior that you raise, in what format are you intending to downstream that to the relevant operating entities below?

And finally, just practically, when you do the split the ring-fence and RBS PLC entity, what legislation actually will you be doing that under? And how practically will you actually move those assets? Thank you.

Ewen Stevenson: Do you want to answer the last two, John? And I'll take the first one?

John Cummins: On the legislation, you would do this by a variety of options, including Section 7 transfers. Obviously we're a Scottish bank, so we would do that under Scottish courts. And then there would be – and we've got – Ewen and Ross mentioned in this morning's meetings. We have a great experience in moving assets, movation of assets around this Company, given the stuff we did in Project Unicorn and the transfer of ABN AMRO assets. So that the legal process would be either consent solicitation or Section 7 transfers, for example.

Ewen Stevenson: On the 2A buffer, you know that we're not allowed to comment on its components or how it's made up. So we can't really add anything further. We had to get permission from the PRA to you put in today's disclosure, and that's the limit of the disclosure we're going to give.

Richard O'Connor: Lee, look on the PRA Web site, there's various policy documents which describe qualitatively 2A, and perhaps look at those. That would be the best we can do.

John Cummins: The consultation paper out, come out, which is worth a read as well, in terms of some of the other things they can decide to add on if it they go through that process. So it's worth a reading. I can't remember the CP number. But definitely worth reading it, in terms of the potential flexibility the FPC and the PRA will have in terms of managing ratios and buffers. But we can't add any more color than we've just given.

Ross Aucutt: And Lee, your second-to-last question around what format. I think internally that would take – at this point, just wait until the rules become finalized until we actually understand how the FSB expects it to be downstreamed.

John Cummins: And we'll follow those rules.

Lee Street: OK, fair enough. Thanks for the clarity. Thank you.

Operator: Thank you. There are no further questions at this time. I would now like to hand the call back to Ewen for any closing comments.

Ewen Stevenson: OK, well, look, thank you all very much for joining the call this afternoon or this morning, depending on where you are. As I said by way of introduction, we're very pleased with the delivery we were able to do in 2004 (sic – "2014"). We think it does position us well to now accelerate our strategy. We think what we've announced today is a fairly significant acceleration of that strategy, focused around growing the core loan books in the U.K..

We've got a very, very good business in the U.K. that's functioning like a good, normal bank, with good returns. But we've got another half of our

balance sheet that we are now going to very very radically manage for value. That will produce a lot of surplus capital.

I think it is a very credit-friendly story as we work through this. There obviously is restructuring risk, but we're very confident, both in terms of the capital generation that this restructuring delivers, and the skills that we've built up over a number of years. That we've got the capabilities and the balance sheet capacity to do this well. So thank you all for your time, and look forward to talking over the coming quarters. If you have any further follow-up questions please e-mail them to Debt Investor Relations or myself. Thanks very much.

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

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