

ROYAL BANK OF SCOTLAND GROUP PLC

Form 6-K

September 30, 2014

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934

30 September 2014

**The Royal Bank of Scotland Group plc**

Gogarburn

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Scotland

United Kingdom

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F X

Form 40-F \_\_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):\_\_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):\_\_

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes \_\_

No X

If "Yes" is marked, indicate below the file number assigned to  
the registrant in connection with Rule 12g3-2(b): 82-\_\_\_\_\_

This report on Form 6-K shall be deemed incorporated by reference into the company's Registration Statement on Form F-3 (File Nos. 333-184147 and 333-184147-01) and to be a part thereof from the date which it was filed, to the extent not superseded by documents or reports subsequently filed or furnished.

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## The Royal Bank of Scotland Group plc

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## 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', 'will', '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 strategic plans, divestments, capitalisation, portfolios, net interest margin, capital and leverage ratios, liquidity, risk-weighted assets (RWAs), RWA equivalents (RWAE), return on equity (ROE), profitability, cost:income ratios, 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 and UK 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, rationalisation of and investment in its IT systems, 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 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 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 reliability and resilience of its IT system, 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.

## Presentation of information

### Non-GAAP financial information

The directors manage RBS's performance by class of business, before certain reconciling items, as is presented in the segmental analysis in note 10 (the "non-statutory basis"). Discussion of RBS's performance focuses on the non-statutory basis as RBS believes that such measures allow a more meaningful analysis of RBS'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 in note 10. These non-GAAP financial measures are not a substitute for GAAP measures. Furthermore, RBS has divided its operations into "RBS excluding RBS Capital Resolution (RCR)" for all periods in 2014 and for prior periods "RBS excluding Non-Core". Certain measures disclosed in this document for RBS excluding RCR/Non-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 RCR/Non-Core. In addition the presentation of Personal & Business Banking ("PBB"), which includes the reportable segments of UK Personal & Business Banking and Ulster Bank, and the presentation of Commercial and Private Banking, which includes the reportable segments of Commercial Banking and Private Banking, are non GAAP financial measures. Furthermore, RBS has presented certain measures "excluding RBS Capital resolution (RCR)" which are deemed non-GAAP measures. Lastly, the liquidity coverage ratio, stressed outflow coverage, net stable funding ratio and stressed coverage ratio 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.

### Divisional Reorganisation

#### Organisational change

On 27 February 2014, RBS announced a refreshed strategic direction with the ambition of building a bank which earns its customers' trust by serving them better than any other bank.

#### Business structure

RBS is now structured to deliver this ambition by organising itself around the needs of its customers, so as to combine customer groups with similar needs into franchises able to deliver co-ordinated services.

The reorganised bank will be a UK-focused retail and corporate bank with an international footprint to drive its corporate business. The previously reported operating divisions are now realigned into three franchises:

Personal & Business Banking (PBB) serves individual and mass affluent customers together with small businesses (generally up to £2 million turnover), with more business bankers moving back into branches. PBB comprises two reportable segments, UK Personal & Business Banking, including Williams & Glyn, (UK PBB) and Ulster Bank.

Commercial & Private Banking (CPB) serves 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. CPB comprises two reportable segments, Commercial Banking and Private Banking.

Corporate & Institutional Banking (CIB) serves 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. CIB is a single reportable segment.



## Presentation of information

### Divisional Reorganisation (continued)

In addition to the segments noted above, RBS will continue to manage and report Citizens Financial Group (CFG) and RBS Capital Resolution (RCR) separately until disposal or wind-down. Residual unallocated costs will continue to be reported within Central items.

In the new reporting structure, US Retail & Commercial (US R&C) is now referred to as CFG and Wealth is now referred to as Private Banking.

Comparatives have been restated accordingly.

### Reporting changes

In order to present a more complete picture of funding, operational and business costs of the franchises and operating segments, the following reporting changes have been implemented:

To improve the transparency of the operating performance of the reportable segments, a number of previously reported reconciling items (Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets and bank levy) have now been allocated to the reportable segments. Only the following will now be reported as reconciling items:

Own credit adjustments

Gain on redemption of own debt

Write-down of goodwill

Asset Protection Scheme

Strategic disposals

Bonus tax

RFS Holdings minority interest

#### Revised allocation of costs

As part of its internal reorganisation, RBS has centralised all services and functions. The costs relating to Services and Functions previously reported as direct expenses in the divisions are now reallocated to businesses using appropriate drivers and reported as indirect expenses in the segmental income statements.

#### Treasury allocations

The basis of allocation of Treasury costs has been amended to align the recovery of funding and hedging costs across RBS and for the transfer of certain assets and their associated costs out of Treasury.

#### Revised segmental return on equity

For the purposes of computing segmental return on equity, notional equity is calculated as a percentage of the monthly average of segmental RWAs. Previously, notional equity was allocated at 10% of RWAs after capital deductions (RWAe). This has been revised to 12% of RWAs across all businesses.

Comparatives have been restated accordingly.

For further details refer to appendix 1.

## **Presentation of information**

### **Non-Core**

Non-Core was dissolved with effect from 31 December 2013.

### **RBS Capital Resolution**

RBS Capital Resolution (RCR) was established with effect from 1 January 2014 by the transfer of capital intensive and higher risk assets from existing divisions. No business lines moved to RCR and prior period segmental reporting has not been restated. The results of RCR were reported separately for the first time in Q1 2014.

## **Recent developments**

### **Citizens Financial Group**

On 8 September 2014, RBS announced the launch of the Initial Public Offering of Citizens Financial Group ('CFG') and on 24 September 2014, RBS announced the final pricing of the IPO. The offer, including the exercise of the over-allotment option, comprises 161,000,000, or 28.75%, of CFG's common stock at a price per share of \$21.50. Gross proceeds realised by RBS at settlement on 29 September 2014 were \$3,461.5 million.

Following the Offer, RBS will continue to hold 71.25% of CFG's shares of common stock, which are subject to a 180-day lock-up. During this period the lock-up agreement is subject to modification, waiver or cancellation.

### **Scottish Independence Referendum**

On 19 September 2014, the Scottish government announced a majority vote against the separation of Scotland from the United Kingdom in the referendum on Scottish independence. In response to this outcome, RBS has stated that it would not be proceeding with its contingency plan to re-domicile The Royal Bank of Scotland Group plc and The Royal Bank of Scotland Plc to England.

**Director**

On the 25 September 2014 RBS announced that its Chairman Sir Philip Hampton will leave the company during 2015 after a suitable successor has been appointed.

**Trading Update**

On the 30 September 2014 RBS issued a brief trading update regarding its anticipated third quarter performance.

**Condensed consolidated income statement**

for the period ended 30 June 2014

|  | Half year ended |                | Quarter ended  |                |                |
|--|-----------------|----------------|----------------|----------------|----------------|
|  | 30 June         | 30 June        | 30 June        | 31 March       | 30 June        |
|  | 2014            | 2013           | 2014           | 2014           | 2013           |
|  | £m              | £m             | £m             | £m             | £m             |
| Interest receivable                                | 7,621           | 8,560          | 3,821          | 3,800          | 4,281          |
| Interest payable                                   | (2,128)         | (3,123)        | (1,023)        | (1,105)        | (1,514)        |
| <b>Net interest income</b>                         | <b>5,493</b>    | <b>5,437</b>   | <b>2,798</b>   | <b>2,695</b>   | <b>2,767</b>   |
| Fees and commissions receivable                    | 2,605           | 2,708          | 1,314          | 1,291          | 1,392          |
| Fees and commissions payable                       | (487)           | (460)          | (251)          | (236)          | (250)          |
| Income from trading activities                     | 1,493           | 2,064          | 541            | 952            | 949            |
| Gain on redemption of own debt                     | 20              | 191            | -              | 20             | 242            |
| Other operating income                             | 1,036           | 1,332          | 345            | 691            | 720            |
| <b>Non-interest income</b>                         | <b>4,667</b>    | <b>5,835</b>   | <b>1,949</b>   | <b>2,718</b>   | <b>3,053</b>   |
| <b>Total income</b>                                | <b>10,160</b>   | <b>11,272</b>  | <b>4,747</b>   | <b>5,413</b>   | <b>5,820</b>   |
| Staff costs  | (3,536)         | (3,727)        | (1,845)        | (1,691)        | (1,840)        |
| Premises and equipment                             | (1,275)         | (1,104)        | (622)          | (653)          | (548)          |
| Other administrative expenses                      | (1,662)         | (2,181)        | (951)          | (711)          | (1,418)        |
| Depreciation and amortisation                      | (554)           | (736)          | (282)          | (272)          | (349)          |
| Write-down of goodwill and other intangible assets | (212)           | -              | (130)          | (82)           | -              |
| <b>Operating expenses</b>                          | <b>(7,239)</b>  | <b>(7,748)</b> | <b>(3,830)</b> | <b>(3,409)</b> | <b>(4,155)</b> |
| <b>Profit before impairment losses</b>             | <b>2,921</b>    | <b>3,524</b>   | <b>917</b>     | <b>2,004</b>   | <b>1,665</b>   |
| Impairment (losses)/recoveries                     | (269)           | (2,150)        | 93             | (362)          | (1,117)        |
| <b>Operating profit before tax</b>                 | <b>2,652</b>    | <b>1,374</b>   | <b>1,010</b>   | <b>1,642</b>   | <b>548</b>     |
| Tax charge   | (733)           | (678)          | (371)          | (362)          | (328)          |
| <b>Profit from continuing operations</b>           | <b>1,919</b>    | <b>696</b>     | <b>639</b>     | <b>1,280</b>   | <b>220</b>     |
| Profit from discontinued operations, net of tax    | 35              | 138            | 26             | 9              | 9              |

|   |              |       |              |       |       |
|---|--------------|-------|--------------|-------|-------|
|   |              |       |              |       |       |
| <b>Profit for the period</b>                          | <b>1,954</b> | 834   | <b>665</b>   | 1,289 | 229   |
| Non-controlling interests                             | <b>(42)</b>  | (117) | <b>(23)</b>  | (19)  | 14    |
| Preference share and other dividends                  | <b>(487)</b> | (182) | <b>(412)</b> | (75)  | (101) |
|   |              |       |              |       |       |
| <b>Profit attributable to ordinary and</b>            |              |       |              |       |       |
| <b>B shareholders</b>                                 | <b>1,425</b> | 535   | <b>230</b>   | 1,195 | 142   |
|   |              |       |              |       |       |
| <b>Earnings/(loss) per ordinary and</b>               |              |       |              |       |       |
| <b>equivalent</b>                                     |              |       |              |       |       |
| <b>B share (EPS)</b>                                  |              |       |              |       |       |
| Basic EPS from continuing and discontinued operations | <b>12.7p</b> | -     | <b>2.0p</b>  | -     | -     |
| Basic EPS from continuing operations                  | <b>12.5p</b> | -     | <b>1.9p</b>  | -     | -     |

## Notes:

- (1) Basic EPS for the half year and quarter ended 30 June 2013 have been restated to reflect the terms of the dividend access share (see Note 9 on page 88).
- (2) Diluted EPS in the half year ended 30 June 2014 and the quarter ended 30 June 2014 were 0.1p lower than basic EPS.

Analysis of results is set out on pages 13 to 23.

## Highlights

**The Royal Bank of Scotland Group (“RBS”) reports an operating profit before tax of £2,652 million for H1 2014, up from £1,374 million in H1 2013, driven by more favourable credit conditions and good results from RBS Capital Resolution, with a consequential beneficial impact on capital ratios.**

“The results show the steady progress we are making as we take the steps to be a much simpler, smaller and fairer bank. These results show that underneath all the noise and huge restructuring of recent years, RBS is a fundamentally stronger bank that can deliver good results for customers and shareholders.”

“There is progress on all of our key priorities - capital is stronger, costs are lower and customer activity is gradually improving - although we have only just started with our programme to make it easier for customers to do more business with us.”

“But let me sound a note of caution. We are actively managing down a slate of significant legacy issues. This includes significant conduct and litigation issues that will likely hit our profits going forward. I am pleased we have had two good quarters, but no one should get ahead of themselves here - there are bumps in the road ahead of us.”

“These results are pleasing but no one at this bank is complacent about the challenges ahead.”

**Ross McEwan, Chief Executive**





## Highlights

### Key points

#### H1 2014 performance

Operating profit before tax was £2,652 million compared with £1,374 million in the first half of 2013, including a gain of £191 million from the sale of the remaining interest in Direct Line Insurance Group in Q1 2014 and a write-down of goodwill of £130 million in Q2 2014. Own credit adjustment was a charge of £51 million compared with a credit of £376 million in H1 2013 which also included a gain of £191 million on redemption of own debt compared with £20 million in H1 2014.

On a non-statutory basis operating performance in the first half of 2014 was good, with all customer-facing businesses reporting improved operating profits compared with H1 2013. Non-statutory operating profit of £2,601 million included £514 million of restructuring costs (H1 2013 - £271 million) and £250 million of litigation and conduct costs (H1 2013 - £620 million), with £150 million added to provisions for Payment Protection Insurance (H1 2013 - £160 million) and £100 million to interest rate swap redress provisions.

Total income declined 10% to £10,160 million. On a non-statutory basis total income declined 6% to £9,978 million. Growth of 3% in Personal & Business Banking (PBB) and 2% in Commercial & Private Banking (CPB) was more than offset by lower income, down 10%, in Corporate & Institutional Banking (CIB), reflecting its smaller balance sheet and reduced risk profile. Net interest margin improved to 2.18%, up 21 basis points compared with H1 2013, with continuing benefits from deposit repricing in PBB and CPB outweighing modest erosion of asset margins.

Operating expenses were 7% lower at £7,239 million. On a non-statutory basis operating expenses were 8% lower at £7,108 million, including £514 million of restructuring costs and £250 million of litigation and conduct costs. Non-statutory operating expenses, excluding restructuring and litigation and conduct costs, were down 8% to £6,344 million. Overall headcount has fallen by 8,000 over the past 12 months.

Impairment losses declined by £1,881 million to £269 million. All core businesses showed significant reductions in impairment losses as UK and Irish credit conditions continued to improve. In RBS Capital Resolution (RCR) there was a net write-back of provisions, reflecting disposals at favourable prices. At 30 June 2014, risk elements in lending (REIL) represented 8.3% of gross loans to customers, compared with 9.4% at 31 December 2013.

The tax charge was £733 million, representing 27.6% of operating profit before tax, and included a £76 million write-off of deferred tax assets.

The Common Equity Tier 1 (CET1) capital ratio strengthened to 10.1%<sup>(1)</sup> from 8.6% at the end of 2013, principally driven by reductions in risk-weighted assets in CIB and RCR and the retained profit for the period. RBS remains on track to achieve its medium-term capital targets.

After charging the initial £320 million Dividend Access Share retirement dividend, profit attributable to ordinary and B shareholders was £1,425 million.

## Highlights

### Key points (continued)

### Q2 2014 performance

Operating profit before tax totalled £1,010 million, after a write-down of goodwill of £130 million and a charge of £190 million for own credit. Profit attributable to ordinary and B shareholders was £230 million, after charging the initial £320 million Dividend Access Share retirement dividend.

On a non-statutory basis operating profit in Q2 2014 was £1,318 million, compared with £174 million in Q2 2013 and £1,283 million in Q1 2014. Restructuring costs totalled £385 million and litigation and conduct costs £250 million.

Total income was 18% lower than in Q2 2013 at £4,747 which included a charge on own credit of £190 million compared with a gain of £139 million on Q1 2014 and a gain of £191 million on the disposal of RBS's remaining interest in Direct Line Insurance Group in Q1 2014. On a non-statutory basis total income was 10% lower than in Q2 2013 at £4,925 million, with a 4% improvement in UK PBB more than offset by the 13% reduction in CIB, reflecting its smaller balance sheet and lower risk levels. Within CIB, Rates, Currencies and Credit income was £765 million, down 10% from Q2 2013 and 25% from Q1 2014. Citizens Financial Group benefited from a net gain of \$283 million on the sale of its Illinois branch network.

Operating expenses were £3,830 million, down 8% from Q2 2013 and 12% from Q1 2014.

Impairments amounted to a net release of £93 million compared with losses of £1,117 million in Q2 2013 and £362 million in Q1 2014, benefiting from improvements in bad debt flows and latent

provision releases totalling £258 million, primarily reflecting improving credit conditions.

## Balance sheet

Total assets fell to £1,011 billion, down from 1,216 billion from June 2013. Funded assets, which exclude derivatives of £275 billion (30 June 2013 - £374 billion), fell to £736 billion, down £107 billion from June 2013, principally driven by the reduction in CIB's balance sheet and the run-off of RCR and Non-Core assets.

In UK PBB, gross new mortgage lending totalled £9.8 billion in H1 2014, a market share of 9.9%. Repayments remain high, with the low interest rate environment enabling higher levels of principal repayment.

In CPB, Commercial Banking, loans and advances in the growable book increased to £64.9 billion, up £2 billion from the prior year, but this was offset by a £2.8 billion planned decline in the non-growable book, which comprises real estate finance, businesses in restructuring and excess single-name concentrations.

Overall SME applications were 11% higher in H1 2014 than in the prior year and gross new lending was up 31% at £5.0 billion, with run-off remaining at a similar level to previous years.

Total net lending flows reported within the scope of the Funding for Lending Scheme were minus £1.5 billion in Q2 2014 with the majority of the decline in large corporates.

Risk-weighted assets (RWAs) fell to £392 billion at the end of June 2014, down £22 billion from the end of March 2014.

The CET1 ratio was 10.1%<sup>(1)</sup> at the end of June 2014, up from 8.6% at the end of 2013 and 9.4% at the end of March 2014 reflecting the attributable profit for the period and lower RWAs.

The bank's liquid asset buffer was £138 billion at the end of June 2014, up slightly from the first quarter but down from £146 billion at the end of 2013, leaving ample headroom to accommodate lending growth in H2 2014.

## Highlights

### Key points (continued)

### Franchise performance

#### Personal & Business Banking

Operating profit increased to £1,049 million from £307 million in the first half of 2013. Operating profit excluding restructuring costs and litigation and conduct costs of £183 million (H1 2013 - £315 million) was £1,232 million in H1 2014, up from £622 million in H1 2013. The increase in operating profit was principally driven by a decline in impairment losses, predominantly in Ulster Bank. In addition, income grew by 5% in UK PBB with higher personal mortgage and deposit balances and stronger deposit margins.

Within PBB, UK Personal & Business Banking (UK PBB) operating profit increased to £994 million from £688 million in the first half of 2013. Operating profit excluding restructuring, litigation and conduct costs of £169 million (H1 2013 - £269 million) rose 22% to £1,163 million, driven by strong income growth (up 5% compared with H1 2013) and a 42% decline in impairment losses.

Ulster Bank operating profit increased to £55 million from a loss of £381 million in the first half of 2013. Operating profit excluding restructuring, litigation and conduct of £14 million (H1 2013 - £46 million) was £69 million compared with a loss of £335 million in H1 2013, principally as a result of the marked improvement in impairment losses.

#### Commercial & Private Banking

Operating profit increased to £780 million from £501 million in the first half of 2013. Operating profit excluding restructuring costs and litigation and conduct costs of £115 million (H1 2013 - £59 million) was £895 million was 60% higher than in H1 2013, with net interest income benefiting from improving deposit margins and impairment losses substantially reduced.

Commercial Banking operating profit increased to £635 million from £413 million in the first half of 2013. Operating profit excluding restructuring costs and litigation and conduct costs of £112 million (H1 2013 - £54 million) rose by 60% to £747 million, with the effect of repricing activity offsetting the impact of a decline in CIB (Markets) revenue share income. Lower impairments reflected fewer significant

individual cases together with £60 million of latent provision releases. Private Banking operating profit was £145 million compared with £88 million in the first half of 2013. Operating profit excluding restructuring costs of £3 million (H1 2013 - £5 million) was 59% higher at £148 million, with net interest income benefiting from improved deposit margins and with cost saving initiatives contributing to an 8% reduction in operating expenses.

#### Corporate & Institutional Banking

Operating profit was £308 million, compared with a loss of £197 million in H1 2013. Operating profit excluding restructuring costs and litigation and conduct costs of £241 million (H1 2013 - £493 million) was £549 million, up 85% from H1 2013. The improvement primarily reflected lower impairments (a net recovery of £39 million compared with losses of £223 million in the prior year).

While Rates income improved from a weak H1 2013 (up 40%), Currencies declined by 27% and Credit by 22%, reflecting lower market volatility and the reduction in CIB's RWA deployment. RWAs fell from £147 billion to £128 billion driven by deleveraging, mitigation and risk-reduction.

## Highlights

### Key points (continued)

### Segmental performance (continued)

#### Citizens Financial Group

Operating profit increased by £68 million (\$158 million), or 19%, to £421 million (\$704 million), reflecting the sale of the Illinois retail branches and small business and select middle market relationships in the Illinois market. Excluding the impact of the sale, £170 million (\$283 million) net gain, and restructuring costs of £69 million (\$115 million) (H1 2013 – £3 million (\$5 million)), operating profit was down 3% driven by lower non-interest income and higher impairment losses partially offset by higher net interest income.

The Illinois branch transaction, completed on 20 June 2014, resulted in a net gain of £170 million (\$283 million) and restructuring costs of £10 million (\$17 million).

Net interest income rose 14%, reflecting an expanded investment securities portfolio and 8% growth in average loans and advances, driven by the transfer of a £2.2 billion (\$3.6 billion) portfolio from Non-Core.

#### RBS Capital Resolution

Over the course of H1 2014 RCR reduced funded assets by £8 billion, or 28%, to £21 billion. RWA equivalent<sup>(2)</sup> decreased by £21 billion, or 33%, to £44 billion.

Operating loss in H1 2014 was £48 million, with an operating profit of £66 million recorded in the second quarter of the year, driven by net impairment releases of £128 million.

The combined effect of the small operating loss and RWA equivalent reduction was net CET1 capital accretion of £2 billion.

### Building the number one bank for trust and service in the UK

RBS is making steady progress towards building a simpler, smaller and fairer bank, and remains focused on delivering the commitments for personal and business customers it announced on 27 February 2014.

RBS now offers its best rates to existing credit card and home insurance customers, adding to earlier progress on savings,

mortgages, loans and current accounts. There is now no deal across the entire Personal Banking product set that is not available to existing customers.

Customer letters and emails have been simplified, and simplification of the product set has continued, with the number of products on offer to Personal Banking customers reduced by 29% since 2012; this will reach over 50% by end 2014.

The branch refurbishment programme has continued with a further roll-out of WiFi.

RBS has reduced the time taken to open an account from five days to one for most personal customers.

By the end of the year, 84% of business banking frontline staff will be based in or above a branch. So that more time can be spent with customers, a further 40 experienced relationship managers have been allocated to serve commercial customers, with a central focus on lending.

Lending procedures are being improved. Lending decisions for commercial customers will by the end of the year be made within five days for all but the most complex applications.



## Highlights

### Outlook

These results reflect increasing economic confidence and improvements in asset values seen in RBS's core UK and Irish markets. Economic growth is expected to continue, although the pace may moderate.

NIM is expected to remain close to H1 levels, with the majority of deposit re-pricing benefits having now taken place.

Income from the fixed income product suite is expected to be lower in the second half of 2014, reflecting both normal seasonal trends and the continuation of the bank's reduced balance sheet risk appetite.

RBS remains on track to deliver its target of £1 billion cost reductions in 2014. Restructuring costs are expected to be higher in the second half of 2014 as the pace of activity to reduce costs in later years picks up. A restructuring charge of around £1.5 billion is expected for 2014, with overall restructuring costs still expected to be around £5 billion over 2014 to 2017 as the change agenda across the bank from economic, legal and regulatory perspectives remains very full.

Credit impairment charges in the second half of the year are expected to remain low, subject to macro economic conditions, resulting in a full year charge of around £1 billion, although at these low levels there will be volatility from quarter to quarter.

RCR funded assets are expected to be down from £29 billion at its inception to around £15 to £18 billion at the end of 2014. The overall cost (comprising impairments, disposal losses and running expenses) for RCR to achieve its goals was originally expected to be around £4.0 to £4.5 billion between 2014 and 2016. In light of the strong performance in the first half and the more favourable economic environment, these costs are now expected to total around £2.5 to £3.0 billion, of which c.£0.8 billion in 2014, although outcomes are subject to significant potential volatility.

The bank is making good progress towards achieving its target CET1 ratio of 11% by the end of 2015 and at least 12% by the end of 2016. However, ongoing conduct and regulatory investigations and litigation

continue to present challenges and uncertainties and are expected to be a drag on capital generation over the coming quarters. The timing and amounts of any further settlements or redress remain uncertain and could be significant.

## Analysis of results

|                                     | Half year ended |         | Quarter ended  |          |         |
|-------------------------------------|-----------------|---------|----------------|----------|---------|
|                                     | 30 June         | 30 June | 30 June        | 31 March | 30 June |
|                                     | 2014            | 2013    | 2014           | 2014     | 2013    |
|                                     | £m              | £m      | £m             | £m       | £m      |
| <b>Net interest income</b>          |                 |         |                |          |         |
| Net interest income (1)             | <b>5,493</b>    | 5,437   | <b>2,798</b>   | 2,695    | 2,767   |
| Average interest-earning assets (1) | <b>507,088</b>  | 555,709 | <b>502,155</b> | 512,079  | 551,375 |
| Net interest margin                 |                 |         |                |          |         |
| - RBS                               | <b>2.18%</b>    | 1.97%   | <b>2.23%</b>   | 2.13%    | 2.01%   |
| - Personal & Business Banking       | <b>3.39%</b>    | 3.15%   | <b>3.40%</b>   | 3.37%    | 3.20%   |
| - Commercial & Private Banking      | <b>2.90%</b>    | 2.69%   | <b>2.91%</b>   | 2.89%    | 2.77%   |
| - Citizens Financial Group          | <b>2.94%</b>    | 2.90%   | <b>2.93%</b>   | 2.94%    | 2.89%   |

Note:

(1) For further analysis and details refer to pages 72 to 74.

## Key points

### H1 2014 compared with H1 2013

Net interest income improved by 1% to £5,493 million. The increase was consistent across all businesses, with notable improvements in PBB (£97 million, 4%) and CPB (£90 million, 7%).

Net interest margin (NIM) increased by 21 basis points to 2.18%, driven by deposit repricing initiatives across a number of businesses. The benefit of reduced funding costs outweighed lower yields on assets.

### Q2 2014 compared with Q1 2014

Net interest income improved by 4% to £2,798 million principally driven by improved margins and an additional day in the quarter.

NIM increased by 10 basis points to 2.23%, driven by lower funding costs, reflecting repricing initiatives across a number of businesses, RCR run-off and a small number of one-off recoveries.

**Q2 2014 compared with Q2 2013**

Net interest income improved by 1% to £2,798 million reflected by improved margins.

NIM increased by 22 basis points to 2.23% benefiting from repricing initiatives across a number of businesses.

## Analysis of results

The following tables reconcile the non-statutory basis results (a non-GAAP financial measure) to the statutory basis results.

|  | Half year ended       |                       | Quarter ended         |                        |                       |
|--|-----------------------|-----------------------|-----------------------|------------------------|-----------------------|
|  | 30 June<br>2014<br>£m | 30 June<br>2013<br>£m | 30 June<br>2014<br>£m | 31 March<br>2014<br>£m | 30 June<br>2013<br>£m |
| <b>Non-interest income</b>                             |                       |                       |                       |                        |                       |
| Fees and commissions receivable                        | 2,605                 | 2,708                 | 1,314                 | 1,291                  | 1,392                 |
| Fees and commissions payable                           | (487)                 | (460)                 | (251)                 | (236)                  | (250)                 |
| Net fees and commissions                               | 2,118                 | 2,248                 | 1,063                 | 1,055                  | 1,142                 |
| Income from trading activities                         |                       |                       |                       |                        |                       |
| - non-statutory basis                                  | 1,482                 | 1,890                 | 626                   | 856                    | 874                   |
| - own credit adjustments*                              | 11                    | 175                   | (84)                  | 95                     | 76                    |
| - RFS Holdings minority interest                       | -                     | (1)                   | (1)                   | 1                      | (1)                   |
| Statutory basis  | 1,493                 | 2,064                 | 541                   | 952                    | 949                   |
| Gain on redemption of own debt                         | 20                    | 191                   | -                     | 20                     | 242                   |
| Other operating income                                 |                       |                       |                       |                        |                       |
| - non-statutory basis                                  | 882                   | 1,028                 | 438                   | 444                    | 661                   |
| - own credit adjustments*                              | (62)                  | 201                   | (106)                 | 44                     | 51                    |
| - strategic disposals                                  | 191                   | -                     | -                     | 191                    | 6                     |
| - RFS Holdings minority interest                       | 25                    | 103                   | 13                    | 12                     | 2                     |
| Statutory basis  | 1,036                 | 1,332                 | 345                   | 691                    | 720                   |
| <b>Total non-interest income - non-statutory basis</b> | <b>4,482</b>          | <b>5,166</b>          | <b>2,127</b>          | <b>2,355</b>           | <b>2,677</b>          |
| <b>Total non-interest income - statutory basis</b>     | <b>4,667</b>          | <b>5,835</b>          | <b>1,949</b>          | <b>2,718</b>           | <b>3,053</b>          |
| *Own credit adjustments impact:                        |                       |                       |                       |                        |                       |
| Income from trading activities                         | 11                    | 175                   | (84)                  | 95                     | 76                    |
| Other operating income                                 | (62)                  | 201                   | (106)                 | 44                     | 51                    |
| Own credit adjustments                                 | (51)                  | 376                   | (190)                 | 139                    | 127                   |

## Key points

### H1 2014 compared with H1 2013

Non-interest declined by £1,168 million or 20% which included a charge on own credit of £62 million compared with a gain of £201 million in H1 2013, partially offset by a gain of £191 million on the disposal of RBS's remaining interest in Direct Line Insurance Group in 2014. On a non-statutory basis non-interest income declined by £684 million or 13%, principally reflecting a 22% reduction in income from trading activities, in line with CIB's smaller balance sheet and reduced risk profile.

A net gain of £170 million (\$283 million) was recorded on CFG's sale of its Illinois branch network.

Gains on the disposal of available-for-sale securities in Treasury were down £245 million to £215 million for H1 2014 (Q2 2014 - £15 million; Q1 2014 - £200 million).

Gain on redemption of own debt was £20 million compared with £191 million in H1 2013.

### Q2 2014 compared with Q1 2014

Non-interest declined by £769 million or 28%, which included a charge of own credit of £190 million compared with a gain of £139 million in Q1 2014 and a gain of £191 million on the disposal of RBS's remaining interest in Direct Line Insurance Group in Q1 2014. On a non-statutory basis non-interest income declined by £228 million or 10%, principally reflecting the seasonality of CIB income and lower disposal income in RCR. This was partly offset by the net gain on sale from CFG's branch sale.

## Analysis of results

### Key points (continued)

#### Q2 2014 compared with Q2 2013

Non-interest income declined by £1,104 million which included a charge on own credit of £190 million compared with a gain of £127 million in Q2 2013. On a non-statutory basis non-interest income declined by £550 million or 21%, which included the weaker performance of Currencies within CIB. This was largely in line with overall market trends and reflected weak client demand and low volatility.

The movements discussed above were partly offset by the stronger performance of Rates in CIB and the net gain on sale of the Illinois retail branches, coupled with higher current account-related fee income.

## Analysis of results

The following tables reconcile the non-statutory basis results (a non-GAAP financial measure) to the statutory basis results.

|                                  | Half year ended       |                       | Quarter ended         |                        |                       |
|----------------------------------|-----------------------|-----------------------|-----------------------|------------------------|-----------------------|
|                                  | 30 June<br>2014<br>£m | 30 June<br>2013<br>£m | 30 June<br>2014<br>£m | 31 March<br>2014<br>£m | 30 June<br>2013<br>£m |
| <b>Operating expenses</b>        |                       |                       |                       |                        |                       |
| Staff costs                      |                       |                       |                       |                        |                       |
| - non-statutory basis            | 3,340                 | 3,585                 | 1,693                 | 1,647                  | 1,764                 |
| - restructuring costs            | 196                   | 142                   | 153                   | 43                     | 76                    |
| - RFS Holdings minority interest | -                     | -                     | (1)                   | 1                      | -                     |
| Statutory basis                  | 3,536                 | 3,727                 | 1,845                 | 1,691                  | 1,840                 |
| Premises and equipment           |                       |                       |                       |                        |                       |
| - non-statutory basis            | 1,079                 | 1,079                 | 485                   | 594                    | 526                   |
| - restructuring costs            | 196                   | 25                    | 137                   | 59                     | 22                    |
| Statutory basis                  | 1,275                 | 1,104                 | 622                   | 653                    | 548                   |
| Other administrative expenses    |                       |                       |                       |                        |                       |
| - non-statutory basis            | 1,292                 | 1,479                 | 605                   | 687                    | 801                   |
| - restructuring costs            | 119                   | 84                    | 94                    | 25                     | 48                    |
| - litigation and conduct costs   | 250                   | 620                   | 250                   | -                      | 570                   |
| - RFS Holdings minority interest | 1                     | (2)                   | 2                     | (1)                    | (1)                   |
| Statutory basis                  | 1,662                 | 2,181                 | 951                   | 711                    | 1,418                 |
| Restructuring costs              |                       |                       |                       |                        |                       |
| - non-statutory basis            | 514                   | 271                   | 385                   | 129                    | 149                   |
| - staff expenses                 | (196)                 | (142)                 | (153)                 | (43)                   | (76)                  |
| - premises and equipment         | (196)                 | (25)                  | (137)                 | (59)                   | (22)                  |
| - other                          | (119)                 | (84)                  | (94)                  | (25)                   | (48)                  |
| - Depreciation and amortisation  | (3)                   | (20)                  | (1)                   | (2)                    | (3)                   |
| Statutory basis                  | -                     | -                     | -                     | -                      | -                     |
| Litigation and conduct costs     |                       |                       |                       |                        |                       |
| - non-statutory basis            | 250                   | 620                   | 250                   | -                      | 570                   |
| - other administrative expenses  | (250)                 | (620)                 | (250)                 | -                      | (570)                 |



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|  |              |              |              |              |              |
|--|--------------|--------------|--------------|--------------|--------------|
| Statutory basis                                    | -            | -            | -            | -            | -            |
| Depreciation and amortisation                      |              |              |              |              |              |
| - non-statutory basis                              | 551          | 716          | 282          | 269          | 346          |
| - integration and restructuring                    | 3            | 20           | 1            | 2            | 3            |
| - RFS Holdings minority interest                   | -            | -            | (1)          | 1            | -            |
|  |              |              |              |              |              |
| Statutory basis                                    | 554          | 736          | 282          | 272          | 349          |
| Write-down of goodwill and other intangible assets |              |              |              |              |              |
| - non-statutory basis                              | 82           | -            | -            | 82           | -            |
| - write-down of goodwill                           | 130          | -            | 130          | -            | -            |
|  |              |              |              |              |              |
| Statutory basis                                    | 212          | -            | 130          | 82           | -            |
|  |              |              |              |              |              |
| <b>Operating expenses - non-statutory basis</b>    | <b>7,108</b> | <b>7,750</b> | <b>3,700</b> | <b>3,408</b> | <b>4,156</b> |
|  |              |              |              |              |              |
| <b>Operating expenses - statutory basis</b>        | <b>7,239</b> | <b>7,748</b> | <b>3,830</b> | <b>3,409</b> | <b>4,155</b> |

## Analysis of results

### Key points

#### H1 2014 compared with H1 2013

Operating expenses were £509 million which included the write-down of goodwill of £130 million in H1 2014. On a non-statutory basis operating expenses were £642 million, 8%, lower. Non-statutory operating expenses excluding restructuring costs of £514 million (H1 2013 - £271 million) and litigation and conduct costs of £250 million (H1 2013 - £620 million) decreased by £515 million or 8% to £6,344 million. Much of the decrease was achieved in CIB through headcount reductions and tight control of discretionary expenditure. Overall operating expense trends are starting to show the benefits of the reshaping of the bank's cost base.

Litigation and conducts costs totalled £250 million compared with £620 million in H1 2013, with an additional provision of £150 million (H1 2013 - £160 million) for Payment Protection Insurance redress recorded in UK PBB and a further £100 million (H1 2013 - £150 million) relating to interest rate hedging product redress booked within Commercial Banking and CIB. H1 2013 included provisions for other regulatory and legal actions of £385 million in CIB.

Restructuring costs increased by £243 million to £514 million, including significant charges in relation to Williams & Glyn and to the restructuring of the property portfolio.

#### Q2 2014 compared with Q1 2014

Operating expenses were up £421 million which included the write-down of goodwill of £130 million in Q2 2014. On a non-statutory basis operating expenses were up £292 million, 9% reflecting higher restructuring and litigation and conduct costs. Non-statutory operating expenses excluding restructuring costs of £385 million (Q1 2014 - £129 million) and litigation and conduct costs of £250 million decreased by £214 million or 7%. This was principally driven by lower staff costs in CIB, operational cost saving initiatives in CPB and lower costs in PBB. This was only partly offset by higher staff costs in RCR.

#### Q2 2014 compared with Q2 2013

Operating expenses were down £325 million, 8% reflecting lower litigation and conduct costs. On a non-statutory basis operating expenses were down £456 million, 11%, reflecting lower litigation and conduct costs. Non-statutory operating expenses excluding restructuring costs of £385 million (Q2 2013 - £149 million) and litigation and conduct costs of £250 million (Q2 2013 - £570 million) decreased by £372 million or 11%. The fall was consistent across all businesses, with notable

declines in CIB (£114 million, 11%), CPB (£46 million, 7%). The decrease was helped by favourable foreign exchange movements.

## Analysis of results

|   | Half year ended |              | Quarter ended  |                 |                 |
|---|-----------------|--------------|----------------|-----------------|-----------------|
|   | 30 June         | 30 June      | 30 June        | 31 March        | 30 June         |
|   | 2014            | 2013         | 2014           | 2014            | 2013            |
|   | £m              | £m           | £m             | £m              | £m              |
| <b>Impairment losses/(recoveries)</b>   |                 |              |                |                 |                 |
| Loans   | 271             | 2,161        | (89)           | 360             | 1,125           |
| Securities  | (2)             | (11)         | (4)            | 2               | (8)             |
| <b>Total impairment losses/(recoveries)</b>                                   | <b>269</b>      | <b>2,150</b> | <b>(93)</b>    | <b>362</b>      | <b>1,117</b>    |
| <b>Loan impairment losses/(recoveries)</b>                                    |                 |              |                |                 |                 |
| - individually assessed   | 113             | 1,472        | (42)           | 155             | 826             |
| - collectively assessed   | 348             | 734          | 221            | 127             | 293             |
| - latent  | (180)           | (36)         | (258)          | 78              | 15              |
| Customer loans  | 281             | 2,170        | (79)           | 360             | 1,134           |
| Bank loans  | (10)            | (9)          | (10)           | -               | (9)             |
| <b>Loan impairment losses/(recoveries)</b>                                    | <b>271</b>      | <b>2,161</b> | <b>(89)</b>    | <b>360</b>      | <b>1,125</b>    |
| RBS excluding RCR/Non-Core  | 290             | 1,258        | 36             | 254             | 659             |
| RCR   | (19)            | n/a          | (125)          | 106             | n/a             |
| Non-Core  | n/a             | 903          | n/a            | n/a             | 466             |
| RBS   | 271             | 2,161        | (89)           | 360             | 1,125           |
| <b>Customer loan impairment charge as a % of gross loans and advances (1)</b> |                 |              |                |                 |                 |
| RBS excluding RCR/Non-Core  | 0.2%            | 0.6%         | -              | 0.3%            | 0.7%            |
| RCR   | (0.1%)          | n/a          | (1.7%)         | 1.2%            | n/a             |
| Non-Core  | n/a             | 3.9%         | n/a            | n/a             | 4.0%            |
|   |                 |              |                |                 |                 |
|   |                 |              | <b>30 June</b> | <b>31 March</b> | <b>31</b>       |
|   |                 |              | <b>2014</b>    | <b>2014</b>     | <b>December</b> |
|   |                 |              |                |                 | <b>2013</b>     |
| Loan impairment provisions  |                 |              | <b>£22.4bn</b> | £24.2bn         | £25.2bn         |

|                          |  |  |                |         |         |
|--------------------------|--|--|----------------|---------|---------|
| Risk elements in lending |  |  | <b>£34.1bn</b> | £37.4bn | £39.4bn |
| Provision coverage (2)   |  |  | <b>66%</b>     | 65%     | 64%     |

## Notes:

- (1) Excludes reverse repurchase agreements and includes disposals groups.
- (2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

**Key points****H1 2014 compared with H1 2013**

Loan impairment losses declined sharply by £1,890 million or 87%, including £180 million of releases of latent provisions (H1 2013 - £36 million). Asset quality continued to improve in the UK and Ireland.

Loan impairments in RCR amounted to a net recovery of £19 million.

Provision coverage strengthened to 66% compared with 64% at the end of 2013. REIL were £5.3 billion lower and represented 8.3% of gross customer loans, compared with 9.4% at the end of 2013.

**Q2 2014 compared with Q1 2014**

A net recovery of £89 million was recorded in Q2 2014, compared with losses of £360 million in Q1 2014.

The improvement in loan impairment losses was driven by the release of latent provisions in CPB and CIB and by a strong credit performance in RCR (a net recovery of £125 million compared with losses of £106 million in Q1 2014).

REIL fell by £3.3 billion. As a percentage of gross loans to customers, REIL declined to 8.3% from 9.0% at 31 March 2014.

## Analysis of results

### Key points (continued)

#### Q2 2014 compared with Q2 2013

Loan impairment recoveries totalled £89 million compared with losses of £1,125 million in Q2 2013 which included £466 million in respect of Non-Core.

The improvement in impairments reflected significantly lower losses in Ulster Bank reflecting stronger credit metrics and the benefits of the investment in programmes to support customers in financial difficulty, and continued strong recoveries across UK PBB and release of latent provisions and non-repeat of significant individual cases in CPB.

In Q2 2014 loan impairment recoveries in RCR were £125 million.

## Analysis of results

| <b>Capital and leverage ratios</b> |                                |                 |                 |  |
|------------------------------------|--------------------------------|-----------------|-----------------|--|
|                                    | <b>CRR end-point basis (1)</b> |                 |                 |  |
|                                    | <b>30 June</b>                 | <b>31 March</b> | <b>31</b>       |  |
|                                    | <b>2014</b>                    | <b>2014</b>     | <b>2013 (2)</b> |  |
|                                    | <b>£bn</b>                     | <b>£bn</b>      | <b>£bn</b>      |  |
| <b>Capital</b>                     |                                |                 |                 |  |
| CET1                               | 39.7                           | 39.1            | 36.8            |  |
| Tier 1                             | 39.7                           | 39.1            | 36.8            |  |
| Total                              | 48.7                           | 47.3            | 45.5            |  |
| <b>RWAs by risk</b>                |                                |                 |                 |  |
| Credit risk                        |                                |                 |                 |  |
| - non-counterparty                 | 283.3                          | 295.2           | 317.9           |  |
| - counterparty                     | 38.6                           | 41.3            | 39.1            |  |
| Market risk                        | 33.4                           | 41.0            | 30.3            |  |
| Operational risk                   | 36.8                           | 36.8            | 41.8            |  |
|                                    | 392.1                          | 414.3           | 429.1           |  |
| <b>Risk asset ratios</b>           |                                |                 |                 |  |
|                                    | %                              | %               | %               |  |
| CET1                               | 10.1                           | 9.4             | 8.6             |  |
| Tier 1                             | 10.1                           | 9.4             | 8.6             |  |
| Total                              | 12.4                           | 11.4            | 10.6            |  |
| <b>Leverage ratio (3)</b>          |                                |                 |                 |  |
|                                    | <b>30 June</b>                 | <b>31 March</b> | <b>31</b>       |  |
|                                    | <b>2014</b>                    | <b>2014</b>     | <b>2013</b>     |  |
| Tier 1 capital - £bn               | 39.7                           | 39.1            | 36.8            |  |
| Exposure - £bn                     | 1,070.2                        | 1,083.4         | 1,082.0         |  |
| Leverage ratio - % (3)             | 3.7                            | 3.6             | 3.4             |  |

Notes:

- (1) Capital Requirements Regulation (CRR) as implemented by the Prudential Resolution Authority in the UK, with effect from 1 January 2014.
- (2) Estimated.
- (3) Leverage ratio is calculated using:
  - CRR end-point Tier 1 capital; and
  - Exposure measure based on guidance in the BCBS 270 proposal issued in January 2014, supplemented by the instructions in the March 2014 Basel III Quantitative Impact Study and the related FAQs.

See Appendix 1 for further details on capital and leverage.

## Key points

### 30 June 2014 compared with 31 March 2014

The CRR end-point CET 1 ratio improved to 10.1% from 9.4%, principally driven by retained earnings after charging the initial DAS dividend of £320 million, and continuing reduction in RWAs and expected loss.

RWAs decreased by £22 billion principally reflecting the £12 billion fall in CIB driven by risk reductions and mitigation costs and £5 billion of run-off and disposals in RCR.



## Analysis of results

### Key points (continued)

### Capital and leverage ratios (continued)

#### 30 June 2014 compared with 31 December 2013

The CRR end-point CET 1 ratio improved to 10.1% from 8.6%, principally driven by retained earnings, continuing reduction in RWAs and regulatory capital deductions relating to deferred tax assets and expected loss.

RWAs decreased by £37 billion principally attributable to the risk reductions and mitigation actions in CIB, and run-off and disposals in RCR.

Leverage ratio improved by 30 basis points reflecting attributable profit, lower regulatory deductions as well as lower leverage exposure, particularly relating to derivatives in CIB.

For further details of RBS's capital and leverage ratios refer to Appendix 1.

## Analysis of results

|   | <b>30 June</b>  | 31 March | 31       |
|---|-----------------|----------|----------|
| <b>Balance sheet</b>                    | <b>2014</b>     | 2014     | December |
|   |                 |          | 2013     |
| Total assets                            | <b>£1,011bn</b> | £1,024bn | £1,028bn |
| Derivatives                             | <b>£275bn</b>   | £278bn   | £288bn   |
| Funded balance sheet (1)                | <b>£736bn</b>   | £746bn   | £740bn   |
| Net loans and advances to customers (2) | <b>£387bn</b>   | £392bn   | £393bn   |
| Customer deposits (3)                   | <b>£401bn</b>   | £404bn   | £418bn   |
| Loan:deposit ratio - RBS (4)            | <b>96%</b>      | 97%      | 94%      |

### Notes:

- (1) Funded balance sheet represents total assets less derivatives.
- (2) Excludes reverse repurchase agreements and stock borrowing, and includes disposal groups.
- (3) Excludes repurchase agreements and stock lending, and includes disposal groups.
- (4) Net of provisions, including disposal groups and excluding repurchase agreements. Excluding disposal groups, the loan:deposit ratios for RBS at 30 June 2014 was 96% (31 March 2014 - 97%; 31 December 2013 - 94%).

## Key points

### 30 June 2014 compared with 31 March 2014

Funded assets decreased by £10 billion to £736 billion principally attributable to lower debt securities in CIB coupled with RCR run-off.

Net loans and advances to customers decreased by £5 billion to £387 billion principally driven by RCR run-off and disposals, the impact of stronger sterling on US dollar denominated loans, partly offset by good mortgage balance growth in UK PBB.

Customer deposits decreased by £3 billion driven by lower balances in CFG adversely impacted by foreign exchange movements, deposit repricing in Private Banking and lower balances in CIB. This was partly offset by increased deposit balances in UK PBB.

**30 June 2014 compared with 31 December 2013**

Funded assets decreased by £4 billion to £736 billion principally driven by RCR run-off.

Net loans and advances to customers decreased by £6 billion reflecting RCR run-off and the impact of currency movements.

Customer deposits fell by £17 billion reflecting a managed run-down of surplus liquidity. The customer funding surplus decreased to £14 billion, while the loan:deposit ratio increased by 2 percentage points to 96%.

## Analysis of results

|   | <b>30 June</b> | 31 March | 31 December |
|---|----------------|----------|-------------|
| <b>Funding and liquidity metrics</b>                                    | <b>2014</b>    | 2014     | 2013        |
| Deposits (1)  | <b>£440bn</b>  | £440bn   | £453bn      |
| Deposits as a percentage of funded balance sheet                        | <b>60%</b>     | 59%      | 61%         |
| Short-term wholesale funding (2)  | <b>£34bn</b>   | £31bn    | £32bn       |
| Wholesale funding (2)   | <b>£102bn</b>  | £102bn   | £108bn      |
| Wholesale funding as a percentage of funded balance sheet               | <b>14%</b>     | 14%      | 15%         |
| Short-term wholesale funding as a percentage of funded balance sheet    | <b>5%</b>      | 4%       | 4%          |
| Short-term wholesale funding as a percentage of total wholesale funding | <b>33%</b>     | 30%      | 30%         |
| Liquidity portfolio   | <b>£138bn</b>  | £131bn   | £146bn      |
| Liquidity portfolio as a percentage of funded balance sheet             | <b>19%</b>     | 18%      | 20%         |
| Liquidity portfolio as a percentage of short-term wholesale funding     | <b>406%</b>    | 423%     | 456%        |

Notes:

- (1) Customer and bank deposits excluding repurchase agreements and stock lending and includes disposal groups.
- (2) Excludes derivative collateral.

## Key points

### 30 June 2014 compared with 31 March 2014

The bank remains highly liquid with short-term wholesale funding covered 4 times by its liquidity portfolio as at 30 June 2014 (4.2 times as at 31 March 2014).

The liquidity portfolio increased by £7 billion to £138 billion, mainly driven by decreases in customer loan balances and higher Discount Window Facility assets.

**30 June 2014 compared with 31 December 2013**

The liquidity portfolio decreased by £8 billion to £138 billion, mainly driven by a targeted reduction in volatile financial institution deposits in the first quarter of 2014, partly offset by decreases in customer loan balances and higher Discount Window Facility assets in the second quarter.

Targeted reductions in long-term wholesale funding and customer deposits contributed to a 700 basis point decrease in the net stable funding ratio to 111%.

## Segment performance

Key measures for each segment are shown in the tables below:

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| <b>Operating profit/(loss) by segment</b> |                 |         |               |          |         |
| UK Personal & Business Banking            | 994             | 688     | 484           | 510      | 268     |
| Ulster Bank                               | 55              | (381)   | 46            | 9        | (210)   |
| Personal & Business Banking               | 1,049           | 307     | 530           | 519      | 58      |
| Commercial Banking                        | 635             | 413     | 314           | 321      | 229     |
| Private Banking                           | 145             | 88      | 70            | 75       | 47      |
| Commercial & Private Banking              | 780             | 501     | 384           | 396      | 276     |
| Corporate & Institutional Banking         | 308             | (197)   | (25)          | 333      | (395)   |
| Central items                             | 91              | 553     | 86            | 5        | 352     |
| Citizens Financial Group                  | 421             | 353     | 277           | 144      | 167     |
| RCR                                       | (48)            | n/a     | 66            | (114)    | n/a     |
| Non-Core                                  | n/a             | (809)   | n/a           | n/a      | (284)   |
| <b>Non statutory basis</b>                | <b>2,601</b>    | 708     | <b>1,318</b>  | 1,283    | 174     |
| <b>Reconciling items</b>                  |                 |         |               |          |         |
| Own credit adjustments                    | (51)            | 376     | (190)         | 139      | 127     |
| Gain on redemption of own debt            | 20              | 191     | -             | 20       | 242     |
| Write-down of goodwill                    | (130)           | -       | (130)         | -        | -       |
| Strategic disposals                       | 191             | -       | -             | 191      | 6       |
| RFS Holdings minority interest            | 21              | 99      | 12            | 9        | (1)     |
| <b>Statutory basis</b>                    | <b>2,652</b>    | 1,374   | <b>1,010</b>  | 1,642    | 548     |

| <b>Impairment losses/(recoveries) by segment</b> |             |       |              |     |       |
|--|-------------|-------|--------------|-----|-------|
| UK Personal & Business Banking                   | <b>148</b>  | 256   | <b>60</b>    | 88  | 126   |
| Ulster Bank                                      | <b>57</b>   | 503   | <b>10</b>    | 47  | 263   |
| Personal & Business Banking                      | <b>205</b>  | 759   | <b>70</b>    | 135 | 389   |
| Commercial Banking                               | <b>31</b>   | 282   | <b>(9)</b>   | 40  | 155   |
| Private Banking                                  | <b>-</b>    | 7     | <b>1</b>     | (1) | 2     |
| Commercial & Private Banking                     | <b>31</b>   | 289   | <b>(8)</b>   | 39  | 157   |
| Corporate & Institutional Banking                | <b>(39)</b> | 223   | <b>(45)</b>  | 6   | 144   |
| Central items                                    | <b>(12)</b> | (3)   | <b>(13)</b>  | 1   | (3)   |
| Citizens Financial Group                         | <b>104</b>  | 51    | <b>31</b>    | 73  | 32    |
| RCR  | <b>(20)</b> | n/a   | <b>(128)</b> | 108 | n/a   |
| Non-Core   | <b>n/a</b>  | 831   | <b>n/a</b>   | n/a | 398   |
| <b>Statutory and non-statutory basis</b>         | <b>269</b>  | 2,150 | <b>(93)</b>  | 362 | 1,117 |

## Segment performance

|                                       | Half year ended |         | Quarter ended |          |         |
|---------------------------------------|-----------------|---------|---------------|----------|---------|
|                                       | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                       | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                       | %               | %       | %             | %        | %       |
| <b>Net interest margin by segment</b> |                 |         |               |          |         |
| UK Personal & Business Banking        | <b>3.62</b>     | 3.50    | <b>3.64</b>   | 3.61     | 3.56    |
| Ulster Bank                           | <b>2.32</b>     | 1.82    | <b>2.35</b>   | 2.29     | 1.84    |
| Personal & Business Banking           | <b>3.39</b>     | 3.15    | <b>3.40</b>   | 3.37     | 3.20    |
| Commercial Banking                    | <b>2.70</b>     | 2.53    | <b>2.73</b>   | 2.68     | 2.63    |
| Private Banking                       | <b>3.72</b>     | 3.33    | <b>3.73</b>   | 3.70     | 3.34    |
| Commercial & Private Banking          | <b>2.90</b>     | 2.69    | <b>2.91</b>   | 2.89     | 2.77    |
| Corporate & Institutional Banking     | <b>0.88</b>     | 0.72    | <b>0.90</b>   | 0.85     | 0.67    |
| Citizens Financial Group              | <b>2.94</b>     | 2.90    | <b>2.93</b>   | 2.94     | 2.89    |
| RCR                                   | <b>(0.01)</b>   | n/a     | <b>0.08</b>   | (0.08)   | n/a     |
| Non-Core                              | <b>n/a</b>      | (0.06)  | <b>n/a</b>    | n/a      | 0.15    |
| <b>RBS net interest margin</b>        | <b>2.18</b>     | 1.97    | <b>2.23</b>   | 2.13     | 2.01    |

|                                 | 30 June      | 31 March | 31 December |
|---------------------------------|--------------|----------|-------------|
|                                 | 2014         | 2014     | 2013        |
|                                 | £bn          | £bn      | £bn         |
| <b>Funded assets by segment</b> |              |          |             |
| UK Personal & Business Banking  | <b>133.6</b> | 132.8    | 132.2       |
| Ulster Bank                     | <b>26.6</b>  | 26.0     | 28.0        |
| Personal & Business Banking     | <b>160.2</b> | 158.8    | 160.2       |
| Commercial Banking              | <b>88.6</b>  | 89.6     | 87.9        |



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|                                   |              |       |       |
|-----------------------------------|--------------|-------|-------|
| Private Banking                   | <b>20.8</b>  | 21.1  | 21.0  |
|                                   |              |       |       |
| Commercial & Private Banking      | <b>109.4</b> | 110.7 | 108.9 |
|                                   |              |       |       |
| Corporate & Institutional Banking | <b>278.7</b> | 286.6 | 268.6 |
| Central items                     | <b>90.3</b>  | 89.5  | 101.9 |
| Citizens Financial Group          | <b>75.7</b>  | 75.7  | 71.3  |
| RCR                               | <b>20.9</b>  | 24.3  | n/a   |
| Non-Core                          | <b>n/a</b>   | n/a   | 28.0  |
|                                   |              |       |       |
|                                   | <b>735.2</b> | 745.6 | 738.9 |
| RFS Holdings minority interest    | <b>1.0</b>   | 0.9   | 0.9   |
|                                   |              |       |       |
| <b>RBS funded assets</b>          | <b>736.2</b> | 746.5 | 739.8 |

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## Segment performance

|  | FLB3         |          |           | Basel 2.5 |
|--|--------------|----------|-----------|-----------|
|  | 30 June      | 31 March | 1 January | 31        |
|  | 2014         | 2014     | 2014      | December  |
|  | £bn          | £bn      | £bn       | 2013      |
|  |              |          |           | £bn       |
| <b>Risk-weighted assets by segment</b>           |              |          |           |           |
| UK Personal & Business Banking                   | 47.0         | 48.5     | 49.7      | 51.2      |
| Ulster Bank                                      | 27.7         | 28.7     | 28.2      | 30.7      |
| Personal & Business Banking                      | 74.7         | 77.2     | 77.9      | 81.9      |
| Commercial Banking                               | 63.0         | 63.5     | 61.5      | 65.8      |
| Private Banking                                  | 11.8         | 12.0     | 12.0      | 12.0      |
| Commercial & Private Banking                     | 74.8         | 75.5     | 73.5      | 77.8      |
| Corporate & Institutional Banking                | 127.8        | 140.2    | 147.1     | 120.4     |
| Other  | 14.8         | 15.5     | 19.4      | 16.2      |
| Citizens Financial Group                         | 60.7         | 61.3     | 60.6      | 56.1      |
| RCR  | 35.1         | 40.5     | 46.7      | n/a       |
| Non-Core   | n/a          | n/a      | n/a       | 29.2      |
| <b>RBS before RFS Holdings minority interest</b> | <b>387.9</b> | 410.2    | 425.2     | 381.6     |
| RFS Holdings minority interest                   | 4.2          | 4.1      | 3.9       | 3.9       |
| <b>RBS risk-weighted assets</b>                  | <b>392.1</b> | 414.3    | 429.1     | 385.5     |

| Employee numbers by segment<br>(full time equivalents rounded to the nearest hundred) | 30 June | 31 March | 31       |
|---|---------|----------|----------|
|   | 2014    | 2014     | December |
|   |         |          | 2013     |
| UK Personal & Business Banking  | 25,700  | 26,300   | 26,700   |
| Ulster Bank   | 4,500   | 4,600    | 4,700    |

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|                                   |                |         |         |
|-----------------------------------|----------------|---------|---------|
| Personal & Business Banking       | <b>30,200</b>  | 30,900  | 31,400  |
|                                   |                |         |         |
| Commercial Banking                | <b>7,100</b>   | 7,300   | 7,300   |
| Private Banking                   | <b>3,500</b>   | 3,500   | 3,500   |
|                                   |                |         |         |
| Commercial & Private Banking      | <b>10,600</b>  | 10,800  | 10,800  |
|                                   |                |         |         |
| Corporate & Institutional Banking | <b>4,500</b>   | 4,400   | 4,700   |
| Centre                            | <b>12,800</b>  | 13,100  | 12,800  |
| Citizens Financial Group          | <b>17,700</b>  | 18,500  | 18,800  |
| RCR                               | <b>800</b>     | 1,100   | n/a     |
| Non-Core                          | <b>n/a</b>     | n/a     | 1,300   |
|                                   |                |         |         |
|                                   | <b>76,600</b>  | 78,800  | 79,800  |
| Services                          | <b>36,900</b>  | 37,800  | 38,600  |
| Integration and restructuring     | <b>100</b>     | 100     | 200     |
|                                   |                |         |         |
| <b>RBS employee numbers</b>       | <b>113,600</b> | 116,700 | 118,600 |

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## Personal &amp; Business Banking

|                                 | Half year ended |         | Quarter ended |          |         |
|---------------------------------|-----------------|---------|---------------|----------|---------|
|                                 | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                 | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                 | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>         |                 |         |               |          |         |
| Net interest income             | 2,599           | 2,502   | 1,321         | 1,278    | 1,270   |
| Net fees and commissions        | 703             | 693     | 338           | 365      | 351     |
| Other non-interest income       | 72              | 78      | 51            | 21       | 57      |
| Non-interest income             | 775             | 771     | 389           | 386      | 408     |
| Total income                    | 3,374           | 3,273   | 1,710         | 1,664    | 1,678   |
| Direct expenses                 |                 |         |               |          |         |
| - staff costs                   | (576)           | (593)   | (288)         | (288)    | (302)   |
| - other costs                   | (260)           | (227)   | (113)         | (147)    | (108)   |
| Indirect expenses               | (1,101)         | (1,072) | (518)         | (583)    | (549)   |
| Restructuring costs             |                 |         |               |          |         |
| - direct                        | 2               | (85)    | 2             | -        | (61)    |
| - indirect                      | (35)            | (45)    | (43)          | 8        | (26)    |
| Litigation and conduct costs    | (150)           | (185)   | (150)         | -        | (185)   |
| Operating expenses              | (2,120)         | (2,207) | (1,110)       | (1,010)  | (1,231) |
| Profit before impairment losses | 1,254           | 1,066   | 600           | 654      | 447     |
| Impairment losses               | (205)           | (759)   | (70)          | (135)    | (389)   |
| Operating profit                | 1,049           | 307     | 530           | 519      | 58      |

| Key metrics | Half year ended |         | Quarter ended |          |         |
|-------------|-----------------|---------|---------------|----------|---------|
|             | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|             | 2014            | 2013    | 2014          | 2014     | 2013    |
|             |                 |         |               |          |         |

| <b>Performance ratios</b> |              |       |              |       |       |
|---------------------------|--------------|-------|--------------|-------|-------|
| Return on equity (1)      | <b>17.0%</b> | 4.3%  | <b>17.4%</b> | 16.7% | 1.7%  |
| Net interest margin       | <b>3.39%</b> | 3.15% | <b>3.40%</b> | 3.37% | 3.20% |
| Cost:income ratio         | <b>63%</b>   | 67%   | <b>65%</b>   | 61%   | 73%   |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

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## Personal & Business Banking

|  | 30 June<br>2014<br>£bn | 31 March<br>2014<br>£bn | Change  | 31<br>December<br>2013<br>£bn | Change  |
|--|------------------------|-------------------------|---------|-------------------------------|---------|
| <b>Capital and balance sheet</b>             |                        |                         |         |                               |         |
| Loans and advances to customers (gross)      | 154.9                  | 155.0                   | -       | 159.2                         | (3%)    |
| Loan impairment provisions                   | (6.1)                  | (6.3)                   | (3%)    | (8.4)                         | (27%)   |
| Net loans and advances to customers          | 148.8                  | 148.7                   | -       | 150.8                         | (1%)    |
| Funded assets                                | 160.2                  | 158.8                   | 1%      | 160.2                         | -       |
| Risk elements in lending                     | 9.1                    | 9.2                     | (1%)    | 13.2                          | (31%)   |
| Provision coverage (1)                       | 67%                    | 68%                     | (100bp) | 63%                           | 400bp   |
| Customer deposits                            | 166.7                  | 165.7                   | 1%      | 166.6                         | -       |
| Assets under management (excluding deposits) | 5.3                    | 5.5                     | (4%)    | 5.8                           | (9%)    |
| Loan:deposit ratio (excluding repos)         | 89%                    | 90%                     | (100bp) | 91%                           | (200bp) |
| Total risk-weighted assets                   | 74.7                   | 77.2                    | (3%)    | 81.9                          | (9%)    |

Note:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

### Key points

Personal & Business Banking (PBB) comprises the former UK Retail and business banking elements of former UK Corporate (UK Personal & Business Banking - UK PBB) and Ulster Bank reportable segments. PBB supports individuals in managing their personal and business banking, with a full range of financial services and advice. Through the RBS, NatWest, and Ulster Bank brands, PBB serves over 18 million personal and business customers in the UK and Ireland. Customers can choose how they manage their finances through access to our branches, online banking, fixed and mobile technology and one of the largest ATM networks in the UK and Ireland.



## UK Personal &amp; Business Banking

|                                 | Half year ended       |                       | Quarter ended         |                        |                       |
|---------------------------------|-----------------------|-----------------------|-----------------------|------------------------|-----------------------|
|                                 | 30 June<br>2014<br>£m | 30 June<br>2013<br>£m | 30 June<br>2014<br>£m | 31 March<br>2014<br>£m | 30 June<br>2013<br>£m |
| <b>Income statement</b>         |                       |                       |                       |                        |                       |
| Net interest income             | 2,276                 | 2,200                 | 1,152                 | 1,124                  | 1,118                 |
| Net fees and commissions        | 637                   | 624                   | 304                   | 333                    | 316                   |
| Other non-interest income       | 49                    | 5                     | 43                    | 6                      | 4                     |
| Non-interest income             | 686                   | 629                   | 347                   | 339                    | 320                   |
| Total income                    | 2,962                 | 2,829                 | 1,499                 | 1,463                  | 1,438                 |
| Direct expenses                 |                       |                       |                       |                        |                       |
| - staff costs                   | (451)                 | (469)                 | (226)                 | (225)                  | (235)                 |
| - other costs                   | (225)                 | (200)                 | (95)                  | (130)                  | (96)                  |
| Indirect expenses               | (975)                 | (947)                 | (455)                 | (520)                  | (484)                 |
| Restructuring costs             |                       |                       |                       |                        |                       |
| - direct                        | (6)                   | (70)                  | (6)                   | -                      | (47)                  |
| - indirect                      | (13)                  | (39)                  | (23)                  | 10                     | (22)                  |
| Litigation and conduct costs    | (150)                 | (160)                 | (150)                 | -                      | (160)                 |
| Operating expenses              | (1,820)               | (1,885)               | (955)                 | (865)                  | (1,044)               |
| Profit before impairment losses | 1,142                 | 944                   | 544                   | 598                    | 394                   |
| Impairment losses               | (148)                 | (256)                 | (60)                  | (88)                   | (126)                 |
| Operating profit                | 994                   | 688                   | 484                   | 510                    | 268                   |



## UK Personal &amp; Business Banking

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| <b>Analysis of income by product</b>  |                 |         |               |          |         |
| Personal advances   | 467             | 443     | 232           | 235      | 220     |
| Personal deposits   | 302             | 227     | 160           | 142      | 124     |
| Mortgages   | 1,287           | 1,277   | 649           | 638      | 649     |
| Cards   | 374             | 419     | 176           | 198      | 210     |
| Business banking  | 490             | 481     | 245           | 245      | 247     |
| Other   | 42              | (18)    | 37            | 5        | (12)    |
| Total income  | 2,962           | 2,829   | 1,499         | 1,463    | 1,438   |
| <b>Analysis of impairments by sector</b>  |                 |         |               |          |         |
| Personal advances   | 79              | 84      | 40            | 39       | 49      |
| Mortgages   | 5               | 26      | 4             | 1        | 16      |
| Business banking  | 30              | 87      | 1             | 29       | 37      |
| Cards   | 34              | 59      | 15            | 19       | 24      |
| Total impairment losses   | 148             | 256     | 60            | 88       | 126     |
| <b>Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector</b> |                 |         |               |          |         |
| Personal advances   | 2.1%            | 2.0%    | 2.1%          | 2.0%     | 2.4%    |
| Mortgages   | -               | 0.1%    | -             | -        | 0.1%    |
| Business banking  | 0.4%            | 1.1%    | -             | 0.8%     | 1.0%    |
| Cards   | 1.3%            | 2.1%    | 1.1%          | 1.4%     | 1.7%    |
| Total   | 0.2%            | 0.4%    | 0.2%          | 0.3%     | 0.4%    |

|                    |  |  |  |  |  |
|--------------------|--|--|--|--|--|
| <b>Key metrics</b> |  |  |  |  |  |
|--------------------|--|--|--|--|--|

|                           | Half year ended |         | Quarter ended  |          |         |
|---------------------------|-----------------|---------|----------------|----------|---------|
|                           | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|                           | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |                |          |         |
| Return on equity (1)      | <b>25.7%</b>    | 16.4%   | <b>25.3%</b>   | 26.0%    | 12.8%   |
| Net interest margin       | <b>3.62%</b>    | 3.50%   | <b>3.64%</b>   | 3.61%    | 3.56%   |
| Cost:income ratio         | <b>61%</b>      | 67%     | <b>64%</b>     | 59%      | 73%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

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## UK Personal &amp; Business Banking

|  | 30 June<br>2014<br>£bn | 31 March<br>2014<br>£bn | Change | 31<br>December<br>2013<br>£bn | Change |
|--|------------------------|-------------------------|--------|-------------------------------|--------|
| <b>Capital and balance sheet</b>             |                        |                         |        |                               |        |
| Loans and advances to customers (gross)      |                        |                         |        |                               |        |
| - personal advances                          | 7.5                    | 7.9                     | (5%)   | 8.1                           | (7%)   |
| - mortgages                                  | 101.8                  | 100.4                   | 1%     | 99.3                          | 3%     |
| - business                                   | 14.6                   | 14.6                    | -      | 14.6                          | -      |
| - cards                                      | 5.3                    | 5.5                     | (4%)   | 5.8                           | (9%)   |
|  | 129.2                  | 128.4                   | 1%     | 127.8                         | 1%     |
| Loan impairment provisions                   | (2.8)                  | (2.9)                   | (3%)   | (3.0)                         | (7%)   |
| Net loans and advances to customers          | 126.4                  | 125.5                   | 1%     | 124.8                         | 1%     |
| Funded assets                                | 133.6                  | 132.8                   | 1%     | 132.2                         | 1%     |
| Risk elements in lending                     | 4.2                    | 4.5                     | (7%)   | 4.7                           | (11%)  |
| Provision coverage (1)                       | 66%                    | 65%                     | 100bp  | 63%                           | 300bp  |
| Customer deposits                            |                        |                         |        |                               |        |
| - personal current accounts                  | 34.2                   | 33.8                    | 1%     | 32.5                          | 5%     |
| - personal savings                           | 80.9                   | 81.1                    | -      | 82.3                          | (2%)   |
| - business/commercial                        | 30.9                   | 29.7                    | 4%     | 30.1                          | 3%     |
| Total customer deposits                      | 146.0                  | 144.6                   | 1%     | 144.9                         | 1%     |
| Assets under management (excluding deposits) | 5.3                    | 5.5                     | (4%)   | 5.8                           | (9%)   |
| Loan:deposit ratio (excluding repos)         | 87%                    | 87%                     | -      | 86%                           | 100bp  |
| Risk-weighted assets (2)                     |                        |                         |        |                               |        |
| - Credit risk (non-counterparty)             | 37.5                   | 39.0                    | (4%)   | 41.4                          | (9%)   |
| - Operational risk                           | 9.5                    | 9.5                     | -      | 9.8                           | (3%)   |

|                            |             |      |      |      |      |
|----------------------------|-------------|------|------|------|------|
| Total risk-weighted assets | <b>47.0</b> | 48.5 | (3%) | 51.2 | (8%) |
|----------------------------|-------------|------|------|------|------|

## Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

## UK Personal & Business Banking

### Key points

The strategic goal of UK PBB is to become the number one personal and business bank for customer trust and advocacy in the UK. To support this, investment of over £1 billion is planned between 2014 and 2017. Through to the end of June 2014 these initiatives included:

Further enhancements to the customer experience were introduced to UK PBB's mobile and digital services. The business currently has more than 5.5 million online users, and 2.8 million customers now using its mobile application, transacting more than £10 billion in digital payments on an annual basis.

UK PBB continued its branch refurbishment programme and completed the roll-out of WiFi across the branch network and expanded its ATM network to include increased presence at shopping centres and train stations across the UK.

UK PBB continued to focus on streamlining processes offering pre-approved loans through online banking and allowing mortgage customers to service their accounts online. We are moving further towards our goal of responding intelligently to each individual customer via their channel of choice.

In line with UK PBB's goal of responsible lending, we introduced the new Clear Rate Credit card in March 2014 ending zero percent balance transfer deals that then revert to higher rates when the deal expires. This product is designed specifically for those customers that want to control and reduce their debt over time without the need to move their balance from card to card or remember when their introductory offer comes to an end.

The CashBack Plus scheme, which rewards personal debit card users through selected retailers, was launched in August 2013 and continued to expand, with more than 1.2 million customers now registered. In February 2014, CashBack Plus won 'Best Card Benefits Programme' at the annual Cards and Payments awards.

Business Banking is the number one business banking franchise in the UK, with a 23% current account market share. The bank's share of business start-ups increased by 2 percentage points to 24% in the 6 months to June with strong gross new lending over the same period. Net promoter scores improved in the relationship-managed space and UK PBB believes that bringing together Personal and Business banking will enable it to more ably satisfy customer needs.

## H1 2014 compared with H1 2013

Operating profit increased by 44% to £994 million, with restructuring costs down £90 million to £19 million. Operating profit, excluding restructuring, litigation and conduct costs of £169 million (H1 2013 - £269 million) increased by 22% to £1,163 million, driven by income growth of 5% and a 42% decline in impairment losses.

Net interest income increased by 3% to £2,276 million, driven by strong deposit growth of 4%, improved margins, and increased personal mortgage balances, up 4%, partly offset by lower income from unsecured lending.

Non-interest income increased by 9%, to £686 million, primarily driven by higher current account-related fee income and higher insurance profit share. Debit card transactional spend increased by 8%, supported by the CashBack Plus programme.

## UK Personal & Business Banking

### Key points (continued)

#### H1 2014 compared with H1 2013 (continued)

Direct costs were up 1% at £676 million, with higher customer compensation and marketing costs only partly offset by a decrease in staff costs driven by lower headcount. Indirect costs were 3% higher at £975 million, reflecting a technology write-off in Q1 2014 of £60 million.

Impairments were £108 million lower due to improved asset quality and lower default volumes.

Risk-weighted assets decreased by 10%, reflecting improvements in the quality of the book and business model enhancements, partly offset by mortgage balance growth.

#### Q2 2014 compared with Q1 2014

Operating profit decreased by 5% to £484 million, reflecting additional conduct costs of £150 million for Payment Protection Insurance redress. Operating profit, excluding restructuring, litigation and conduct costs of £179 million (Q1 2014 – (£10) million) increased by 33% to £663 million, driven by income growth of 2% and lower costs (down 11%). Impairments also continued to improve.

Net interest income increased by 2% to £1,152 million, primarily due to improved deposit income from increased balances and margins. Strong mortgage balance growth of £1.4 billion (gross new business lending market share was 10%) was offset by modest pressure on mortgage margins.

Non-interest income increased by 2% to £347 million, largely due to higher insurance profit share. Card transaction-related fee income improved with transaction levels up 6%.

Direct costs decreased by 10% to £321 million driven by a remediation provision of £15 million in Q1 2014. Indirect costs declined by 13% to £455 million.

Impairments were £28 million lower due to lower customer defaults across all products, reflecting continued improvement in asset quality. Recoveries across personal and business banking continued to improve.

Risk-weighted assets decreased by 3%, reflecting personal unsecured balance reductions partly offset by mortgage balance growth.

#### Q2 2014 compared with Q2 2013

Operating profit increased by 81% to £484 million, with restructuring, litigation and conduct costs down £50 million to £179 million. Operating profit, excluding restructuring, litigation and conduct costs of £179 million (Q2 2013 - £229 million) increased by 33% to £663 million, with income up 4% and operating expenses, excluding restructuring and litigation and conduct costs, down 5%. Impairments also improved, halving to £60 million.

Net interest income increased by 3% to £1,152 million, driven by strong deposit income with balance growth of 4% and improved margins.

Non-interest income increased by 8% to £347 million, benefiting from higher current account-related fee income and higher insurance profit share.

Direct costs of £321 million were 3% lower, with staff cost benefits from lower headcount. Indirect costs were down 6%.

Impairments decreased by 52%, to £60 million, reflecting improvements in the quality of the book and continued strong recoveries across UK PBB.



**Ulster Bank**

|                                 | Half year ended       |                       | Quarter ended         |                        |                       |
|---------------------------------|-----------------------|-----------------------|-----------------------|------------------------|-----------------------|
|                                 | 30 June<br>2014<br>£m | 30 June<br>2013<br>£m | 30 June<br>2014<br>£m | 31 March<br>2014<br>£m | 30 June<br>2013<br>£m |
| <b>Income statement</b>         |                       |                       |                       |                        |                       |
| Net interest income             | 323                   | 302                   | 169                   | 154                    | 152                   |
| Net fees and commissions        | 66                    | 69                    | 34                    | 32                     | 35                    |
| Other non-interest income       | 23                    | 73                    | 8                     | 15                     | 53                    |
| Non-interest income             | 89                    | 142                   | 42                    | 47                     | 88                    |
| Total income                    | 412                   | 444                   | 211                   | 201                    | 240                   |
| Direct expenses                 |                       |                       |                       |                        |                       |
| - staff costs                   | (125)                 | (124)                 | (62)                  | (63)                   | (67)                  |
| - other costs                   | (35)                  | (27)                  | (18)                  | (17)                   | (12)                  |
| Indirect expenses               | (126)                 | (125)                 | (63)                  | (63)                   | (65)                  |
| Restructuring costs             |                       |                       |                       |                        |                       |
| - direct                        | 8                     | (15)                  | 8                     | -                      | (14)                  |
| - indirect                      | (22)                  | (6)                   | (20)                  | (2)                    | (4)                   |
| Litigation and conduct costs    | -                     | (25)                  | -                     | -                      | (25)                  |
| Operating expenses              | (300)                 | (322)                 | (155)                 | (145)                  | (187)                 |
| Profit before impairment losses | 112                   | 122                   | 56                    | 56                     | 53                    |
| Impairment losses               | (57)                  | (503)                 | (10)                  | (47)                   | (263)                 |
| Operating profit/(loss)         | 55                    | (381)                 | 46                    | 9                      | (210)                 |

## Ulster Bank

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| <b>Analysis of income by business</b>   |                 |         |               |          |         |
| Corporate   | 134             | 170     | 65            | 69       | 88      |
| Retail  | 190             | 209     | 100           | 90       | 120     |
| Other   | 88              | 65      | 46            | 42       | 32      |
| Total income  | 412             | 444     | 211           | 201      | 240     |
| <b>Analysis of impairments by sector</b>  |                 |         |               |          |         |
| Mortgages   | 35              | 181     | 16            | 19       | 91      |
| Commercial real estate  |                 |         |               |          |         |
| - investment  | 9               | 97      | 1             | 8        | 51      |
| - development   | (6)             | 26      | (3)           | (3)      | 12      |
| Other corporate   | 8               | 186     | (9)           | 17       | 111     |
| Other lending   | 11              | 13      | 5             | 6        | (2)     |
| Total impairment losses   | 57              | 503     | 10            | 47       | 263     |
| <b>Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector</b> |                 |         |               |          |         |
| Mortgages   | 0.4%            | 1.8%    | 0.4%          | 0.4%     | 1.8%    |
| Commercial real estate  |                 |         |               |          |         |
| - investment  | 1.8%            | 5.4%    | 0.4%          | 3.2%     | 5.7%    |
| - development   | (3.0%)          | 7.4%    | (3.0%)        | (3.0%)   | 6.9%    |
| Other corporate   | 0.3%            | 5.0%    | (0.7%)        | 1.3%     | 5.9%    |
| Other lending   | 2.2%            | 2.0%    | 2.0%          | 2.4%     | (0.6%)  |
| Total   | 0.4%            | 3.1%    | 0.2%          | 0.7%     | 3.2%    |

| <b>Key metrics</b>        |                 |         |                |          |         |
|---------------------------|-----------------|---------|----------------|----------|---------|
|                           | Half year ended |         | Quarter ended  |          |         |
|                           | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|                           | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |                |          |         |
| Return on equity (1)      | <b>2.7%</b>     | (14.9%) | <b>4.6%</b>    | 0.9%     | (16.8%) |
| Net interest margin       | <b>2.32%</b>    | 1.82%   | <b>2.35%</b>   | 2.29%    | 1.84%   |
| Cost:income ratio         | <b>73%</b>      | 73%     | <b>73%</b>     | 72%      | 78%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

## Ulster Bank

|   | 30 June<br>2014<br>£bn | 31 March<br>2014<br>£bn | Change  | 31<br>December<br>2013<br>£bn | Change    |
|---|------------------------|-------------------------|---------|-------------------------------|-----------|
| <b>Capital and balance sheet</b>        |                        |                         |         |                               |           |
| Loans and advances to customers (gross) |                        |                         |         |                               |           |
| Mortgages                               | 18.1                   | 18.8                    | (4%)    | 19.0                          | (5%)      |
| Commercial real estate                  |                        |                         |         |                               |           |
| - investment                            | 1.0                    | 1.0                     | -       | 3.4                           | (71%)     |
| - development                           | 0.4                    | 0.4                     | -       | 0.7                           | (43%)     |
| Other corporate                         | 5.2                    | 5.4                     | (4%)    | 7.1                           | (27%)     |
| Other lending                           | 1.0                    | 1.0                     | -       | 1.2                           | (17%)     |
|   | 25.7                   | 26.6                    | (3%)    | 31.4                          | (18%)     |
| Loan impairment provisions              | (3.3)                  | (3.4)                   | (3%)    | (5.4)                         | (39%)     |
| Net loans and advances to customers     | 22.4                   | 23.2                    | (3%)    | 26.0                          | (14%)     |
| Funded assets                           | 26.6                   | 26.0                    | 2%      | 28.0                          | (5%)      |
| Risk elements in lending                |                        |                         |         |                               |           |
| - Mortgages                             | 3.3                    | 3.1                     | 6%      | 3.2                           | 3%        |
| - Commercial real estate                |                        |                         |         |                               |           |
| - investment                            | 0.3                    | 0.3                     | -       | 2.3                           | (87%)     |
| - development                           | 0.2                    | 0.2                     | -       | 0.5                           | (60%)     |
| - Other corporate                       | 0.9                    | 0.9                     | -       | 2.3                           | (61%)     |
| - Other lending                         | 0.2                    | 0.2                     | -       | 0.2                           | -         |
| Total risk elements in lending          | 4.9                    | 4.7                     | 4%      | 8.5                           | (42%)     |
| Provision coverage (1)                  | 68%                    | 72%                     | (400bp) | 64%                           | 400bp     |
| Customer deposits                       | 20.7                   | 21.1                    | (2%)    | 21.7                          | (5%)      |
| Loan:deposit ratio (excluding repos)    | 108%                   | 110%                    | (200bp) | 120%                          | (1,200bp) |
| Risk-weighted assets (2)                |                        |                         |         |                               |           |
| - Credit risk                           |                        |                         |         |                               |           |

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|                          |             |      |       |  |      |       |
|--------------------------|-------------|------|-------|--|------|-------|
| - non-counterparty       | <b>26.0</b> | 26.7 | (3%)  |  | 28.2 | (8%)  |
| - counterparty           | <b>0.1</b>  | 0.3  | (67%) |  | 0.3  | (67%) |
| - Market risk            | <b>0.1</b>  | 0.2  | (50%) |  | 0.5  | (80%) |
| - Operational risk       | <b>1.5</b>  | 1.5  | -     |  | 1.7  | (12%) |
|                          |             |      |       |  |      |       |
| Risk-weighted assets     | <b>27.7</b> | 28.7 | (3%)  |  | 30.7 | (10%) |
|                          |             |      |       |  |      |       |
| Spot exchange rate - €/£ | <b>1.25</b> | 1.21 |       |  | 1.20 |       |

Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

## Ulster Bank

### Key points

Ulster Bank returned to profitability in H1 2014, the first half-yearly profit recorded since 2008. The macroeconomic environment across the island of Ireland has stabilised considerably but trading conditions continue to be volatile and the regulatory environment remains challenging.

### Key financial highlights:

The transfer of assets to RCR coupled with the benefits of the investment in programmes to support customers in financial difficulty has driven a significant reduction in impairment losses.

Lending activity has increased in 2014, albeit repayments continue to exceed new lending.

Net interest margin has improved reflecting a strong focus on reducing the overall cost of funding for Ulster Bank.

Tight management of expenses remains a key priority; however the investment required to address legacy issues remains significant.

The right-sizing of the branch network and rationalising of the property footprint is progressing.

The number of mortgage customers more than 90 days in arrears has declined in each of the last 15 months, a trend not seen elsewhere in the market. This reflects the investment made to support customers in financial difficulty.

### Further progress was made in H1 2014 to make it simple and easy for customers to do business:

There has been a significant increase in new lending activity following the launch of the big YES mortgage campaign and 'Ahead for Business' campaign. New mortgage lending increased by 44% compared with the same period in 2013 while over £650 million of new lending has been made available to business customers.

Customers have continued to move towards direct channels with 86% of all activity now outside the traditional branch.

The separation of Ulster Bank batch processing from NatWest and RBS brands was successfully delivered in H1 2014. This significantly reduces the risk of disruption to customers.

The creation of RCR resulted in the net transfer of £4.4 billion of gross assets to RCR on 1 January 2014. This has had a significant impact on the comparison of 2014 financial performance with that reported in 2013.

### **H1 2014 compared with H1 2013**

Ulster Bank posted an operating profit of £55 million for H1 2014, compared with a loss of £381 million in H1 2013, with the improvement primarily driven by a significant reduction in impairment losses across all portfolios. Operating profit, excluding restructuring, litigation and conduct costs of £14 million (H1 2013 - £46 million) was £69 million for H1 2014, compared with a loss of £335 million for H1 2013.

Net interest margin increased by 50 basis points to 2.32% primarily reflecting a significant reduction in deposit pricing coupled with the impact of the transfer of underperforming assets to RCR. Net interest income increased by £21 million with the benefit of deposit repricing partly offset by lower income on the tracker mortgage book following reductions in the European Central Bank refinancing interest rate.

Non-interest income decreased by £53 million primarily due to a favourable mark-to-market movement of £36 million on economic hedges on the mortgage portfolio in H1 2013 as well as the impact of the asset transfer to RCR.

## Ulster Bank

### Key points (continued)

#### H1 2014 compared with H1 2013 (continued)

Operating expenses decreased by £22 million reflecting lower headcount and a £32 million reduction in restructuring, litigation and conduct costs, only partly offset by the impact of a cost realignment following the creation of RCR, £22 million, and the introduction of the new bank levy in the Republic of Ireland, £8 million.

Impairment losses decreased by £446 million or 89% with reductions across all portfolios. This reflects further de-risking of the balance sheet following the transfer of underperforming assets to RCR and the benefit of the ongoing reduction in mortgage arrears.

The loan:deposit ratio of 108% improved by 12 percentage points during H1 2014, largely reflecting the impact of the transfer of loan balances to RCR.

#### Q2 2014 compared with Q1 2014

Operating profit increased by £37 million to £46 million driven by higher income and a further reduction in impairment losses, partly offset by higher restructuring costs. Operating profit, excluding restructuring, litigation and conduct costs of £12 million (Q1 2014 - £2 million) was up £47 million to £58 million.

Total income increased by £10 million to £211 million. Net interest income increased by £15 million, to £169 million, reflecting lower funding costs and the recognition of interest income on previously non-performing assets. Net interest margin increased by 6 basis points to 2.35%.

Operating expenses, excluding restructuring costs of £12 million, remained stable. Restructuring costs increased by £10 million as Ulster Bank continued to adjust its property footprint. The cost:income ratio, excluding restructuring, litigation and conduct costs of £12 million (Q1 2014 - £2 million) improved by 3 percentage points to 68% driven by higher income.

Impairment losses decreased by £37 million largely due to the release of a provision on a segment of the corporate portfolio. Within the mortgage portfolio, a change to the treatment of arrears capitalisations led to a 6% increase in risk elements in lending and a shift in the provisioning of these cases from latent to collective. This, coupled with improving credit metrics, contributed to a £102 million latent provision release in Q2.

Loan:deposit ratio improved from 110% to 108%.



## Q2 2014 compared with Q2 2013

A significant reduction in impairment losses was the key driver of the £256 million improvement in operating profit. Operating profit, excluding restructuring, litigation and conduct costs of £12 million (Q2 2013 - £43 million) was up £225 million to £58 million.

Total income decreased by £29 million primarily due to a number of substantial one-off gains in Q2 2013 in non-interest income. Net interest income increased by £17 million to £169 million largely driven by initiatives to reduce Ulster bank's funding costs. Net interest margin increased by 51 basis points reflecting improved deposit margins coupled with the impact of the asset transfer to RCR.

Operating expenses reduced by £32 million largely due to a reduction in litigation and conduct costs. Excluding restructuring, litigation and conduct costs of £12 million (Q2 2013 - £43 million), operating expenses were flat with the benefit of lower headcount offset by the cost realignment following the creation of RCR, £11 million, and the introduction of the new bank levy in the Republic of Ireland, £4 million.

Impairment losses improved by £253 million or 96%, reflecting stronger credit metrics across all portfolios.

## Commercial &amp; Private Banking

|                                 | Half year ended |         | Quarter ended |          |         |
|---------------------------------|-----------------|---------|---------------|----------|---------|
|                                 | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                 | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                 | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>         |                 |         |               |          |         |
| Net interest income             | 1,343           | 1,253   | 685           | 658      | 643     |
| Net fees and commissions        | 620             | 657     | 311           | 309      | 334     |
| Other non-interest income       | 150             | 170     | 74            | 76       | 101     |
| Non-interest income             | 770             | 827     | 385           | 385      | 435     |
| Total income                    | 2,113           | 2,080   | 1,070         | 1,043    | 1,078   |
| Direct expenses                 |                 |         |               |          |         |
| - staff                         | (426)           | (427)   | (213)         | (213)    | (215)   |
| - other                         | (155)           | (175)   | (74)          | (81)     | (94)    |
| Indirect expenses               | (606)           | (629)   | (293)         | (313)    | (317)   |
| Restructuring costs             |                 |         |               |          |         |
| - direct                        | (42)            | (15)    | (42)          | -        | (8)     |
| - indirect                      | (23)            | (19)    | (22)          | (1)      | (11)    |
| Litigation and conduct costs    | (50)            | (25)    | (50)          | -        | -       |
| Operating expenses              | (1,302)         | (1,290) | (694)         | (608)    | (645)   |
| Profit before impairment losses | 811             | 790     | 376           | 435      | 433     |
| Impairment (losses)/recoveries  | (31)            | (289)   | 8             | (39)     | (157)   |
| Operating profit                | 780             | 501     | 384           | 396      | 276     |

| <b>Key metrics</b>        |                 |         |               |          |         |
|---------------------------|-----------------|---------|---------------|----------|---------|
|                           | Half year ended |         | Quarter ended |          |         |
|                           | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                           | 2014            | 2013    | 2014          | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |               |          |         |

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|                      |              |       |              |       |       |
|----------------------|--------------|-------|--------------|-------|-------|
| Return on equity (1) | <b>12.9%</b> | 7.8%  | <b>12.8%</b> | 13.1% | 8.6%  |
| Net interest margin  | <b>2.90%</b> | 2.69% | <b>2.91%</b> | 2.89% | 2.77% |
| Cost:income ratio    | <b>62%</b>   | 62%   | <b>65%</b>   | 58%   | 60%   |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

## Commercial & Private Banking

|   | 30 June | 31 March |         | 31       |        |
|---|---------|----------|---------|----------|--------|
|   | 2014    | 2014     |         | December |        |
|   | £bn     | £bn      | Change  | 2013     | Change |
|   |         |          |         | £bn      |        |
| <b>Capital and balance sheet</b>          |         |          |         |          |        |
| Loans and advances to customers (gross)   | 101.7   | 103.0    | (1%)    | 101.8    | -      |
| Loan impairment provisions                | (1.3)   | (1.4)    | (7%)    | (1.6)    | (19%)  |
| Net loans and advances to customers       | 100.4   | 101.6    | (1%)    | 100.2    | -      |
| Funded assets                             | 109.4   | 110.7    | (1%)    | 108.9    | -      |
| Assets under management (Private Banking) | 28.7    | 28.5     | 1%      | 29.7     | (3%)   |
| Risk elements in lending                  | 3.1     | 3.7      | (16%)   | 4.6      | (33%)  |
| Provision coverage (1)                    | 40%     | 38%      | 200bp   | 38%      | 200bp  |
| Customer deposits (excluding repos)       | 123.9   | 124.2    | -       | 127.9    | (3%)   |
| Loan:deposit ratio                        | 81%     | 82%      | (100bp) | 78%      | 300bp  |
| Risk-weighted assets (2)                  |         |          |         |          |        |
| - Credit risk                             |         |          |         |          |        |
| - non-counterparty                        | 66.3    | 67.2     | (1%)    | 69.7     | (5%)   |
| - counterparty                            | 0.1     | -        | -       | -        | -      |
| - Market risk                             | 0.1     | -        | -       | 0.1      | -      |
| - Operational risk                        | 8.3     | 8.3      | -       | 8.0      | 4%     |
|   | 74.8    | 75.5     | (1%)    | 77.8     | (4%)   |

Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

## Key points

Highlights

Commercial & Private Banking comprises parts of the former UK Corporate, Wealth and International Banking divisions. It is committed to supporting the bank's ambition to be the number one bank for customer service, trust and advocacy in its chosen markets by 2020. Commercial Banking's customers range from UK businesses with an annual turnover of £2 million up to large UK corporations, including real estate and institutional customers. Aligning the Private Banking business with Commercial Banking will enable the bank to better serve and connect those who own and run businesses.

With a set of strong brands including NatWest, Lombard, Coutts and Adam & Company, the Commercial & Private Banking business provides its customers with dedicated relationship management and access to sophisticated products and services including lending, speciality finance, transaction banking, risk management and wealth management.

During the remainder of 2014, the Private Banking and Commercial Banking teams will continue to join forces to increase business in the UK.

## Commercial Banking

|                                 | Half year ended |         | Quarter ended |          |         |
|---------------------------------|-----------------|---------|---------------|----------|---------|
|                                 | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                 | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                 | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>         |                 |         |               |          |         |
| Net interest income             | <b>999</b>      | 936     | <b>511</b>    | 488      | 484     |
| Net fees and commissions        | <b>448</b>      | 477     | <b>227</b>    | 221      | 243     |
| Other non-interest income       | <b>121</b>      | 136     | <b>60</b>     | 61       | 82      |
| Non-interest income             | <b>569</b>      | 613     | <b>287</b>    | 282      | 325     |
| Total income                    | <b>1,568</b>    | 1,549   | <b>798</b>    | 770      | 809     |
| Direct expenses                 |                 |         |               |          |         |
| - staff                         | <b>(267)</b>    | (254)   | <b>(134)</b>  | (133)    | (127)   |
| - other                         | <b>(122)</b>    | (145)   | <b>(59)</b>   | (63)     | (77)    |
| Indirect expenses               | <b>(401)</b>    | (401)   | <b>(189)</b>  | (212)    | (205)   |
| Restructuring costs             |                 |         |               |          |         |
| - direct                        | <b>(40)</b>     | (14)    | <b>(40)</b>   | -        | (7)     |
| - indirect                      | <b>(22)</b>     | (15)    | <b>(21)</b>   | (1)      | (9)     |
| Litigation and conduct costs    | <b>(50)</b>     | (25)    | <b>(50)</b>   | -        | -       |
| Operating expenses              | <b>(902)</b>    | (854)   | <b>(493)</b>  | (409)    | (425)   |
| Profit before impairment losses | <b>666</b>      | 695     | <b>305</b>    | 361      | 384     |
| Impairment (losses)/recoveries  | <b>(31)</b>     | (282)   | <b>9</b>      | (40)     | (155)   |
| Operating profit                | <b>635</b>      | 413     | <b>314</b>    | 321      | 229     |

## Commercial Banking

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| <b>Analysis of income by business</b>   |                 |         |               |          |         |
| Commercial lending  | 894             | 962     | 448           | 446      | 501     |
| Deposits  | 153             | 88      | 81            | 72       | 50      |
| Asset and invoice finance   | 366             | 334     | 186           | 180      | 170     |
| Other   | 155             | 165     | 83            | 72       | 88      |
| Total income  | 1,568           | 1,549   | 798           | 770      | 809     |
| <b>Analysis of impairments by sector</b>  |                 |         |               |          |         |
| Commercial real estate  | (6)             | 162     | (17)          | 11       | 100     |
| Asset and invoice finance   | 2               | 6       | -             | 2        | 5       |
| Private sector education, health, social work,<br>recreational and community services | (10)            | 63      | -             | (10)     | 40      |
| Banks & financial institutions  | 1               | 2       | (1)           | 2        | -       |
| Wholesale and retail trade repairs  | 14              | 3       | 2             | 12       | (4)     |
| Hotels and restaurants  | (1)             | 19      | (4)           | 3        | 8       |
| Manufacturing   | 7               | (4)     | 4             | 3        | (5)     |
| Construction  | 4               | (1)     | 2             | 2        | (4)     |
| Other   | 20              | 32      | 5             | 15       | 15      |
|   | 31              | 282     | (9)           | 40       | 155     |
| <b>Loan impairment charge as % of gross customer loans and advances by sector</b>     |                 |         |               |          |         |
| Commercial real estate  | (0.1%)          | 1.5%    | (0.4%)        | 0.2%     | 1.8%    |
| Asset and invoice finance   | -               | 0.1%    | -             | 0.1%     | 0.2%    |
| Private sector education, health, social work,<br>recreational and community services | (0.3%)          | 1.6%    | -             | (0.5%)   | 2.1%    |
| Banks & financial institutions  | -               | 0.1%    | (0.1%)        | 0.1%     | -       |

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|                                    |               |        |               |      |        |
|------------------------------------|---------------|--------|---------------|------|--------|
| Wholesale and retail trade repairs | <b>0.5%</b>   | 0.1%   | <b>0.1%</b>   | 0.8% | (0.3%) |
| Hotels and restaurants             | <b>(0.1%)</b> | 0.9%   | <b>(0.5%)</b> | 0.3% | 0.7%   |
| Manufacturing                      | <b>0.4%</b>   | (0.2%) | <b>0.4%</b>   | 0.3% | (0.5%) |
| Construction                       | <b>0.4%</b>   | (0.1%) | <b>0.4%</b>   | 0.4% | (0.7%) |
| Other                              | <b>0.2%</b>   | 0.3%   | <b>0.1%</b>   | 0.3% | 0.3%   |
|                                    |               |        |               |      |        |
| Total                              | <b>0.1%</b>   | 0.7%   | -             | 0.2% | 0.7%   |

| <b>Key metrics</b>        | Half year ended |         | Quarter ended  |          |         |
|---------------------------|-----------------|---------|----------------|----------|---------|
|                           | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|                           | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |                |          |         |
| Return on equity (1)      | <b>12.5%</b>    | 7.6%    | <b>12.4%</b>   | 12.6%    | 8.5%    |
| Net interest margin       | <b>2.70%</b>    | 2.53%   | <b>2.73%</b>   | 2.68%    | 2.63%   |
| Cost:income ratio         | <b>58%</b>      | 55%     | <b>62%</b>     | 53%      | 53%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).



## Commercial Banking

|  | 30 June | 31 March |         | 31       |        |
|--|---------|----------|---------|----------|--------|
|  | 2014    | 2014     |         | December |        |
|  | £bn     | £bn      | Change  | 2013     | Change |
|  |         |          |         | £bn      |        |
| <b>Capital and balance sheet</b>                 |         |          |         |          |        |
| Loans and advances to customers (gross)          |         |          |         |          |        |
| - Commercial real estate                         | 18.8    | 19.0     | (1%)    | 20.2     | (7%)   |
| - Asset and invoice finance                      | 13.7    | 13.6     | 1%      | 11.7     | 17%    |
| - Private sector education, health, social work, |         |          |         |          |        |
| recreational and community services              | 7.2     | 7.5      | (4%)    | 7.9      | (9%)   |
| - Banks & financial institutions                 | 6.9     | 7.3      | (5%)    | 6.9      | -      |
| - Wholesale and retail trade repairs             | 5.9     | 6.0      | (2%)    | 5.8      | 2%     |
| - Hotels and restaurants                         | 3.3     | 3.6      | (8%)    | 3.6      | (8%)   |
| - Manufacturing                                  | 3.9     | 3.7      | 5%      | 3.7      | 5%     |
| - Construction                                   | 2.0     | 2.1      | (5%)    | 2.1      | (5%)   |
| - Other  | 23.4    | 23.4     | -       | 23.1     | 1%     |
|  | 85.1    | 86.2     | (1%)    | 85.0     | -      |
| Loan impairment provisions                       | (1.2)   | (1.3)    | (8%)    | (1.5)    | (20%)  |
| Net loans and advances to customers              | 83.9    | 84.9     | (1%)    | 83.5     | 0%     |
| Funded assets                                    | 88.6    | 89.6     | (1%)    | 87.9     | 1%     |
| Risk elements in lending                         | 2.9     | 3.4      | (15%)   | 4.3      | (33%)  |
| Provision coverage (1)                           | 41%     | 37%      | 400bp   | 38%      | 300bp  |
| Customer deposits (excluding repos)              | 88.0    | 87.6     | -       | 90.7     | (3%)   |
| Loan:deposit ratio                               | 95%     | 97%      | (200bp) | 92%      | 300bp  |
| Risk-weighted assets (2)                         |         |          |         |          |        |
| - Credit risk (non-counterparty)                 | 56.6    | 57.1     | (1%)    | 59.7     | (5%)   |
| - Operational risk                               | 6.4     | 6.4      | -       | 6.1      | 5%     |
|  | 63.0    | 63.5     | (1%)    | 65.8     | (4%)   |

Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

### Key points

During the first half of 2014, the Commercial Banking business has been reshaped to meet the needs of its customers in the most efficient way. Complexity and costs are targeted to decline, with lower staff levels, predominantly in non-customer-facing departments, supported by focused investment aimed at making it easier for customers to do business:

Over 40 additional experienced relationship managers have been allocated to serve Commercial Banking customers, with a central focus on lending.

Lending procedures are changing to speed up the process and to meet the business's commitment to make all but the most complex loan decisions within five days by the end of 2014.

A new online loan application facility for smaller business customers was launched in February 2014, which will be extended to larger SMEs over the course of 2014.

Two-thirds of lending decisions are now made locally.

60% of Relationship Managers have now completed an accreditation programme.

## Commercial Banking

### Key points (continued)

Whilst these changes and investments are being made, Commercial Banking continued to focus on delivering for its customers:

An additional 5,000 customers have received proactive 'Statements of Appetite', bringing the total to over 17,000. Over £7 billion of new or additional funding has now been offered.

The number of complaints from SME customers fell by 7.5% compared to last year.

A positive trend in the Net Promoter Score has been achieved over the last 12 months.

For the sixth consecutive year, Lombard received the Business Moneyfacts award for 'Best Leasing & Asset Finance Provider'.

### H1 2014 compared with H1 2013

Operating profit increased to £635 million delivering a return on equity of 12.5% with lower impairments and higher income more than offsetting increased charges for restructuring, litigation and conduct costs (£58 million). Excluding restructuring costs of £62 million (H1 2013 - £29 million) and conduct costs of £50 million (H1 2013 - £25 million), operating profit increased by £280 million and return on equity was 14.7%.

Net interest income increased by 7% reflecting re-pricing activity, partially offset by reduced yields on current accounts due to the continued low rate environment.

Non-interest income decreased by 7% from lower other income (£56 million), including fees and disposal gains (£27 million), a decline in CIB (Markets) revenue share income (£17 million) partially offset by lower costs arising from closing out interest rate hedging products associated with impaired loans (£30 million).

Operating expenses increased by £48 million from higher restructuring and conduct related costs (£58 million), including interest rate swap redress, up £25 million, partially offset by direct costs down £10 million as cost saving initiatives start to take effect.

Impairments were down £251 million reflecting fewer individual cases across the portfolio, primarily in mid to large corporate and latent provision releases of £58 million, as credit conditions improved in Q2 2014.

The loan:deposit ratio increased by 200 basis points to 95%, primarily a result of reduced deposits, down 3%, reflecting the rebalancing of the Bank's liquidity position.

Risk-weighted assets were £2.8 billion lower reflecting the net movement of transfers to RCR and from Non-Core, effective from 1 January 2014.

## **Q2 2014 compared with Q1 2014**

Operating profit declined by 2% as increased income and lower impairments were more than offset by higher restructuring, litigation and conduct costs. Excluding these costs of £111 million (Q1 2014 - £1 million), operating profit increased by £103 million.

Net interest income increased by 5% from margin expansion on deposits and the benefit of an additional day in the quarter.

Non-interest income increased by 2% primarily from improved transaction services income £7 million, with stable income from asset finance, CIB revenue share and other lending fees.

Operating expenses, up 21%, were impacted by £61 million of restructuring costs in the quarter, as the business aligns itself to better support its customers, and included a £50 million charge for interest rate swap redress. Operating expenses, excluding restructuring and litigation and conduct costs of £111 million (Q1 2014 - £1 million), decreased by 6% due to operational cost saving initiatives.

## Commercial Banking

### Key points (continued)

#### Q2 2014 compared with Q1 2014 (continued)

Impairments declined by £49 million primarily from a release of latent provisions of £58 million as credit conditions improved.

The loan:deposit ratio declined by 200 basis points from a 1% decline in asset volumes, most of which was in the mid to large corporate business.

Risk-weighted assets decreased by 1% primarily due to balance sheet movements.

#### Q2 2014 compared with Q2 2013

Operating profit improved by £85 million, driven by lower impairments partially offset by higher restructuring, litigation and conduct charges.

Net interest income increased by 6% in line with the half year trends noted above. Improved margins from re-pricing activity offset lower yields due to the continued low interest rate environment.

Non-interest income decreased by 12% from lower CIB (Markets) revenue share and gains from equity disposals partially offset by the reduced close out charges on interest rate hedging products as noted above.

Operating expenses were up reflecting increased restructuring, litigation and conduct costs in Q2 2014, which were partially offset by lower direct and indirect costs.

Impairments decreased by £164 million reflecting fewer significant individual cases and the latent provisions release in Q2 2014.

## Private Banking

|                                 | Half year ended |         | Quarter ended |          |         |
|---------------------------------|-----------------|---------|---------------|----------|---------|
|                                 | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                 | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                 | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>         |                 |         |               |          |         |
| Net interest income             | 344             | 317     | 174           | 170      | 159     |
| Net fees and commissions        | 172             | 180     | 84            | 88       | 91      |
| Other non-interest income       | 29              | 34      | 14            | 15       | 19      |
| Non-interest income             | 201             | 214     | 98            | 103      | 110     |
| Total income                    | 545             | 531     | 272           | 273      | 269     |
| Direct expenses                 |                 |         |               |          |         |
| - staff                         | (159)           | (173)   | (79)          | (80)     | (88)    |
| - other                         | (33)            | (30)    | (15)          | (18)     | (17)    |
| Indirect expenses               | (205)           | (228)   | (104)         | (101)    | (112)   |
| Restructuring costs             |                 |         |               |          |         |
| - direct                        | (2)             | (1)     | (2)           | -        | (1)     |
| - indirect                      | (1)             | (4)     | (1)           | -        | (2)     |
| Operating expenses              | (400)           | (436)   | (201)         | (199)    | (220)   |
| Profit before impairment losses | 145             | 95      | 71            | 74       | 49      |
| Impairment (losses)/recoveries  | -               | (7)     | (1)           | 1        | (2)     |
| Operating profit                | 145             | 88      | 70            | 75       | 47      |

|                                       | Half year ended |         | Quarter ended |          |         |
|---------------------------------------|-----------------|---------|---------------|----------|---------|
|                                       | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                       | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                       | £m              | £m      | £m            | £m       | £m      |
| <b>Analysis of income by business</b> |                 |         |               |          |         |
| Investments                           | 90              | 97      | 45            | 45       | 49      |

|              |            |     |            |     |     |
|--------------|------------|-----|------------|-----|-----|
| Banking      | <b>455</b> | 434 | <b>227</b> | 228 | 220 |
|              |            |     |            |     |     |
| Total income | <b>545</b> | 531 | <b>272</b> | 273 | 269 |

| <b>Key metrics</b>        | Half year ended |         | Quarter ended  |          |         |
|---------------------------|-----------------|---------|----------------|----------|---------|
|                           | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|                           | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |                |          |         |
| Return on equity (1)      | <b>15.0%</b>    | 8.9%    | <b>14.5%</b>   | 15.3%    | 9.4%    |
| Net interest margin       | <b>3.72%</b>    | 3.33%   | <b>3.73%</b>   | 3.70%    | 3.34%   |
| Cost:income ratio         | <b>73%</b>      | 82%     | <b>74%</b>     | 73%      | 82%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

## Private Banking

|   | 30 June | 31 March |         | 31       |         |
|---|---------|----------|---------|----------|---------|
|   | 2014    | 2014     |         | December |         |
|   | £bn     | £bn      | Change  | 2013     | Change  |
|   |         |          |         | £bn      |         |
| <b>Capital and balance sheet</b>        |         |          |         |          |         |
| Loans and advances to customers (gross) |         |          |         |          |         |
| - personal                              | 5.5     | 5.5      | -       | 5.5      | -       |
| - mortgages                             | 8.7     | 8.7      | -       | 8.7      | -       |
| - other                                 | 2.4     | 2.6      | (8%)    | 2.6      | (8%)    |
|   | 16.6    | 16.8     | (1%)    | 16.8     | (1%)    |
| Loan impairment provisions              | (0.1)   | (0.1)    | -       | (0.1)    | -       |
| Net loans and advances to customers     | 16.5    | 16.7     | (1%)    | 16.7     | (1%)    |
| Funded assets                           | 20.8    | 21.1     | (1%)    | 21.0     | (1%)    |
| Assets under management                 | 28.7    | 28.5     | 1%      | 29.7     | (3%)    |
| Risk elements in lending                | 0.2     | 0.3      | (33%)   | 0.3      | (33%)   |
| Provision coverage (1)                  | 39%     | 45%      | (600bp) | 43%      | (400bp) |
| Customer deposits (excluding repos)     | 35.9    | 36.6     | (2%)    | 37.2     | (3%)    |
| Loan:deposit ratio                      | 46%     | 45%      | 100bp   | 45%      | 100bp   |
| Risk-weighted assets (2)                |         |          |         |          |         |
| - Credit risk                           |         |          |         |          |         |
| - non-counterparty                      | 9.7     | 10.1     | (4%)    | 10.0     | (3%)    |
| - counterparty                          | 0.1     | -        | -       | -        | -       |
| - Market risk                           | 0.1     | -        | -       | 0.1      | -       |
| - Operational risk                      | 1.9     | 1.9      | -       | 1.9      | -       |
|   | 11.8    | 12.0     | (2%)    | 12.0     | (2%)    |

Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Highlights

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(2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

### **Key points**

The Private Banking business continues to invest in expanding its product offering in response to client demand for global, integrated solutions. Enhancements in the first half of 2014 included the introduction of an around-the-clock weekday dealing capability for foreign exchange products, serving Coutts's UK and international client-base.

We are currently reviewing our strategy, focusing on options for our non-UK related activities. The review is expected to complete later in the year.

In the UK, further refinements to Coutts's Retail Distribution Review compliant advice framework have improved efficiency, with total assets under advice now standing at £4.5 billion.

## Private Banking

### Key points (continued)

#### H1 2014 compared with H1 2013

Operating profit was £145 million for the first half of 2014, delivering a return on equity of 15.0%. Excluding restructuring costs of £3 million (H1 2013 - £5 million), operating profit increased by £55 million and the return on equity was 15.3%, driven by improved income, lower operating expenses and lower impairments.

Total income was £14 million, or 3%, higher. Net interest income increased by £27 million due to a combination of improved deposit margins following a re-pricing exercise in the UK and lower treasury charges. Non-interest income declined by £13 million reflecting the impact of adverse foreign exchange movements and lower transactional activity in the international business.

Operating expenses declined by 8% to £400 million. Operating expenses excluding restructuring, litigation and conduct costs of £3 million (H1 2013 - £5 million) were down £34 million, 8%, at £397 million reflecting savings from the streamlining of the property footprint, favourable foreign exchange movements, reduced headcount and the continued management of discretionary costs.

Impairment charges declined by £7 million as a result of fewer specific impairments.

Client assets and liabilities were 7% lower than the previous year, with the decrease in assets under management driven by low margin custody asset outflows, adverse foreign exchange movements, portfolio exits and reduced balances in the UK. Deposits were £3.0 billion lower, largely as a result of re-pricing action in the UK. Lending declined by £0.5 billion as repayments outstripped new lending in the latter part of 2013.

#### Q2 2014 compared with Q1 2014

Operating profit was £70 million for the quarter, £5 million lower, largely as a result of a small increase in impairments and operating expenses, with income broadly flat.

Operating expenses were up £2 million, wholly as a result of increased restructuring costs.

Client assets and liabilities were 1% lower than the prior quarter, wholly driven by a £0.7 billion reduction in deposits following the UK re-pricing exercise and outflows in the international business. Assets under management increased by £0.2 billion due to positive market movements. Lending remained broadly flat.

**Q2 2014 compared with Q2 2013**

Operating profit increased by £23 million benefitting from higher income, lower costs and lower impairments.

Total income was £3 million, 1%, higher. Net interest income rose by £15 million due to improved deposit margins following a re-pricing exercise in the UK and lower treasury charges. Non-interest income declined by £12 million largely as a result of adverse foreign exchange movements and lower transactional activity in the international business.

Operating expenses declined by £19 million reflecting savings from the streamlining of the property footprint, reduced headcount, beneficial foreign exchange movements and the continued tight management of discretionary costs.

## Corporate &amp; Institutional Banking

|  | Half year ended |         | Quarter ended |          |         |
|--|-----------------|---------|---------------|----------|---------|
|  | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|  | 2014            | 2013    | 2014          | 2014     | 2013    |
|  | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>                |                 |         |               |          |         |
| Net interest income                    | 365             | 313     | 186           | 179      | 141     |
| Net fees and commissions               | 490             | 556     | 247           | 243      | 275     |
| Income from trading activities         | 1,482           | 1,753   | 597           | 885      | 787     |
| Other operating income                 | 90              | 86      | 46            | 44       | 33      |
| Non-interest income                    | 2,062           | 2,395   | 890           | 1,172    | 1,095   |
| Total income                           | 2,427           | 2,708   | 1,076         | 1,351    | 1,236   |
| Direct expenses                        |                 |         |               |          |         |
| - staff                                | (488)           | (580)   | (216)         | (272)    | (247)   |
| - other                                | (260)           | (284)   | (147)         | (113)    | (154)   |
| Indirect expenses                      | (1,169)         | (1,325) | (581)         | (588)    | (657)   |
| Restructuring costs                    |                 |         |               |          |         |
| - direct                               | (28)            | (37)    | (13)          | (15)     | (24)    |
| - indirect                             | (163)           | (46)    | (139)         | (24)     | (20)    |
| Litigation and conduct costs           | (50)            | (410)   | (50)          | -        | (385)   |
| Operating expenses                     | (2,158)         | (2,682) | (1,146)       | (1,012)  | (1,487) |
| Profit/(loss) before impairment losses | 269             | 26      | (70)          | 339      | (251)   |
| Impairment recoveries/(losses)         | 39              | (223)   | 45            | (6)      | (144)   |
| Operating profit/(loss)                | 308             | (197)   | (25)          | 333      | (395)   |

|  | Half year ended | Quarter ended |
|--|-----------------|---------------|
|--|-----------------|---------------|

|  | <b>30 June</b> | 30 June | <b>30 June</b> | 31 March | 30 June |
|--|----------------|---------|----------------|----------|---------|
|  | <b>2014</b>    | 2013    | <b>2014</b>    | 2014     | 2013    |
|  | <b>£m</b>      | £m      | <b>£m</b>      | £m       | £m      |
| <b>Analysis of income by product</b>                   |                |         |                |          |         |
| Rates  | <b>656</b>     | 467     | <b>297</b>     | 359      | 255     |
| Currencies   | <b>351</b>     | 479     | <b>159</b>     | 192      | 282     |
| Credit   | <b>774</b>     | 992     | <b>309</b>     | 465      | 315     |
| Global Transaction Services                            | <b>421</b>     | 425     | <b>214</b>     | 207      | 211     |
| Portfolio  | <b>318</b>     | 323     | <b>156</b>     | 162      | 167     |
|  |                |         |                |          |         |
| Total (excluding revenue share and run-off businesses) | <b>2,520</b>   | 2,686   | <b>1,135</b>   | 1,385    | 1,230   |
| Inter-segment revenue share                            | <b>(119)</b>   | (141)   | <b>(59)</b>    | (60)     | (68)    |
| Run-off businesses                                     | <b>26</b>      | 163     | <b>-</b>       | 26       | 74      |
|  |                |         |                |          |         |
| Total income   | <b>2,427</b>   | 2,708   | <b>1,076</b>   | 1,351    | 1,236   |

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## Corporate &amp; Institutional Banking

| Key metrics               | Half year ended |         | Quarter ended |          |         |
|---------------------------|-----------------|---------|---------------|----------|---------|
|                           | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                           | 2014            | 2013    | 2014          | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |               |          |         |
| Return on equity (1)      | 2.7%            | (1.6%)  | (0.5%)        | 5.6%     | (6.8%)  |
| Net interest margin       | 0.88%           | 0.72%   | 0.90%         | 0.85%    | 0.67%   |
| Cost:income ratio         | 89%             | 99%     | 107%          | 75%      | 120%    |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of the monthly average of segmental RWAs).

|   | 30 June | 31 March |           | 31 December |          |
|---|---------|----------|-----------|-------------|----------|
|   | 2014    | 2014     |           | 2013        |          |
|   | £bn     | £bn      | Change    | £bn         | Change   |
| <b>Capital and balance sheet</b>        |         |          |           |             |          |
| Loans and advances to customers (gross) | 69.2    | 70.7     | (2%)      | 69.1        | -        |
| Loan impairment provisions              | (0.2)   | (0.2)    | -         | (0.9)       | (78%)    |
| Net loans and advances to customers     | 69.0    | 70.5     | (2%)      | 68.2        | 1%       |
| Net loans and advances to banks (1)     | 19.4    | 20.0     | (3%)      | 20.5        | (5%)     |
| Reverse repos                           | 78.8    | 78.1     | 1%        | 76.2        | 3%       |
| Securities                              | 67.9    | 75.0     | (9%)      | 72.1        | (6%)     |
| Cash and eligible bills                 | 18.7    | 21.0     | (11%)     | 20.6        | (9%)     |
| Other                                   | 24.9    | 22.0     | 13%       | 11.0        | 126%     |
| Funded assets                           | 278.7   | 286.6    | (3%)      | 268.6       | 4%       |
| Provision coverage (2)                  | 168%    | 199%     | (3,100bp) | 59%         | 10,900bp |

|                                     |              |       |       |       |       |
|-------------------------------------|--------------|-------|-------|-------|-------|
| Repos                               | <b>73.1</b>  | 77.5  | (6%)  | 74.8  | (2%)  |
| Customer deposits (excluding repos) | <b>55.5</b>  | 57.1  | (3%)  | 64.8  | (14%) |
| Bank deposits (excluding repos)     | <b>31.7</b>  | 29.5  | 7%    | 30.2  | 5%    |
| Debt securities in issue            | <b>17.3</b>  | 18.1  | (4%)  | 21.5  | (20%) |
|                                     |              |       |       |       |       |
| Risk-weighted assets (3)            |              |       |       |       |       |
| - Credit risk                       |              |       |       |       |       |
| - non-counterparty                  | <b>58.4</b>  | 59.0  | (1%)  | 61.8  | (6%)  |
| - counterparty                      | <b>28.9</b>  | 34.0  | (15%) | 17.5  | 65%   |
| - Market risk                       | <b>28.7</b>  | 35.3  | (19%) | 26.4  | 9%    |
| - Operational risk                  | <b>11.8</b>  | 11.9  | (1%)  | 14.7  | (20%) |
|                                     |              |       |       |       |       |
|                                     | <b>127.8</b> | 140.2 | (9%)  | 120.4 | 6%    |

## Notes:

- (1) Excludes disposal groups.
- (2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (3) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis. On a fully loaded Basel 3 basis risk-weighted assets at 1 January 2014 were £147.1 billion.

## Corporate & Institutional Banking

### Key points

The creation of Corporate & Institutional Banking (CIB) (which comprises the former Markets and International Banking divisions) is largely complete. The new franchise will continue to focus on the corporate and institutional client base while maintaining the same vigorous levels of cost reduction and capital management. The commitment to clients was highlighted this quarter when the business was awarded Global Finance's Best Supply Chain Finance provider in Western Europe for the seventh consecutive year and also received The Banker's Loans Deal of the Year Europe award.

The low interest rate and low volatility trading environment continues to be challenging. Investor activity remains subdued and excess client liquidity has curtailed lending. Opportunities for income generation were limited in comparison to the same period last year, when central bank intervention generated significant volatility.

### H1 2014 compared with H1 2013

Operating profit increased by £505 million, reflecting lower impairments, cost reductions and lower litigation and conduct costs, partially offset by lower income as the business continued to reduce in size to focus on core activities. Restructuring costs were also higher. Operating profit excluding restructuring, litigation and conduct costs of £241 million (H1 2013 - £493 million) increased by £253 million or 85% to £549 million.

Rates income increased by £189 million, 40%, compared with a weak H1 2013. Income associated with continued deleveraging and de-risking of the business supported the result.

Currencies income was £128 million or 27% lower than in H1 2013, when the business took advantage of volatility caused by central bank intervention in the United States and Japan.

Credit income was £218 million or 22% lower in H1 2014 compared with H1 2013, which benefited from the general credit market rally. This, combined with a reduced deployment of risk-weighted assets, resulted in lower income. Within Credit income, Asset Backed Product (ABP) income was £510 million, compared with £617 million in H1 2013.

Global Transaction Services and Portfolio were both flat compared with H1 2013, reflecting the subdued levels of client activity and continued low margin market environment.

Operating expenses were down by 20%, reflecting lower litigation and conduct costs partly offset by higher restructuring costs. Operating expenses excluding restructuring, litigation and conduct costs



of £241 million (H1 2013 - £493 million) fell by 12%, driven by headcount reductions and tight control of discretionary expenditure.

Impairments represented a net recovery of £39 million, compared with a loss of £223 million in H1 2013, driven by the release of latent provisions, reflecting the creation of RCR and improving credit conditions and the non-repeat of significant individual cases.

Funded assets increased compared with 31 December 2013 as activity levels picked up. Compared with 30 June 2013, however, funded assets fell significantly, down from £328 billion to £279 billion, reflecting the refocusing of the business on core activities.

Risk-weighted assets increased following the introduction of CRD IV on 1 January 2014. On a like-for-like Basel III basis, risk-weighted assets fell significantly from £172 billion at 30 June 2013, to £128 billion at 30 June 2014. This was driven by a range of mitigation and de-risking actions and the transfer of £13 billion of risk-weighted assets to RCR.

## Corporate & Institutional Banking

### Key points (continued)

#### Q2 2014 compared with Q1 2014

An operating loss of £25 million was driven by restructuring costs and litigation and conduct costs of £202 million. Excluding these items of £202 million (Q1 2014 - £39 million), operating profit was £177 million, down £195 million, reflecting lower income principally in Credit and Rates.

Client activity in Rates weakened compared with Q1 2014, and trading gains were lower. As a result, income declined by £62 million.

Currencies income, down £33 million, continued to be impacted by limited volume and volatility in a highly competitive market environment.

Credit income decreased by 34%, driven by a lower level of gains in asset backed products following more favourable market movements in Q1 2014. ABP income was £188 million compared with £322 million in Q1 2014.

Global Transaction Services and Portfolio remained stable as they continued to be impacted by the low margin environment and subdued client activity.

Operating expenses increased by 13% due to restructuring and litigation and conduct costs. Operating expenses excluding restructuring, litigation and conduct costs of £202 million (Q1 2014 - £39 million) were down 3%, driven by lower staff costs.

Funded assets remained broadly stable in a subdued market environment. The small reduction was driven by debt securities in the Rates business.

Risk-weighted assets fell by £12 billion, reflecting continued mitigation actions and reduced risk exposures.

#### Q2 2014 compared with Q2 2013

Rates increased by £42 million, 16%, despite a low volatility environment, benefiting from income associated with de-risking the business in contrast to Q2 2013, which was impacted by difficult trading conditions.

Currencies income was £123 million or 44% lower, reflecting the subdued market conditions, compared to greater volatility in Q2 2013 following central bank intervention in the United States and

Japan.

Income from Portfolio fell £11 million or 7%. Q2 2013 included a gain on an asset sale.

Operating expenses fell by £341 million, 23%, driven by lower litigation and conduct costs and the ongoing cost reduction programme, partially offset by a £108 million increase in restructuring costs.

## Central items

|                             | Half year ended |         | Quarter ended |          |         |
|-----------------------------|-----------------|---------|---------------|----------|---------|
|                             | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                             | 2014            | 2013    | 2014          | 2014     | 2013    |
|                             | £m              | £m      | £m            | £m       | £m      |
| Central items not allocated | 91              | 553     | 86            | 5        | 352     |

Funding and operating costs have been allocated to operating divisions based on direct service usage, the 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.

## Key points

### H1 2014 compared with H1 2013

Central items not allocated represented a credit of £91 million compared with a credit of £553 million in H1 2013. The change was principally driven by lower gains on the disposal of available-for-sale securities in Treasury, which were down £245 million to £215 million for H1 2014, along with a £150 million restructuring charge relating to the Williams & Glyn franchise.

### Q2 2014 compared with Q1 2014

Central items not allocated represented a credit of £86 million compared with a credit of £5 million in Q1 2014. The improvement principally reflects lower restructuring costs relating to Williams & Glyn and favourable movements in respect of fair value movements on derivatives not qualifying for hedge accounting in Treasury partially offset by lower AFS gains.

### Q2 2014 compared with Q2 2013

Central items not allocated represented a credit of £86 million compared with a credit of £352 million in

Q2 2013. The change was principally driven by lower gains on the disposal of available-for-sale securities in Treasury, which were down £342 million to £13 million for Q2 2014.

## Citizens Financial Group (£ Sterling)

|                                      | Half year ended |         | Quarter ended |          |         |
|--------------------------------------|-----------------|---------|---------------|----------|---------|
|                                      | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                      | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                      | £m              | £m      | £m            | £m       | £m      |
| <b>Income statement</b>              |                 |         |               |          |         |
| Net interest income                  | 987             | 939     | 499           | 488      | 469     |
| Net fees and commissions             | 350             | 382     | 181           | 169      | 192     |
| Other non-interest income            | 270             | 188     | 210           | 60       | 86      |
| Non-interest income                  | 620             | 570     | 391           | 229      | 278     |
| Total income                         | 1,607           | 1,509   | 890           | 717      | 747     |
| Direct expenses                      |                 |         |               |          |         |
| - staff                              | (512)           | (572)   | (261)         | (251)    | (286)   |
| - other                              | (501)           | (482)   | (252)         | (249)    | (233)   |
| Indirect expenses                    | -               | (48)    | -             | -        | (27)    |
| Restructuring costs                  | (69)            | (3)     | (69)          | -        | (2)     |
| Operating expenses                   | (1,082)         | (1,105) | (582)         | (500)    | (548)   |
| Profit before impairment losses      | 525             | 404     | 308           | 217      | 199     |
| Impairment losses                    | (104)           | (51)    | (31)          | (73)     | (32)    |
| Operating profit                     | 421             | 353     | 277           | 144      | 167     |
| Average exchange rate - US\$/£       | 1.669           | 1.544   | 1.683         | 1.655    | 1.536   |
| <b>Analysis of income by product</b> |                 |         |               |          |         |
| Mortgages and home equity            | 223             | 249     | 111           | 112      | 123     |
| Personal lending and cards           | 204             | 204     | 106           | 98       | 104     |
| Retail deposits                      | 376             | 379     | 190           | 186      | 189     |
| Commercial lending                   | 333             | 335     | 168           | 165      | 167     |
| Commercial deposits                  | 216             | 200     | 109           | 107      | 98      |
| Other                                | 255             | 142     | 206           | 49       | 66      |

|   |              |        |               |        |        |
|---|--------------|--------|---------------|--------|--------|
| Total income  | <b>1,607</b> | 1,509  | <b>890</b>    | 717    | 747    |
| <b>Analysis of impairments by sector</b>  |              |        |               |        |        |
| Residential mortgages   | <b>1</b>     | 12     | <b>6</b>      | (5)    | 10     |
| Home equity   | <b>34</b>    | 37     | <b>15</b>     | 19     | 18     |
| SBO home equity   | <b>4</b>     | -      | <b>(17)</b>   | 21     | -      |
| Corporate and commercial  | <b>8</b>     | (35)   | <b>(1)</b>    | 9      | (11)   |
| Other consumer  | <b>55</b>    | 37     | <b>26</b>     | 29     | 15     |
| Securities  | <b>2</b>     | -      | <b>2</b>      | -      | -      |
| Total impairment losses   | <b>104</b>   | 51     | <b>31</b>     | 73     | 32     |
| <b>Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector</b> |              |        |               |        |        |
| Residential mortgages   | -            | 0.4%   | <b>0.4%</b>   | (0.3%) | 0.7%   |
| Home equity   | <b>0.6%</b>  | 0.5%   | <b>0.5%</b>   | 0.6%   | 0.5%   |
| SBO home equity   | <b>0.6%</b>  | -      | <b>(5.6%)</b> | 6.5%   | -      |
| Corporate and commercial  | <b>0.1%</b>  | (0.3%) | -             | 0.1%   | (0.2%) |
| Other consumer  | <b>1.2%</b>  | 0.8%   | <b>1.2%</b>   | 1.3%   | 0.7%   |
| Total   | <b>0.4%</b>  | 0.2%   | <b>0.2%</b>   | 0.5%   | 0.2%   |

## Citizens Financial Group (£ Sterling)

| Key metrics               | Half year ended |         | Quarter ended |          |         |
|---------------------------|-----------------|---------|---------------|----------|---------|
|                           | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                           | 2014            | 2013    | 2014          | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |               |          |         |
| Return on equity (1)      | 7.5%            | 6.6%    | 9.8%          | 5.1%     | 6.3%    |
| Net interest margin       | 2.94%           | 2.90%   | 2.93%         | 2.94%    | 2.89%   |
| Cost:income ratio         | 67%             | 73%     | 65%           | 70%      | 73%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of monthly average of segmental RWAs).

|   | 30 June | 31 March | Change | 31       | Change |
|---|---------|----------|--------|----------|--------|
|   | 2014    | 2014     |        | December |        |
|   | £bn     | £bn      |        | 2013     |        |
| <b>Capital and balance sheet</b>        |         |          |        |          |        |
| Loans and advances to customers (gross) |         |          |        |          |        |
| - residential mortgages                 | 6.4     | 6.2      | 3%     | 5.8      | 10%    |
| - home equity                           | 11.3    | 12.0     | (6%)   | 12.1     | (7%)   |
| - SBO home equity                       | 1.2     | 1.3      | (8%)   | -        | 100%   |
| - corporate and commercial              | 24.2    | 24.7     | (2%)   | 24.1     | -      |
| - other consumer                        | 9.1     | 9.0      | 1%     | 8.6      | 6%     |
|   | 52.2    | 53.2     | (2%)   | 50.6     | 3%     |
| Loan impairment provisions              | (0.5)   | (0.5)    | -      | (0.3)    | 67%    |
| Net loans and advances to customers     | 51.7    | 52.7     | (2%)   | 50.3     | 3%     |
| Funded assets                           | 75.7    | 75.7     | -      | 71.3     | 6%     |
| Investment securities                   | 14.5    | 14.9     | (3%)   | 12.9     | 12%    |
| Risk elements in lending                |         |          |        |          |        |
| - retail                                | 1.1     | 1.1      | -      | 0.9      | 22%    |



|                                      |              |       |         |       |         |
|--------------------------------------|--------------|-------|---------|-------|---------|
| - commercial                         | <b>0.2</b>   | 0.2   | -       | 0.1   | 100%    |
|                                      |              |       |         |       |         |
| Total risk elements in lending       | <b>1.3</b>   | 1.3   | -       | 1.0   | 30%     |
| Provision coverage (1)               | <b>38%</b>   | 41%   | (300bp) | 26%   | 1,200bp |
|                                      |              |       |         |       |         |
| Customer deposits (excluding repos)  | <b>52.9</b>  | 54.9  | (4%)    | 55.1  | (4%)    |
| Bank deposits (excluding repos)      | <b>4.7</b>   | 3.4   | 38%     | 2.0   | 135%    |
| Loan:deposit ratio (excluding repos) | <b>98%</b>   | 96%   | 200bp   | 91%   | 700bp   |
| Risk-weighted assets (2)             |              |       |         |       |         |
| - Credit risk                        |              |       |         |       |         |
| - non-counterparty                   | <b>54.8</b>  | 55.4  | (1%)    | 50.7  | 8%      |
| - counterparty                       | <b>0.8</b>   | 0.8   | -       | 0.5   | 60%     |
| - Operational risk                   | <b>5.1</b>   | 5.1   | -       | 4.9   | 4%      |
|                                      |              |       |         |       |         |
|                                      | <b>60.7</b>  | 61.3  | (1%)    | 56.1  | 8%      |
|                                      |              |       |         |       |         |
| Spot exchange rate - US\$/£          | <b>1.711</b> | 1.668 |         | 1.654 |         |

## Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

**Key points**

Sterling strengthened against the US dollar during the first half of 2014, with the spot exchange rate at 30 June 2014 increasing 3% compared with 31 December 2013.

## Citizens Financial Group (US dollar)

|                                      | Half year ended |         | Quarter ended |          |         |
|--------------------------------------|-----------------|---------|---------------|----------|---------|
|                                      | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                                      | 2014            | 2013    | 2014          | 2014     | 2013    |
|                                      | \$m             | \$m     | \$m           | \$m      | \$m     |
| <b>Income statement</b>              |                 |         |               |          |         |
| Net interest income                  | 1,647           | 1,449   | 838           | 809      | 720     |
| Net fees and commissions             | 584             | 590     | 305           | 279      | 295     |
| Other non-interest income            | 452             | 291     | 353           | 99       | 133     |
| Non-interest income                  | 1,036           | 881     | 658           | 378      | 428     |
| Total income                         | 2,683           | 2,330   | 1,496         | 1,187    | 1,148   |
| Direct expenses                      |                 |         |               |          |         |
| - staff                              | (855)           | (883)   | (439)         | (416)    | (439)   |
| - other                              | (835)           | (744)   | (423)         | (412)    | (359)   |
| Indirect expenses                    | -               | (74)    | -             | -        | (40)    |
| Restructuring costs                  | (115)           | (5)     | (115)         | -        | (3)     |
| Operating expenses                   | (1,805)         | (1,706) | (977)         | (828)    | (841)   |
| Profit before impairment losses      | 878             | 624     | 519           | 359      | 307     |
| Impairment losses                    | (174)           | (78)    | (53)          | (121)    | (48)    |
| Operating profit                     | 704             | 546     | 466           | 238      | 259     |
| <b>Analysis of income by product</b> |                 |         |               |          |         |
| Mortgages and home equity            | 373             | 384     | 188           | 185      | 189     |
| Personal lending and cards           | 340             | 314     | 178           | 162      | 159     |
| Retail deposits                      | 627             | 586     | 319           | 308      | 291     |
| Commercial lending                   | 556             | 518     | 283           | 273      | 257     |
| Commercial deposits                  | 360             | 309     | 183           | 177      | 151     |
| Other                                | 427             | 219     | 345           | 82       | 101     |
| Total income                         | 2,683           | 2,330   | 1,496         | 1,187    | 1,148   |

|  |             |        |               |        |        |
|--|-------------|--------|---------------|--------|--------|
|  |             |        |               |        |        |
| <b>Analysis of impairments by sector</b>   |             |        |               |        |        |
| Residential mortgages  | <b>1</b>    | 19     | <b>10</b>     | (9)    | 16     |
| Home equity  | <b>57</b>   | 56     | <b>25</b>     | 32     | 27     |
| SBO home equity  | <b>6</b>    | -      | <b>(28)</b>   | 34     | -      |
| Corporate and commercial   | <b>13</b>   | (53)   | <b>(2)</b>    | 15     | (17)   |
| Other consumer   | <b>94</b>   | 56     | <b>45</b>     | 49     | 22     |
| Securities   | <b>3</b>    | -      | <b>3</b>      | -      | -      |
|  |             |        |               |        |        |
| Total impairment losses  | <b>174</b>  | 78     | <b>53</b>     | 121    | 48     |
|  |             |        |               |        |        |
| <b>Loan impairment charge as % of gross</b>  |             |        |               |        |        |
| <b>customer loans and advances (excluding reverse repurchase agreements) by sector</b> |             |        |               |        |        |
| Residential mortgages  | -           | 0.4%   | <b>0.4%</b>   | (0.3%) | 0.7%   |
| Home equity  | <b>0.6%</b> | 0.5%   | <b>0.5%</b>   | 0.6%   | 0.5%   |
| SBO home equity  | <b>0.6%</b> | -      | <b>(5.6%)</b> | 6.5%   | -      |
| Corporate and commercial   | <b>0.1%</b> | (0.3%) | -             | 0.1%   | (0.2%) |
| Other consumer   | <b>1.2%</b> | 0.8%   | <b>1.2%</b>   | 1.3%   | 0.7%   |
|  |             |        |               |        |        |
| Total  | <b>0.4%</b> | 0.2%   | <b>0.2%</b>   | 0.5%   | 0.2%   |

**Citizens Financial Group (US dollar)**

| <b>Key metrics</b>        | Half year ended |         | Quarter ended  |          |         |
|---------------------------|-----------------|---------|----------------|----------|---------|
|                           | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|                           | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
| <b>Performance ratios</b> |                 |         |                |          |         |
| Return on equity (1)      | <b>7.5%</b>     | 6.6%    | <b>9.8%</b>    | 5.1%     | 6.3%    |
| Net interest margin       | <b>2.94%</b>    | 2.90%   | <b>2.93%</b>   | 2.94%    | 2.89%   |
| Cost:income ratio         | <b>67%</b>      | 73%     | <b>65%</b>     | 70%      | 73%     |

Note:

- (1) Return on equity is based on segmental operating profit after tax divided by average notional equity (based on 12% of monthly average of segmental RWAs).

## Citizens Financial Group (US dollar)

|   | 30 June<br>2014<br>\$bn | 31 March<br>2014<br>\$bn | Change  | 31<br>December<br>2013<br>\$bn | Change  |
|---|-------------------------|--------------------------|---------|--------------------------------|---------|
| <b>Capital and balance sheet</b>        |                         |                          |         |                                |         |
| Loans and advances to customers (gross) |                         |                          |         |                                |         |
| - residential mortgages                 | 10.9                    | 10.3                     | 6%      | 9.6                            | 14%     |
| - home equity                           | 19.4                    | 20.0                     | (3%)    | 20.1                           | (3%)    |
| - SBO home equity                       | 2.0                     | 2.1                      | (5%)    | -                              | 100%    |
| - corporate and commercial              | 41.4                    | 41.2                     | -       | 39.8                           | 4%      |
| - other consumer                        | 15.6                    | 15.2                     | 3%      | 14.1                           | 11%     |
|   | 89.3                    | 88.8                     | 1%      | 83.6                           | 7%      |
| Loan impairment provisions              | (0.9)                   | (0.9)                    | -       | (0.4)                          | 125%    |
| Net loans and advances to customers     | 88.4                    | 87.9                     | 1%      | 83.2                           | 6%      |
| Funded assets                           | 129.5                   | 126.2                    | 3%      | 117.9                          | 10%     |
| Investment securities                   | 24.9                    | 24.9                     | -       | 21.3                           | 17%     |
| Risk elements in lending                |                         |                          |         |                                |         |
| - retail                                | 1.9                     | 1.9                      | -       | 1.5                            | 27%     |
| - commercial                            | 0.3                     | 0.3                      | -       | 0.2                            | 50%     |
| Total risk elements in lending          | 2.2                     | 2.2                      | -       | 1.7                            | 29%     |
| Provision coverage (1)                  | 38%                     | 41%                      | (300bp) | 26%                            | 1,200bp |
| Customer deposits (excluding repos)     | 90.5                    | 91.6                     | (1%)    | 91.1                           | (1%)    |
| Bank deposits (excluding repos)         | 8.0                     | 5.7                      | 40%     | 3.3                            | 142%    |
| Loan:deposit ratio (excluding repos)    | 98%                     | 96%                      | 200bp   | 91%                            | 700bp   |
| Risk-weighted assets (2)                |                         |                          |         |                                |         |
| - Credit risk                           |                         |                          |         |                                |         |
| - non-counterparty                      | 93.8                    | 92.4                     | 2%      | 83.8                           | 12%     |
| - counterparty                          | 1.3                     | 1.3                      | -       | 0.8                            | 63%     |
| - Operational risk                      | 8.7                     | 8.5                      | 2%      | 8.2                            | 6%      |

|  |              |       |    |      |     |
|--|--------------|-------|----|------|-----|
|  |              |       |    |      |     |
|  | <b>103.8</b> | 102.2 | 2% | 92.8 | 12% |

## Notes:

- (1) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (2) Risk-weighted assets at 31 December 2013 are on a Basel 2.5 basis.

**Key points**

H1 2014 and Q2 2014 results are not directly comparable with prior year periods; prior year results exclude Non-Core operations and include Group allocations. In the context of the planned disposal of Citizens Financial Group, central Group costs are no longer allocated to the division.

**H1 2014 compared with H1 2013**

Operating profit increased by £68 million (\$158 million), or 19%, to £421 million (\$704 million), reflecting the sale of the Illinois retail branches and small business and select middle market relationships in the Illinois market. Excluding the impact of the sale, £170 million (\$283 million) net gain, and restructuring costs, £69 million (\$115 million) (H1 2013 - £3 million (\$5 million)), operating profit was down 4% driven by lower non-interest income and higher impairment losses partially offset by higher net interest income.

## Citizens Financial Group (US dollar)

### Key points (continued)

#### H1 2014 compared with H1 2013 (continued)

The branch sale comprised retail branches located in Illinois, including certain customer deposits of £2.8 million (\$4.8 billion) and selected loans of £0.6 billion (\$1.0 billion) (primarily middle market, small business, home equity and credit card balances). The transaction which completed on 20 June 2014 and resulted in a net gain of £170 million (\$283 million) and restructuring costs of £10 million (\$17 million).

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 up £48 million (\$198 million), or 5%, to £987 million (\$1,647 million) driven by a larger investment portfolio, loan growth including the transfer of assets from Non-Core, the benefit of interest rate swaps and deposit pricing discipline.

Higher rates led to investment security purchases resulting in average portfolio growth of £3.0 billion (\$6.3 billion) over the year.

Average loans and advances were flat. On a US dollar basis average loans and advances were up 9%, driven by the £2.1 billion (\$3.6 billion) transfer of assets from Non-Core, commercial and auto loan growth, a strategic initiative to purchase residential mortgages and to hold more originations on the balance sheet. This was partially offset by home equity run-off.

Average customer deposits were down 10%, with planned run-off of high priced deposits. Consumer checking balances were down 5% and small business checking balances were down 4%, principally due to the strengthening of sterling against the US dollar. On a US dollar basis consumer and small business checking balances both grew by 3% over the year.

Excluding the gain on the sale of the Illinois branches of £170 million (\$283 million), non-interest income was down £120 million (\$128 million), or 21%, to £450 million (\$753 million) reflecting lower securities gains of £41 million (\$69 million), lower mortgage banking fees of £29 million (\$49 million), as refinancing volumes have slowed, and lower deposit fees of £19 million (\$31 million) due to a change in the posting order of customer transactions, partially offset by higher commercial banking fee income of £13 million (\$21 million). Mortgage origination activity has slowed as market rates have risen, leading to lower applications combined with lower levels of gains on sales of mortgages.

Excluding restructuring costs of £69 million (\$115 million) (H1 2013 - £3 million (\$5 million)), operating expenses were down £89 million (\$11 million), or 8%, to £1,013 million (\$1,690 million) driven by the removal of indirect costs in 2014, incentive reversals for prior year plans and lower retirement costs partially offset by lower mortgage servicing rights impairment recapture and higher consumer regulatory compliance costs.

Restructuring costs include costs related to the sale of the Illinois branches and other initiatives intended to improve the overall effectiveness and efficiency of the franchise.

Impairment losses increased by £53 million (\$96 million) to £104 million (\$174 million) due to a reserve build of £9 million (\$15 million) in H1 2014 compared with a reserve release of £38 million (\$58 million) in H1 2013 and higher charge-offs including those related to assets transferred from Non-Core.



## Citizens Financial Group (US dollar)

### Key points (continued)

#### Q2 2014 compared with Q1 2014

#### Q2 2014 compared with Q1 2014 (continued)

Operating profit increased by £133 million (\$228 million), or 92%, to £277 million (\$466 million) largely due to the sale of the Illinois retail branches and small business and select middle market relationships. Excluding the impact of the sale, £170 million (\$283 million), and restructuring costs, £69 million (\$115 million), operating profit was up £32 million (\$60 million), or 22%, to £176 million (\$298 million) driven by lower impairment losses.

Net interest income was up £11 million (\$29 million), or 4% at £499 million (\$838 million) driven by a larger investment portfolio, loan growth and the impact of day count.

Average loans and advances were flat. On a US dollar basis average loans and advances were up 2%, driven by higher commercial loans, auto loan organic growth and purchases and a strategic initiative to purchase residential mortgages.

Excluding the gain on the sale of the Illinois retail branches of £170 million (\$283 million) in Q2 2014, non-interest income was broadly in line with the prior quarter.

Excluding restructuring costs of £69 million (\$115 million), operating expenses were up £13 million (\$34 million), or 3%, at £513 million (\$862 million) due to higher incentives as Q1 2014 included incentive reversals for prior year plans.

Impairment losses decreased by £42 million (\$68 million) to £31 million (\$53 million) for the quarter due to lower charge-offs of £11 million (\$19 million) and a reserve release in Q2 2014 of £11 million (\$19 million) reflecting asset quality improvements, compared to a reserve build in Q1 2014 of £21 million (\$34 million).

#### Q2 2014 compared with Q2 2013

Excluding the impact of the Illinois retail branch sale, £170 million (\$283 million net gain), and restructuring costs, £69 million (\$115 million) (Q2 2013 - £2 million (\$3 million)), operating profit increased by £7 million (\$36 million), or 4%, driven by higher net interest income and lower operating expenses partially offset by lower non-interest income.

Income and expense drivers are consistent with H1 2014 compared with H1 2013.

Impairment losses were broadly in line with prior year despite the Non-Core transfer.

**RBS Capital Resolution**

RCR is managed and analysed by four business pillars - Ulster Bank, Real Estate Finance, Corporate and Markets. Real Estate Finance excludes commercial real estate lending in Ulster Bank.

|   | <b>Half year<br/>ended</b> | Quarter ended           |                  |
|---|----------------------------|-------------------------|------------------|
|   | <b>30 June<br/>2014</b>    | <b>30 June<br/>2014</b> | 31 March<br>2014 |
|   | <b>£m</b>                  | <b>£m</b>               | £m               |
| <b>Income statement</b>                 |                            |                         |                  |
| Net interest income/(expense)           | 11                         | 16                      | (5)              |
| Funding costs of rental assets          | (12)                       | (9)                     | (3)              |
| Net interest income/(expense)           | (1)                        | 7                       | (8)              |
| Net fees and commissions                | 31                         | 17                      | 14               |
| Income from trading activities (1)      | (53)                       | (69)                    | 16               |
| Other operating income (1)              | 131                        | 80                      | 51               |
| Non-interest income                     | 109                        | 28                      | 81               |
| Total income                            | 108                        | 35                      | 73               |
| Direct expenses                         |                            |                         |                  |
| - staff                                 | (89)                       | (51)                    | (38)             |
| - other                                 | (32)                       | (14)                    | (18)             |
| Indirect expenses                       | (55)                       | (32)                    | (23)             |
| Operating expenses                      | (176)                      | (97)                    | (79)             |
| Operating loss before impairment losses | (68)                       | (62)                    | (6)              |
| Impairment recoveries/(losses) (1)      | 20                         | 128                     | (108)            |
| Operating (loss)/profit                 | (48)                       | 66                      | (114)            |
| <b>Total income</b>                     |                            |                         |                  |

|   |        |        |        |
|---|--------|--------|--------|
| Ulster Bank   | 1      | 14     | (13)   |
| Real Estate Finance   | 96     | 13     | 83     |
| Corporate   | (14)   | (12)   | (2)    |
| Markets   | 25     | 20     | 5      |
|   |        |        |        |
| Total income  | 108    | 35     | 73     |
|   |        |        |        |
| <b>Impairment (recoveries)/losses</b>                                       |        |        |        |
| Ulster Bank   | (15)   | (67)   | 52     |
| Real Estate Finance   | (34)   | (123)  | 89     |
| Corporate   | 39     | 73     | (34)   |
| Markets   | (10)   | (11)   | 1      |
|   |        |        |        |
| Total impairment (recoveries)/losses  | (20)   | (128)  | 108    |
|   |        |        |        |
| <b>Loan impairment charge as % of gross customer loans and advances (2)</b> |        |        |        |
| Ulster Bank   | (0.2%) | (1.9%) | 1.3%   |
| Real Estate Finance   | (0.9%) | (6.6%) | 4.1%   |
| Corporate   | 1.0%   | 3.7%   | (1.5%) |
| Markets   | (2.0%) | (3.6%) | -      |
|   |        |        |        |
| Total   | (0.1%) | (1.7%) | 1.2%   |

## Notes:

- (1) Q2 2014 results included £225 million (Q1 2014 - £56 million) of net gains from the disposal of assets, comprising £6 million gain (Q1 2014 - £5 million loss) in income from trading activities, £38 million of losses (Q1 2014 - £3 million) in other operating income and £257 million (Q1 2014 - £64 million) release of impairment provisions.
- (2) Includes disposal groups.

**RBS Capital Resolution**

|  |  |  | <b>30 June</b> | 31 March |
|--|--|--|----------------|----------|
|  |  |  | <b>2014</b>    | 2014     |
|  |  |  | <b>£bn</b>     | £bn      |
| <b>Capital and balance sheet</b>                 |  |  |                |          |
| Loans and advances to customers (gross) (1)      |  |  | <b>30.0</b>    | 34.0     |
| Loan impairment provisions                       |  |  | <b>(14.4)</b>  | (15.7)   |
| Net loans and advances to customers              |  |  | <b>15.6</b>    | 18.3     |
| Debt securities                                  |  |  | <b>1.9</b>     | 2.2      |
| Total funded assets                              |  |  | <b>20.9</b>    | 24.3     |
| Total third party assets (including derivatives) |  |  | <b>34.4</b>    | 38.8     |
| Risk elements in lending                         |  |  | <b>20.4</b>    | 23.0     |
| Provision coverage (2)                           |  |  | <b>71%</b>     | 68%      |
| Risk-weighted assets (3)                         |  |  |                |          |
| - Credit risk                                    |  |  |                |          |
| - non-counterparty                               |  |  | <b>22.6</b>    | 29.6     |
| - counterparty                                   |  |  | <b>8.2</b>     | 5.7      |
| - Market risk                                    |  |  | <b>4.3</b>     | 5.2      |
|  |  |  | <b>35.1</b>    | 40.5     |
| <b>Gross loans and advances to customers (1)</b> |  |  |                |          |
| Ulster Bank                                      |  |  | <b>13.9</b>    | 15.5     |
| Real Estate Finance                              |  |  | <b>7.4</b>     | 8.6      |
| Corporate  |  |  | <b>7.8</b>     | 9.1      |
| Markets  |  |  | <b>0.9</b>     | 0.8      |
|  |  |  | <b>30.0</b>    | 34.0     |
| <b>Funded assets</b>                             |  |  |                |          |
| Ulster Bank                                      |  |  | <b>3.5</b>     | 4.4      |
| Real Estate Finance (3)                          |  |  | <b>6.7</b>     | 7.7      |
| Corporate  |  |  | <b>7.4</b>     | 8.6      |
| Markets  |  |  | <b>3.3</b>     | 3.6      |

|                                  |  |  |             |      |
|----------------------------------|--|--|-------------|------|
|                                  |  |  |             |      |
|                                  |  |  | <b>20.9</b> | 24.3 |
|                                  |  |  |             |      |
| <b>Risk weighted assets (4)</b>  |  |  |             |      |
| Ulster Bank                      |  |  | <b>2.3</b>  | 2.8  |
| Real Estate Finance              |  |  | <b>6.4</b>  | 11.5 |
| Corporate                        |  |  | <b>15.1</b> | 14.7 |
| Markets                          |  |  | <b>11.3</b> | 11.5 |
|                                  |  |  |             |      |
|                                  |  |  | <b>35.1</b> | 40.5 |
|                                  |  |  |             |      |
| <b>RWA equivalent (RWAe) (5)</b> |  |  |             |      |
| Ulster Bank                      |  |  | <b>4.5</b>  | 6.7  |
| Real Estate Finance              |  |  | <b>10.5</b> | 13.4 |
| Corporate                        |  |  | <b>16.6</b> | 17.0 |
| Markets                          |  |  | <b>11.9</b> | 13.8 |
|                                  |  |  |             |      |
|                                  |  |  | <b>43.5</b> | 50.9 |

## Notes:

- (1) Includes disposal groups.
- (2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.
- (3) Real Estate Finance funded assets comprise those in the UK (£4.4 billion), Germany (£1.0 billion), Spain (£0.5 billion) and other geographies (£0.8 billion).
- (4) On a fully loaded Basel 3 basis risk-weighted assets at 1 January 2014 were £46.7 billion.
- (5) 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%; this results in an end point CRR RWAe conversion multiplier of 10.

## RBS Capital Resolution

| Funded assets and RWaE | Non-performing (1) |     |      |     |                 | Performing (1) |      |      |      |                     | Total         |      |      |      |                 |
|------------------------|--------------------|-----|------|-----|-----------------|----------------|------|------|------|---------------------|---------------|------|------|------|-----------------|
|                        | Funded assets      |     | RWaE | RWA | Capital deducts | Funded assets  |      | RWaE | RWA  | Capital deducts (2) | Funded assets |      | RWaE | RWA  | Capital deducts |
|                        | Gross              | Net |      |     |                 | Gross          | Net  |      |      |                     | Gross         | Net  |      |      |                 |
|                        | £bn                | £bn | £bn  | £bn | £m              | £bn            | £bn  | £bn  | £bn  | £m                  | £bn           | £bn  | £bn  | £bn  | £bn             |
| 30 June 2014           |                    |     |      |     |                 |                |      |      |      |                     |               |      |      |      |                 |
| Ulster Bank            | 13.0               | 2.6 | 4.4  | -   | 446             | 1.1            | 0.9  | 0.1  | 2.3  | (229)               | 14.1          | 3.5  | 4.5  | 2.3  |                 |
| Real Estate Finance    | 5.0                | 2.7 | 4.1  | 0.3 | 389             | 4.1            | 4.0  | 6.4  | 6.1  | 16                  | 9.1           | 6.7  | 10.5 | 6.4  |                 |
| Corporate Markets      | 2.6                | 1.2 | 1.8  | -   | 184             | 6.3            | 6.2  | 14.8 | 15.1 | (28)                | 8.9           | 7.4  | 16.6 | 15.1 |                 |
|                        | 0.1                | 0.1 | 0.5  | 0.2 | 34              | 3.2            | 3.2  | 11.4 | 11.1 | 30                  | 3.3           | 3.3  | 11.9 | 11.3 |                 |
| Total RCR              | 20.7               | 6.6 | 10.8 | 0.5 | 1,053           | 14.7           | 14.3 | 32.7 | 34.6 | (211)               | 35.4          | 20.9 | 43.5 | 35.1 |                 |
| 31 March 2014          |                    |     |      |     |                 |                |      |      |      |                     |               |      |      |      |                 |
| Ulster Bank            | 14.6               | 3.6 | 6.3  | 0.1 | 622             | 1.1            | 0.8  | 0.4  | 2.7  | (235)               | 15.7          | 4.4  | 6.7  | 2.8  |                 |
| Real Estate Finance    | 5.4                | 2.9 | 2.9  | 0.3 | 260             | 4.9            | 4.8  | 10.5 | 11.2 | (76)                | 10.3          | 7.7  | 13.4 | 11.5 |                 |
| Corporate Markets      | 2.9                | 1.2 | 2.1  | 0.1 | 209             | 7.5            | 7.4  | 14.9 | 14.6 | 28                  | 10.4          | 8.6  | 17.0 | 14.7 |                 |
|                        | 0.2                | 0.2 | 0.3  | -   | 26              | 3.4            | 3.4  | 13.5 | 11.5 | 205                 | 3.6           | 3.6  | 13.8 | 11.5 |                 |
| Total RCR              | 23.1               | 7.9 | 11.6 | 0.5 | 1,117           | 16.9           | 16.4 | 39.3 | 40.0 | (78)                | 40.0          | 24.3 | 50.9 | 40.5 | 1               |
| 1 January 2014         |                    |     |      |     |                 |                |      |      |      |                     |               |      |      |      |                 |
|                        | 14.8               | 3.7 | 7.6  | 0.2 | 738             | 1.4            | 1.1  | 1.3  | 3.1  | (179)               | 16.2          | 4.8  | 8.9  | 3.3  |                 |

|                     |      |     |      |     |       |      |      |      |      |      |      |      |      |      |   |  |
|---------------------|------|-----|------|-----|-------|------|------|------|------|------|------|------|------|------|---|--|
| Ulster Bank         |      |     |      |     |       |      |      |      |      |      |      |      |      |      |   |  |
| Real Estate Finance | 7.2  | 4.2 | 6.1  | 0.3 | 580   | 5.8  | 5.3  | 12.5 | 13.2 | (75) | 13.0 | 9.5  | 18.6 | 13.5 |   |  |
| Corporate           | 3.3  | 1.7 | 2.9  | 0.2 | 269   | 8.1  | 8.1  | 18.2 | 16.2 | 208  | 11.4 | 9.8  | 21.1 | 16.4 |   |  |
| Markets             | 0.2  | 0.1 | 0.6  | -   | 58    | 4.7  | 4.7  | 15.8 | 13.5 | 233  | 4.9  | 4.8  | 16.4 | 13.5 |   |  |
|                     |      |     |      |     |       |      |      |      |      |      |      |      |      |      |   |  |
| 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 |  |

## Notes:

- Performing assets are those with an internal asset quality band of AQ1 - 9; and non-performing assets
- (1) are in AQ10 with a probability of default being 100%.  
The negative capital deductions are a result of the latent loss provisions held in respect of the
  - (2) performing portfolio.
  - (3) Capital deductions relating to expected loss less impairment provisions were £823 million (31 March 2014 - £960 million; 1 January 2014 - £1,774 million).



## RBS Capital Resolution

| <b>Funded assets</b>               |           |             |                  |             |       |          |
|------------------------------------|-----------|-------------|------------------|-------------|-------|----------|
|                                    | 1 April   |             |                  |             |       | 30 June  |
|                                    | 2014      | Net run-off | Disposals<br>(1) | Impairments | Other | 2014     |
| <b>Quarter ended 30 June 2014</b>  | £bn       | £bn         | £bn              | £bn         | £bn   | £bn      |
| Ulster Bank                        | 4.4       | (0.1)       | (0.8)            | 0.1         | (0.1) | 3.5      |
| Real Estate Finance                | 7.7       | (0.4)       | (0.6)            | 0.1         | (0.1) | 6.7      |
| Corporate                          | 8.6       | (0.8)       | (0.2)            | (0.1)       | (0.1) | 7.4      |
| Markets                            | 3.6       | (0.1)       | (0.2)            | -           | -     | 3.3      |
| Total                              | 24.3      | (1.4)       | (1.8)            | 0.1         | (0.3) | 20.9     |
|                                    | 1 January |             |                  |             |       | 31 March |
|                                    | 2014      | Net run-off | Disposals<br>(1) | Impairments | Other | 2014     |
| <b>Quarter ended 31 March 2014</b> | £bn       | £bn         | £bn              | £bn         | £bn   | £bn      |
| Ulster Bank                        | 4.8       | (0.1)       | (0.2)            | (0.1)       | -     | 4.4      |
| Real Estate Finance                | 9.5       | (1.2)       | (0.5)            | (0.1)       | -     | 7.7      |
| Corporate                          | 9.8       | (0.7)       | (0.5)            | -           | -     | 8.6      |
| Markets                            | 4.8       | (0.5)       | (0.7)            | -           | -     | 3.6      |
| Total                              | 28.9      | (2.5)       | (1.9)            | (0.2)       | -     | 24.3     |

| <b>Risk-weighted assets</b>       |         |             |                  |                   |             |              |
|-----------------------------------|---------|-------------|------------------|-------------------|-------------|--------------|
|                                   | 1 April |             |                  | Risk              |             | 30 June      |
|                                   | 2014    | Net run-off | Disposals<br>(1) | parameters<br>(2) | Impairments | Other<br>(3) |
| <b>Quarter ended 30 June 2014</b> | £bn     | £bn         | £bn              | £bn               | £bn         | £bn          |
| Ulster Bank                       | 2.8     | -           | (0.1)            | (0.4)             | -           | -            |
| Total                             | 2.8     | -           | (0.1)            | (0.4)             | -           | -            |

|  |           |             |               |                |             |           |             |
|--|-----------|-------------|---------------|----------------|-------------|-----------|-------------|
| Real Estate Finance                                      | 11.5      | (0.2)       | (0.6)         | (4.2)          | -           | (0.1)     | <b>6.4</b>  |
| Corporate  | 14.7      | (0.6)       | (0.5)         | 2.2            | (0.4)       | (0.3)     | <b>15.1</b> |
| Markets  | 11.5      | (1.6)       | (0.7)         | 2.2            | -           | (0.1)     | <b>11.3</b> |
|  |           |             |               |                |             |           |             |
| Total  | 40.5      | (2.4)       | (1.9)         | (0.2)          | -           | (0.5)     | <b>35.1</b> |
|  |           |             |               |                |             |           |             |
|  | 1 January |             |               | Risk           |             |           | 31 March    |
|  | 2014      | Net run-off | Disposals (1) | parameters (2) | Impairments | Other (3) | 2014        |
| Quarter ended 31 March 2014                              | £bn       | £bn         | £bn           | £bn            | £bn         | £bn       | £bn         |
|  |           |             |               |                |             |           |             |
| Ulster Bank  | 3.3       | (0.5)       | -             | -              | -           | -         | 2.8         |
| Real Estate Finance                                      | 13.5      | (1.6)       | (0.1)         | (0.3)          | -           | -         | 11.5        |
| Corporate  | 16.4      | (0.3)       | (0.5)         | (0.8)          | -           | (0.1)     | 14.7        |
| Markets  | 13.5      | (0.2)       | (0.6)         | (1.2)          | -           | -         | 11.5        |
|  |           |             |               |                |             |           |             |
| Total  | 46.7      | (2.6)       | (1.2)         | (2.3)          | -           | (0.1)     | 40.5        |
|  |           |             |               |                |             |           |             |
| For the notes to this table refer to the following page. |           |             |               |                |             |           |             |

## RBS Capital Resolution

| <b>Capital deductions</b>          |              |              |               |              |              |             |              |
|------------------------------------|--------------|--------------|---------------|--------------|--------------|-------------|--------------|
|                                    | 1 April      |              |               | Risk         |              | Other       | 30 June      |
|                                    | 2014         | Net run-off  | Disposals (1) | parameters   | Impairments  | (3)         | 2014         |
| <b>Quarter ended 30 June 2014</b>  | £m           | £m           | £m            | (2)          | £m           | £m          | £m           |
| Ulster Bank                        | 387          | (26)         | (103)         | 17           | (46)         | (12)        | 217          |
| Real Estate Finance                | 184          | (81)         | (29)          | 242          | 101          | (12)        | 405          |
| Corporate                          | 237          | (23)         | (62)          | 97           | (83)         | (10)        | 156          |
| Markets                            | 231          | (9)          | (79)          | (79)         | -            | -           | 64           |
| <b>Total</b>                       | <b>1,039</b> | <b>(139)</b> | <b>(273)</b>  | <b>277</b>   | <b>(28)</b>  | <b>(34)</b> | <b>842</b>   |
|                                    | 1 January    |              |               | Risk         |              | Other       | 31 March     |
|                                    | 2014         | Net run-off  | Disposals (1) | parameters   | Impairments  | (3)         | 2014         |
| <b>Quarter ended 31 March 2014</b> | £m           | £m           | £m            | (2)          | £m           | £m          | £m           |
| Ulster Bank                        | 559          | (2)          | (14)          | (135)        | (17)         | (4)         | 387          |
| Real Estate Finance                | 505          | (211)        | (59)          | 31           | (78)         | (4)         | 184          |
| Corporate                          | 477          | (71)         | 17            | (159)        | (27)         | -           | 237          |
| Markets                            | 291          | -            | -             | (56)         | -            | (4)         | 231          |
| <b>Total</b>                       | <b>1,832</b> | <b>(284)</b> | <b>(56)</b>   | <b>(319)</b> | <b>(122)</b> | <b>(12)</b> | <b>1,039</b> |

| <b>RWA equivalent</b>             |         |             |               |            |             |       |         |
|-----------------------------------|---------|-------------|---------------|------------|-------------|-------|---------|
|                                   | 1 April |             |               | Risk       |             | Other | 30 June |
|                                   | 2014    | Net run-off | Disposals (1) | parameters | Impairments | (3)   | 2014    |
| <b>Quarter ended 30 June 2014</b> | £bn     | £bn         | £bn           | (2)        | £bn         | £bn   | £bn     |
|                                   |         |             |               |            |             |       |         |

## Edgar Filing: ROYAL BANK OF SCOTLAND GROUP PLC - Form 6-K

|                                |           |             |               |                   |             |              |             |
|--------------------------------|-----------|-------------|---------------|-------------------|-------------|--------------|-------------|
| Ulster Bank                    | 6.7       | (0.3)       | (1.1)         | (0.2)             | (0.5)       | (0.1)        | <b>4.5</b>  |
| Real Estate Finance            | 13.4      | (1.0)       | (0.9)         | (1.8)             | 1.0         | (0.2)        | <b>10.5</b> |
| Corporate                      | 17.0      | (0.8)       | (1.1)         | 3.2               | (1.2)       | (0.5)        | <b>16.6</b> |
| Markets                        | 13.8      | (1.7)       | (1.5)         | 1.4               | -           | (0.1)        | <b>11.9</b> |
|                                |           |             |               |                   |             |              |             |
| Total                          | 50.9      | (3.8)       | (4.6)         | 2.6               | (0.7)       | (0.9)        | <b>43.5</b> |
|                                |           |             |               |                   |             |              |             |
|                                | 1 January |             |               | Risk              |             |              | 31 March    |
|                                | 2014      | Net run-off | Disposals (1) | parameters<br>(2) | Impairments | Other<br>(3) | 2014        |
| Quarter ended 31<br>March 2014 | £bn       | £bn         | £bn           | £bn               | £bn         | £bn          | £bn         |
|                                |           |             |               |                   |             |              |             |
| Ulster Bank                    | 8.9       | (0.5)       | (0.1)         | (1.4)             | (0.2)       | -            | 6.7         |
| Real Estate Finance            | 18.6      | (3.7)       | (0.7)         | -                 | (0.8)       | -            | 13.4        |
| Corporate                      | 21.1      | (1.0)       | (0.3)         | (2.4)             | (0.3)       | (0.1)        | 17.0        |
| Markets                        | 16.4      | (0.2)       | (0.6)         | (1.7)             | -           | (0.1)        | 13.8        |
|                                |           |             |               |                   |             |              |             |
| Total                          | 65.0      | (5.4)       | (1.7)         | (5.5)             | (1.3)       | (0.2)        | 50.9        |
|                                |           |             |               |                   |             |              |             |

Notes:

- (1) Includes all aspects relating to disposals, including associated removal of deductions from regulatory capital.
- (2) Principally reflects credit migration and other technical adjustments.
- (3) Includes fair value adjustments and foreign exchange movements.

## RBS Capital Resolution

| Gross loans and advances, REIL and related impairments |           |      |            |           |            |            |            |             |
|--|-----------|------|------------|-----------|------------|------------|------------|-------------|
| Credit metrics   |           |      |            |           |            |            | YTD        |             |
|  |           |      |            | REIL as a | Provisions | Provisions | Impairment | YTD         |
|  | Gross     |      |            | % of      | as a %     | as a % of  | charge/    | Amounts     |
|  | loans (1) | REIL | Provisions | gross     | of REIL    | gross      | (gain) (2) | written-off |
| 30 June 2014   | £bn       | £bn  | £bn        | %         | %          | %          | £m         | £m          |
| <b>By sector:</b>                                      |           |      |            |           |            |            |            |             |
| Commercial real estate                                 |           |      |            |           |            |            |            |             |
| - investment   | 10.7      | 8.2  | 4.4        | 77        | 54         | 41         | (35)       | 839         |
| - development  | 7.6       | 7.0  | 6.1        | 92        | 87         | 80         | (65)       | 222         |
| Asset finance  | 2.5       | 0.9  | 0.4        | 36        | 44         | 16         | 19         | 21          |
| Other corporate  | 9.1       | 4.3  | 3.5        | 47        | 81         | 38         | 71         | 532         |
| Other  | 0.1       | -    | -          | -         | -          | -          | -          | 5           |
|  | 30.0      | 20.4 | 14.4       | 68        | 71         | 48         | (10)       | 1,619       |
| <b>By donating segment and sector</b>                  |           |      |            |           |            |            |            |             |
| Ulster Bank  |           |      |            |           |            |            |            |             |
| Commercial real estate                                 |           |      |            |           |            |            |            |             |
| - investment   | 4.5       | 4.3  | 2.7        | 96        | 63         | 60         | (42)       | 126         |
| - development  | 6.5       | 6.4  | 5.8        | 98        | 91         | 89         | (79)       | 192         |
| Other corporate  | 2.9       | 2.3  | 2.1        | 79        | 91         | 72         | 106        | 157         |
| Total Ulster Bank                                      | 13.9      | 13.0 | 10.6       | 94        | 82         | 76         | (15)       | 475         |
| Commercial Banking                                     |           |      |            |           |            |            |            |             |
| Commercial real estate                                 |           |      |            |           |            |            |            |             |

|                                 |             |             |             |           |           |           |             |              |
|---------------------------------|-------------|-------------|-------------|-----------|-----------|-----------|-------------|--------------|
| - investment                    | 2.2         | 1.3         | 0.5         | 59        | 38        | 23        | 33          | 51           |
| - development                   | 0.8         | 0.5         | 0.2         | 63        | 40        | 25        | 15          | 11           |
| Asset finance                   | -           | -           | -           | -         | -         | -         | -           | 3            |
| Other corporate                 | 1.2         | 0.6         | 0.4         | 50        | 67        | 33        | 30          | 113          |
| Other                           | -           | -           | -           | -         | -         | -         | -           | 4            |
|                                 |             |             |             |           |           |           |             |              |
| <b>Total Commercial Banking</b> | <b>4.2</b>  | <b>2.4</b>  | <b>1.1</b>  | <b>57</b> | <b>46</b> | <b>26</b> | <b>78</b>   | <b>182</b>   |
|                                 |             |             |             |           |           |           |             |              |
| <b>CIB</b>                      |             |             |             |           |           |           |             |              |
| Commercial real estate          |             |             |             |           |           |           |             |              |
| - investment                    | 4.0         | 2.6         | 1.2         | 65        | 46        | 30        | (26)        | 662          |
| - development                   | 0.3         | 0.1         | 0.1         | 33        | 100       | 33        | (1)         | 19           |
| Asset finance                   | 2.5         | 0.9         | 0.4         | 36        | 44        | 16        | 19          | 18           |
| Other corporate                 | 5.0         | 1.4         | 1.0         | 28        | 71        | 20        | (65)        | 262          |
| Other                           | 0.1         | -           | -           | -         | -         | -         | -           | 1            |
|                                 |             |             |             |           |           |           |             |              |
| <b>Total CIB</b>                | <b>11.9</b> | <b>5.0</b>  | <b>2.7</b>  | <b>42</b> | <b>54</b> | <b>23</b> | <b>(73)</b> | <b>962</b>   |
|                                 |             |             |             |           |           |           |             |              |
| <b>Total</b>                    | <b>30.0</b> | <b>20.4</b> | <b>14.4</b> | <b>68</b> | <b>71</b> | <b>48</b> | <b>(10)</b> | <b>1,619</b> |
|                                 |             |             |             |           |           |           |             |              |
| <b>Of which:</b>                |             |             |             |           |           |           |             |              |
| UK                              | 13.9        | 8.0         | 5.0         | 58        | 63        | 36        | (71)        | 1,057        |
| Europe                          | 15.0        | 12.0        | 9.2         | 80        | 77        | 61        | 78          | 553          |
| US                              | 0.3         | 0.1         | -           | 33        | -         | -         | (8)         | 2            |
| RoW                             | 0.8         | 0.3         | 0.2         | 38        | 67        | 25        | (9)         | 7            |
|                                 |             |             |             |           |           |           |             |              |
|                                 | <b>30.0</b> | <b>20.4</b> | <b>14.4</b> | <b>68</b> | <b>71</b> | <b>48</b> | <b>(10)</b> | <b>1,619</b> |
|                                 |             |             |             |           |           |           |             |              |
| Banks                           | 0.6         | -           | -           | -         | -         | -         | (10)        | -            |

## Notes:

- (1) Includes disposal groups.
- (2) Impairment losses include those relating to AFS securities; sector analyses above include allocation of latent impairment charges.

**RBS Capital Resolution****Gross loans and advances, REIL and related impairments** (continued)

|                                |           |            | Impairment |             |
|--------------------------------|-----------|------------|------------|-------------|
|                                | Gross     | Provisions | charge/    | Amounts     |
|                                | loans (1) |            | (gain) (2) | written-off |
| 31 March 2014                  | £bn       | £bn        | £m         | £m          |
| By donating segment and sector |           |            |            |             |
| Ulster Bank                    |           |            |            |             |
| Commercial real estate         |           |            |            |             |
| - investment                   | 5.4       | 3.1        | 47         | 3           |
| - development                  | 7.1       | 6.2        | (29)       | 31          |
| Other corporate                | 3.0       | 2.0        | 34         | 25          |
| Total Ulster Bank              | 15.5      | 11.3       | 52         | 59          |
| Commercial Banking             |           |            |            |             |
| Commercial real estate         |           |            |            |             |
| - investment                   | 2.4       | 0.5        | 52         | 1           |
| - development                  | 0.7       | 0.3        | 13         | 1           |
| Other corporate                | 1.7       | 0.5        | 16         | 25          |
| Other                          | -         | -          | -          | 5           |
| Total Commercial Banking       | 4.8       | 1.3        | 81         | 32          |
| CIB                            |           |            |            |             |
| Commercial real estate         |           |            |            |             |
| - investment                   | 5.1       | 1.4        | 34         | 370         |
| - development                  | 0.3       | 0.1        | 10         | 3           |
| Asset finance                  | 2.5       | 0.4        | 8          | -           |
| Other corporate                | 5.6       | 1.2        | (47)       | 326         |
| Other                          | 0.2       | -          | (30)       | -           |
| Total CIB                      | 13.7      | 3.1        | (25)       | 699         |

|       |      |      |     |     |
|-------|------|------|-----|-----|
|       |      |      |     |     |
| Total | 34.0 | 15.7 | 108 | 790 |
|       |      |      |     |     |
| Banks | 0.7  | -    | -   | -   |

## Notes:

- (1) Includes disposal groups.
- (2) Impairment losses include those relating to AFS securities; sector analyses above include allocation of latent impairment charges.



## RBS Capital Resolution

### Key points

#### H1 2014

Funded assets have reduced by £8 billion, or 28%, to £21 billion since inception on 1 January 2014, driven by disposals and run-off.

RWA equivalent decreased by £21 billion, or 33%, to £44 billion during H1 2014. This primarily reflects disposals and run-off, supplemented by methodology changes and lower operational and market risk RWAs.

The operating loss of £48 million benefited from £281 million of disposal gains and recoveries in H1 2014 with underlying impairments of £301 million.

The net effect of the operating loss and RWA equivalent (RWAe) reduction resulted in net CET1 accretion of £2 billion.

#### Q2 2014 compared with Q1 2014

##### Capital

RWAe reduction of £7 billion, to £44 billion, reflects a combination of disposals, run-off and lower market risk RWAs.

The operating focus in the quarter was on capital intensive positions to maximise the capital accretion benefit. Reductions in these positions were achieved in a capital accretive manner and consistent with our asset management principles. Disposal activity was spread across all sectors, with the most notable reductions in the Ulster Bank and Real Estate business pillars.

##### Funded assets

Funded assets fell to £21 billion, a reduction of £3 billion, or 14%, during the quarter.

The reduction was achieved by a mixture of run-off and disposals, and continued to benefit from a combination of strong liquidity in the market and asset demand in specific sectors. The first major disposal in Ireland was completed in Q2 2014 which reduced funded assets by £0.5 billion.

The percentage mix of assets across each of the business pillars remained broadly stable.

## Operating performance

Operating profit for the second quarter was £66 million, a £180 million improvement compared with Q1 2014 and included a £36 million latent provision release reflecting improving credit conditions. The operating performance also benefited from a number of disposal gains and recoveries with good pricing in the market and efficient execution.

The favourable market conditions were reflected in higher than anticipated sale prices for assets disposed of in the quarter, resulting in disposal gains of £225 million, primarily through the write back of impairment provisions, compared with £56 million in Q1 2014.

The net effect of the operating profit of £66 million and RWAE reduction of £7 billion<sup>(1)</sup> resulted in net CET1 accretion of £0.8 billion in the quarter.

## Funding employed

RCR continues to be funded primarily by RBS Treasury and has no material third party deposits.

A run off profile of 85% over three years has been assumed for RCR's asset base with the associated funding cost being calculated from Treasury issuance maturing in line with the run down of the RCR balance sheet.

## Note

(1) Capital equivalent - £0.7 billion at an internal CET1 ratio of 10%.

## Condensed consolidated income statement

for the period ended 30 June 2014

|  | Half year ended |                | Quarter ended  |                |                |
|--|-----------------|----------------|----------------|----------------|----------------|
|  | 30 June         | 30 June        | 30 June        | 31 March       | 30 June        |
|  | 2014            | 2013           | 2014           | 2014           | 2013           |
|  | £m              | £m             | £m             | £m             | £m             |
| Interest receivable                                | 7,621           | 8,560          | 3,821          | 3,800          | 4,281          |
| Interest payable                                   | (2,128)         | (3,123)        | (1,023)        | (1,105)        | (1,514)        |
| <b>Net interest income</b>                         | <b>5,493</b>    | <b>5,437</b>   | <b>2,798</b>   | <b>2,695</b>   | <b>2,767</b>   |
| Fees and commissions receivable                    | 2,605           | 2,708          | 1,314          | 1,291          | 1,392          |
| Fees and commissions payable                       | (487)           | (460)          | (251)          | (236)          | (250)          |
| Income from trading activities                     | 1,493           | 2,064          | 541            | 952            | 949            |
| Gain on redemption of own debt                     | 20              | 191            | -              | 20             | 242            |
| Other operating income                             | 1,036           | 1,332          | 345            | 691            | 720            |
| <b>Non-interest income</b>                         | <b>4,667</b>    | <b>5,835</b>   | <b>1,949</b>   | <b>2,718</b>   | <b>3,053</b>   |
| <b>Total income</b>                                | <b>10,160</b>   | <b>11,272</b>  | <b>4,747</b>   | <b>5,413</b>   | <b>5,820</b>   |
| Staff costs  | (3,536)         | (3,727)        | (1,845)        | (1,691)        | (1,840)        |
| Premises and equipment                             | (1,275)         | (1,104)        | (622)          | (653)          | (548)          |
| Other administrative expenses                      | (1,662)         | (2,181)        | (951)          | (711)          | (1,418)        |
| Depreciation and amortisation                      | (554)           | (736)          | (282)          | (272)          | (349)          |
| Write-down of goodwill and other intangible assets | (212)           | -              | (130)          | (82)           | -              |
| <b>Operating expenses</b>                          | <b>(7,239)</b>  | <b>(7,748)</b> | <b>(3,830)</b> | <b>(3,409)</b> | <b>(4,155)</b> |
| <b>Profit before impairment losses</b>             | <b>2,921</b>    | <b>3,524</b>   | <b>917</b>     | <b>2,004</b>   | <b>1,665</b>   |
| Impairment (losses)/recoveries                     | (269)           | (2,150)        | 93             | (362)          | (1,117)        |
| <b>Operating profit before tax</b>                 | <b>2,652</b>    | <b>1,374</b>   | <b>1,010</b>   | <b>1,642</b>   | <b>548</b>     |
| Tax charge   | (733)           | (678)          | (371)          | (362)          | (328)          |
| <b>Profit from continuing operations</b>           | <b>1,919</b>    | <b>696</b>     | <b>639</b>     | <b>1,280</b>   | <b>220</b>     |

|  |              |       |            |       |       |
|--|--------------|-------|------------|-------|-------|
| Profit from discontinued operations, net of tax                  | 35           | 138   | 26         | 9     | 9     |
| <b>Profit for the period</b>                                     | <b>1,954</b> | 834   | <b>665</b> | 1,289 | 229   |
| Non-controlling interests  | (42)         | (117) | (23)       | (19)  | 14    |
| Preference share and other dividends                             | (487)        | (182) | (412)      | (75)  | (101) |
| <b>Profit attributable to ordinary and B shareholders</b>        | <b>1,425</b> | 535   | <b>230</b> | 1,195 | 142   |
| <b>Earnings/(loss) per ordinary and equivalent B share (EPS)</b> |              |       |            |       |       |
| Basic EPS from continuing and discontinued operations            | 12.7p        | -     | 2.0p       | -     | -     |
| Basic EPS from continuing operations                             | 12.5p        | -     | 1.9p       | -     | -     |

## Notes:

- (1) Basic EPS for the half year and quarter ended 30 June 2013 have been restated to reflect the terms of the dividend access share (see Note 9 on page 88).
- (2) Diluted EPS in the half year ended 30 June 2014 and the quarter ended 30 June 2014 were 0.1p lower than basic EPS.

**Condensed consolidated statement of comprehensive income**  
**for the period ended 30 June 2014**

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| <b>Profit for the period</b>                            | <b>1,954</b>    | 834     | <b>665</b>    | 1,289    | 229     |
| <b>Items that qualify for reclassification</b>          |                 |         |               |          |         |
| Available-for-sale financial assets                     | <b>529</b>      | (733)   | <b>265</b>    | 264      | (1,009) |
| Cash flow hedges  | <b>248</b>      | (1,536) | <b>(47)</b>   | 295      | (1,502) |
| Currency translation                                    | <b>(733)</b>    | 1,310   | <b>(598)</b>  | (135)    | 113     |
| Tax   | <b>(160)</b>    | 726     | <b>(72)</b>   | (88)     | 678     |
| <b>Other comprehensive (loss)/income after tax</b>      | <b>(116)</b>    | (233)   | <b>(452)</b>  | 336      | (1,720) |
| <b>Total comprehensive income/(loss) for the period</b> | <b>1,838</b>    | 601     | <b>213</b>    | 1,625    | (1,491) |
| <b>Total comprehensive income/(loss) is</b>             |                 |         |               |          |         |
| <b>attributable to:</b>                                 |                 |         |               |          |         |
| Non-controlling interests                               | <b>30</b>       | 134     | <b>6</b>      | 24       | (15)    |
| Preference shareholders                                 | <b>140</b>      | 152     | <b>75</b>     | 65       | 81      |
| Paid-in equity holders                                  | <b>27</b>       | 30      | <b>17</b>     | 10       | 20      |
| Dividend access share                                   | <b>320</b>      | -       | <b>320</b>    | -        | -       |
| Ordinary and B shareholders                             | <b>1,321</b>    | 285     | <b>(205)</b>  | 1,526    | (1,577) |
|   | <b>1,838</b>    | 601     | <b>213</b>    | 1,625    | (1,491) |

**Key points**

The movement in available-for-sale financial assets during both the half year and quarter reflects unrealised gains predominately arising on Spanish and US bonds, partially offset by realised gains on high quality UK, Dutch and German sovereign bonds.

Cash flow hedging gains in H1 largely result from decreases in Sterling, Euro and US dollar swap rates in the main durations of the underlying portfolio.

Currency translation losses during the half year and quarter are principally due to the strengthening of Sterling against the US dollar and, in the quarter, the Euro.

**Condensed consolidated balance sheet**

at 30 June 2014

|   | 30 June          | 31 March         | 31               |
|---|------------------|------------------|------------------|
|   | 2014             | 2014             | December         |
|   | £m               | £m               | 2013             |
|   |                  |                  | £m               |
| <b>Assets</b>                                     |                  |                  |                  |
| Cash and balances at central banks                | 68,670           | 69,647           | 82,659           |
| Net loans and advances to banks                   | 28,904           | 28,302           | 27,555           |
| Reverse repurchase agreements and stock borrowing | 28,163           | 26,470           | 26,516           |
| Loans and advances to banks                       | 57,067           | 54,772           | 54,071           |
| Net loans and advances to customers               | 385,554          | 390,780          | 390,825          |
| Reverse repurchase agreements and stock borrowing | 53,542           | 51,743           | 49,897           |
| Loans and advances to customers                   | 439,096          | 442,523          | 440,722          |
| Debt securities                                   | 112,794          | 120,737          | 113,599          |
| Equity shares                                     | 7,834            | 9,761            | 8,811            |
| Settlement balances                               | 19,682           | 16,900           | 5,591            |
| Derivatives                                       | 274,906          | 277,294          | 288,039          |
| Intangible assets                                 | 12,173           | 12,428           | 12,368           |
| Property, plant and equipment                     | 7,115            | 7,437            | 7,909            |
| Deferred tax                                      | 3,107            | 3,289            | 3,478            |
| Prepayments, accrued income and other assets      | 7,418            | 7,077            | 7,614            |
| Assets of disposal groups                         | 1,246            | 1,905            | 3,017            |
| <b>Total assets</b>                               | <b>1,011,108</b> | <b>1,023,770</b> | <b>1,027,878</b> |
| <b>Liabilities</b>                                |                  |                  |                  |
| Bank deposits                                     | 39,179           | 35,371           | 35,329           |
| Repurchase agreements and stock lending           | 31,722           | 31,691           | 28,650           |
| Deposits by banks                                 | 70,901           | 67,062           | 63,979           |
| Customer deposits                                 | 401,226          | 401,276          | 414,396          |
| Repurchase agreements and stock lending           | 51,540           | 57,085           | 56,484           |
| Customer accounts                                 | 452,766          | 458,361          | 470,880          |
| Debt securities in issue                          | 59,087           | 61,755           | 67,819           |
| Settlement balances                               | 15,128           | 17,175           | 5,313            |
| Short positions                                   | 39,019           | 37,850           | 28,022           |
| Derivatives                                       | 270,087          | 274,506          | 285,526          |
| Accruals, deferred income and other liabilities   | 14,876           | 15,336           | 16,017           |

|                                     |                  |           |           |
|-------------------------------------|------------------|-----------|-----------|
| Retirement benefit liabilities      | <b>2,742</b>     | 2,829     | 3,210     |
| Deferred tax                        | <b>605</b>       | 583       | 507       |
| Subordinated liabilities            | <b>24,809</b>    | 24,139    | 24,012    |
| Liabilities of disposal groups      | <b>125</b>       | 3,238     | 3,378     |
|                                     |                  |           |           |
| <b>Total liabilities</b>            | <b>950,145</b>   | 962,834   | 968,663   |
|                                     |                  |           |           |
| <b>Equity</b>                       |                  |           |           |
| Non-controlling interests           | <b>618</b>       | 612       | 473       |
| Owners' equity*                     |                  |           |           |
| Called up share capital             | <b>6,811</b>     | 6,752     | 6,714     |
| Reserves                            | <b>53,534</b>    | 53,572    | 52,028    |
|                                     |                  |           |           |
| Total equity                        | <b>60,963</b>    | 60,936    | 59,215    |
|                                     |                  |           |           |
| <b>Total liabilities and equity</b> | <b>1,011,108</b> | 1,023,770 | 1,027,878 |
|                                     |                  |           |           |
| * Owners' equity attributable to:   |                  |           |           |
| Ordinary and B shareholders         | <b>55,053</b>    | 55,032    | 53,450    |
| Other equity owners                 | <b>5,292</b>     | 5,292     | 5,292     |
|                                     |                  |           |           |
|                                     | <b>60,345</b>    | 60,324    | 58,742    |



## Average balance sheet

|  | Half year ended |         | Quarter ended |          |
|--|-----------------|---------|---------------|----------|
|  | 30 June         | 30 June | 30 June       | 31 March |
|  | 2014            | 2013    | 2014          | 2014     |
|  | %               | %       | %             | %        |
| <b>Average yields, spreads and margins of the banking business</b> |                 |         |               |          |
| Gross yield on interest-earning assets of banking business         | 3.03            | 3.11    | 3.05          | 3.01     |
| Cost of interest-bearing liabilities of banking business           | (1.20)          | (1.50)  | (1.17)        | (1.24)   |
| <b>Interest spread of banking business</b>                         | <b>1.83</b>     | 1.61    | <b>1.88</b>   | 1.77     |
| Benefit from interest-free funds                                   | 0.36            | 0.36    | 0.35          | 0.36     |
| <b>Net interest margin of banking business</b>                     | <b>2.18</b>     | 1.97    | <b>2.23</b>   | 2.13     |
| <b>Average interest rates</b>                                      |                 |         |               |          |
| Base rate  | 0.50            | 0.50    | 0.50          | 0.50     |
| London inter-bank three month offered rates                        |                 |         |               |          |
| - Sterling   | 0.52            | 0.51    | 0.52          | 0.52     |
| - Eurodollar   | 0.23            | 0.28    | 0.23          | 0.23     |
| - Euro   | 0.30            | 0.21    | 0.30          | 0.30     |

## Average balance sheet

|                                      | Half year ended |          |        | Half year ended |          |        |
|--------------------------------------|-----------------|----------|--------|-----------------|----------|--------|
|                                      | 30 June 2014    |          |        | 30 June 2013    |          |        |
|                                      | Average         |          |        | Average         |          |        |
|                                      | balance         | Interest | Rate   | balance         | Interest | Rate   |
|                                      | £m              | £m       | %      | £m              | £m       | %      |
| <b>Assets</b>                        |                 |          |        |                 |          |        |
| Loans and advances to banks          | 69,097          | 178      | 0.52   | 74,631          | 222      | 0.60   |
| Loans and advances to customers      | 382,284         | 7,061    | 3.72   | 406,483         | 7,640    | 3.79   |
| Debt securities                      | 55,707          | 382      | 1.38   | 74,595          | 698      | 1.89   |
| Interest-earning assets              |                 |          |        |                 |          |        |
| - banking business (1)               | 507,088         | 7,621    | 3.03   | 555,709         | 8,560    | 3.11   |
| - trading business (2)               | 176,200         |          |        | 232,773         |          |        |
| Non-interest earning assets          | 351,509         |          |        | 521,802         |          |        |
| Total assets                         | 1,034,797       |          |        | 1,310,284       |          |        |
| <b>Liabilities</b>                   |                 |          |        |                 |          |        |
| Deposits by banks                    | 16,991          | 95       | 1.13   | 26,410          | 223      | 1.70   |
| Customer accounts                    | 297,928         | 987      | 0.67   | 332,939         | 1,577    | 0.96   |
| Debt securities in issue             | 38,728          | 557      | 2.90   | 54,267          | 698      | 2.59   |
| Subordinated liabilities             | 23,016          | 432      | 3.79   | 23,955          | 447      | 3.76   |
| Internal funding of trading business | (20,254)        | 57       | (0.57) | (18,266)        | 178      | (1.97) |
| Interest-bearing liabilities         |                 |          |        |                 |          |        |
| - banking business                   | 356,409         | 2,128    | 1.20   | 419,305         | 3,123    | 1.50   |
| - trading business (2)               | 185,308         |          |        | 236,675         |          |        |
| Non-interest-bearing liabilities     |                 |          |        |                 |          |        |
| - demand deposits                    | 81,316          |          |        | 76,820          |          |        |
| - other liabilities                  | 351,614         |          |        | 507,624         |          |        |
| Owners' equity (3)                   | 60,150          |          |        | 69,860          |          |        |
| Total liabilities and owners' equity | 1,034,797       |          |        | 1,310,284       |          |        |

Notes:

- (1) 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.
- (2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (3) Including equity attributable to ordinary and B shareholders of £53,931 million (H1 2013 - £63,261 million).

## Average balance sheet

|                                      | Quarter ended            |                |           | Quarter ended            |                |           |
|--------------------------------------|--------------------------|----------------|-----------|--------------------------|----------------|-----------|
|                                      | 30 June 2014             |                |           | 31 March 2014            |                |           |
|                                      | 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          | 66,047                   | 89             | 0.54      | 72,181                   | 89             | 0.50      |
| Loans and advances to customers      | 380,731                  | 3,543          | 3.73      | 383,857                  | 3,518          | 3.72      |
| Debt securities                      | 55,377                   | 189            | 1.37      | 56,041                   | 193            | 1.40      |
| Interest-earning assets              |                          |                |           |                          |                |           |
| - banking business (1)               | 502,155                  | 3,821          | 3.05      | 512,079                  | 3,800          | 3.01      |
| - trading business (2)               | 175,066                  |                |           | 177,347                  |                |           |
| Non-interest earning assets          | 358,298                  |                |           | 344,641                  |                |           |
| Total assets                         | 1,035,519                |                |           | 1,034,067                |                |           |
| <b>Liabilities</b>                   |                          |                |           |                          |                |           |
| Deposits by banks                    | 16,983                   | 41             | 0.97      | 16,884                   | 54             | 1.30      |
| Customer accounts                    | 294,937                  | 471            | 0.64      | 300,953                  | 516            | 0.70      |
| Debt securities in issue             | 37,690                   | 270            | 2.87      | 39,778                   | 287            | 2.93      |
| Subordinated liabilities             | 23,536                   | 220            | 3.75      | 22,386                   | 212            | 3.84      |
| Internal funding of trading business | (22,224)                 | 21             | (0.38)    | (18,262)                 | 36             | (0.80)    |
| Interest-bearing liabilities         |                          |                |           |                          |                |           |
| - banking business                   | 350,922                  | 1,023          | 1.17      | 361,739                  | 1,105          | 1.24      |
| - trading business (2)               | 184,529                  |                |           | 186,096                  |                |           |
| Non-interest-bearing liabilities     |                          |                |           |                          |                |           |
| - demand deposits                    | 82,213                   |                |           | 80,409                   |                |           |
| - other liabilities                  | 357,505                  |                |           | 345,875                  |                |           |
| Owners' equity (3)                   | 60,350                   |                |           | 59,948                   |                |           |
| Total liabilities and owners' equity | 1,035,519                |                |           | 1,034,067                |                |           |

Notes:

- (1) 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.
- (2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (3) Including equity attributable to ordinary and B shareholders of £54,425 million (Q1 2014 - £53,436 million).

**Condensed consolidated statement of changes in equity**

for the period ended 30 June 2014

|  | Half year ended |         | Quarter ended |          |         |
|--|-----------------|---------|---------------|----------|---------|
|  | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|  | 2014            | 2013    | 2014          | 2014     | 2013    |
|  | £m              | £m      | £m            | £m       | £m      |
| <b>Called-up share capital</b>                           |                 |         |               |          |         |
| At beginning of period                                   | 6,714           | 6,582   | 6,752         | 6,714    | 6,619   |
| Ordinary shares issued                                   | 97              | 50      | 59            | 38       | 13      |
| At end of period   | 6,811           | 6,632   | 6,811         | 6,752    | 6,632   |
| <b>Paid-in equity</b>                                    |                 |         |               |          |         |
| At beginning and end of period                           | 979             | 979     | 979           | 979      | 979     |
| <b>Share premium account</b>                             |                 |         |               |          |         |
| At beginning of period                                   | 24,667          | 24,361  | 24,760        | 24,667   | 24,455  |
| Ordinary shares issued                                   | 218             | 122     | 125           | 93       | 28      |
| At end of period   | 24,885          | 24,483  | 24,885        | 24,760   | 24,483  |
| <b>Merger reserve</b>                                    |                 |         |               |          |         |
| At beginning and end of period                           | 13,222          | 13,222  | 13,222        | 13,222   | 13,222  |
| <b>Available-for-sale reserve</b>                        |                 |         |               |          |         |
| At beginning of period                                   | (308)           | (346)   | (62)          | (308)    | (10)    |
| Unrealised gains/(losses)                                | 844             | 14      | 411           | 433      | (568)   |
| Realised gains   | (366)           | (605)   | (148)         | (218)    | (441)   |
| Tax  | (68)            | 333     | (63)          | (5)      | 305     |
| Recycled to profit or loss on disposal of businesses (1) | 36              | (110)   | -             | 36       | -       |
| At end of period   | 138             | (714)   | 138           | (62)     | (714)   |
| <b>Cash flow hedging reserve</b>                         |                 |         |               |          |         |
| At beginning of period                                   | (84)            | 1,666   | 141           | (84)     | 1,635   |
| Amount recognised in equity                              | 968             | (859)   | 315           | 653      | (1,118) |
| Amount transferred from equity to earnings               | (720)           | (677)   | (362)         | (358)    | (384)   |

|  |       |         |       |       |         |
|--|-------|---------|-------|-------|---------|
| Tax  | (70)  | 361     | -     | (70)  | 358     |
|  |       |         |       |       |         |
| At end of period                                     | 94    | 491     | 94    | 141   | 491     |
|  |       |         |       |       |         |
| <b>Foreign exchange reserve</b>                      |       |         |       |       |         |
| At beginning of period                               | 3,691 | 3,908   | 3,551 | 3,691 | 5,072   |
| Retranslation of net assets                          | (872) | 1,430   | (702) | (170) | 44      |
| Foreign currency gains on hedges of net assets       | 155   | (131)   | 123   | 32    | 70      |
| Tax  | (11)  | (3)     | (9)   | (2)   | 15      |
| Recycled to profit or loss on disposal of businesses | -     | (3)     | -     | -     | -       |
|  |       |         |       |       |         |
| At end of period                                     | 2,963 | 5,201   | 2,963 | 3,551 | 5,201   |
|  |       |         |       |       |         |
| <b>Capital redemption reserve</b>                    |       |         |       |       |         |
| At beginning and end of period                       | 9,131 | 9,131   | 9,131 | 9,131 | 9,131   |
|  |       |         |       |       |         |
| <b>Contingent capital reserve</b>                    |       |         |       |       |         |
| At beginning and end of period                       | -     | (1,208) | -     | -     | (1,208) |

For the notes to this table refer the following page.

**Condensed consolidated statement of changes in equity**

for the period ended 30 June 2014

|   | Half year ended |               | Quarter ended |               |               |
|---|-----------------|---------------|---------------|---------------|---------------|
|   | 30 June         | 30 June       | 30 June       | 31 March      | 30 June       |
|   | 2014            | 2013          | 2014          | 2014          | 2013          |
|   | £m              | £m            | £m            | £m            | £m            |
| <b>Retained earnings</b>  |                 |               |               |               |               |
| At beginning of period  | 867             | 10,596        | 1,986         | 867           | 10,949        |
| Profit attributable to ordinary and B<br>shareholders and other equity owners |                 |               |               |               |               |
| - continuing operations   | 1,895           | 607           | 627           | 1,268         | 241           |
| - discontinued operations   | 17              | 110           | 15            | 2             | 2             |
| Equity preference dividends paid  | (140)           | (152)         | (75)          | (65)          | (81)          |
| Dividend Access Share dividend  | (320)           | -             | (320)         | -             | -             |
| Paid-in equity dividends paid, net of tax                                     | (27)            | (30)          | (17)          | (10)          | (20)          |
| Loss on disposal of own shares held   | -               | (18)          | -             | -             | (18)          |
| Shares released for employee benefits   | (41)            | (1)           | (5)           | (36)          | (1)           |
| Share-based payments  |                 |               |               |               |               |
| - gross   | 8               | (4)           | 47            | (39)          | 33            |
| - tax   | (1)             | (3)           | -             | (1)           | -             |
| At end of period  | 2,258           | 11,105        | 2,258         | 1,986         | 11,105        |
| <b>Own shares held</b>  |                 |               |               |               |               |
| At beginning of period  | (137)           | (213)         | (136)         | (137)         | (211)         |
| Disposal of own shares  | 1               | 73            | -             | 1             | 71            |
| Shares released for employee benefits   | -               | 1             | -             | -             | 1             |
| At end of period  | (136)           | (139)         | (136)         | (136)         | (139)         |
| <b>Owners' equity at end of period</b>  | <b>60,345</b>   | <b>69,183</b> | <b>60,345</b> | <b>60,324</b> | <b>69,183</b> |
| <b>Non-controlling interests</b>  |                 |               |               |               |               |
| At beginning of period  | 473             | 1,770         | 612           | 473           | 532           |
| Currency translation adjustments and<br>other movements                       | (16)            | 14            | (19)          | 3             | (1)           |
| Profit/(loss) attributable to non-controlling<br>interests                    |                 |               |               |               |               |
| - continuing operations   | 24              | 89            | 12            | 12            | (21)          |



|   |               |               |               |               |               |
|---|---------------|---------------|---------------|---------------|---------------|
| - discontinued operations   | 18            | 28            | 11            | 7             | 7             |
| Movements in available-for-sale securities                              |               |               |               |               |               |
| - unrealised (losses)/gains   | (2)           | 9             | (1)           | (1)           | -             |
| - realised losses   | 6             | -             | 3             | 3             | -             |
| - tax   | -             | (1)           | -             | -             | -             |
| - recycled to profit or loss on disposal of discontinued operations (2) | -             | (5)           | -             | -             | -             |
| Equity raised   | 115           | -             | -             | 115           | -             |
| Equity withdrawn and disposals  | -             | (1,429)       | -             | -             | (42)          |
|   |               |               |               |               |               |
| <b>At end of period</b>   | <b>618</b>    | <b>475</b>    | <b>618</b>    | <b>612</b>    | <b>475</b>    |
|   |               |               |               |               |               |
| <b>Total equity at end of period</b>                                    | <b>60,963</b> | <b>69,658</b> | <b>60,963</b> | <b>60,936</b> | <b>69,658</b> |

## Notes:

- (1) Net of tax - £11 million (Q1 2014 - £11 million; Q2 2013 - £35 million).  
(2) Net of tax - £1 million in H1 2013.

For an explanation of the movements in the available-for-sale, cash flow hedging and foreign exchange reserves refer to page 70.

**Condensed consolidated cash flow statement**

for the period ended 30 June 2014

|   | <b>Half year ended</b> |                |
|---|------------------------|----------------|
|   | <b>30 June</b>         | <b>30 June</b> |
|   | <b>2014</b>            | <b>2013</b>    |
|   | <b>£m</b>              | <b>£m</b>      |
| <b>Operating activities</b>                                   |                        |                |
| Operating profit before tax on continuing operations          | <b>2,652</b>           | 1,374          |
| Operating profit before tax on discontinued operations        | <b>40</b>              | 161            |
| Adjustments for non-cash items                                | <b>(897)</b>           | (7,378)        |
|   |                        |                |
| <b>Net cash inflow/(outflow) from trading activities</b>      | <b>1,795</b>           | (5,843)        |
| Changes in operating assets and liabilities                   | <b>(7,634)</b>         | 431            |
|   |                        |                |
| <b>Net cash flows from operating activities before tax</b>    | <b>(5,839)</b>         | (5,412)        |
| Income taxes received/(paid)                                  | <b>41</b>              | (260)          |
|   |                        |                |
| <b>Net cash flows from operating activities</b>               | <b>(5,798)</b>         | (5,672)        |
|   |                        |                |
| <b>Net cash flows from investing activities</b>               | <b>(641)</b>           | 12,293         |
|   |                        |                |
| <b>Net cash flows from financing activities</b>               | <b>921</b>             | (1,408)        |
|   |                        |                |
| Effects of exchange rate changes on cash and cash equivalents | <b>(2,391)</b>         | 4,948          |
|   |                        |                |
| <b>Net (decrease)/increase in cash and cash equivalents</b>   | <b>(7,909)</b>         | 10,161         |
| Cash and cash equivalents at beginning of period              | <b>121,177</b>         | 132,841        |
|   |                        |                |
| <b>Cash and cash equivalents at end of period</b>             | <b>113,268</b>         | 143,002        |

## Notes

### 1. Basis of preparation

The Group's condensed consolidated financial statements have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and IAS 34 'Interim Financial Reporting'. They should be read in conjunction with the Group's 2013 Annual Report on Form 20-F which were 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 (EU) (together IFRS).

From 13 March 2013, Direct Line Group (DLG) was classified as an associated undertaking and at 31 December 2013 the Group's interest in DLG was transferred to disposal groups. The Group disposed of its remaining interest in DLG in February 2014.

The consolidated financial statements comprise the condensed consolidated income statement, condensed consolidated statement of comprehensive income, condensed consolidated balance sheet, condensed consolidated statement of changed in equity, condensed consolidated cash flow statement and related explanatory notes 1 to 18 and have been prepared in accordance with IAS 34 'Interim Financial Reporting'.

The Group's 2014 condensed consolidated financial statements have been prepared in compliance with the British Bankers' Association Code for Financial Reporting Disclosure published in September 2010.

### Going concern

The Group's business activities and financial position, and the factors likely to affect its future development and performance are discussed on pages 6 to 136. Its objectives and policies in managing the financial risks to which it is exposed and its regulatory capital resources, liquidity and funding management are discussed in the Capital and risk management appendix. A summary of the risk factors which could materially affect the Group's future results are described on pages 138 to 140.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group will continue in operational existence for the foreseeable future. Accordingly, the results for the half year ended 30 June 2014 have been prepared on a going concern

basis.

## 2. Accounting policies

There have been no significant changes to the Group's principal accounting policies as set out on pages 369 to 381 of the Group's 2013 Annual Report on Form 20-F apart from the adoption of new and revised IFRSs that are effective from 1 January 2014:

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies identified in the application of the standard's criteria for offsetting financial assets and financial liabilities.

'Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)' applies to investment entities; such entities should account for their subsidiaries (other than those that provide services related to the entity's investment activities) at fair value through profit or loss.

IFRIC 21 'Levies' provides guidance on accounting for levies payable to public authorities if certain conditions are met on a particular date.

IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' aligns IAS 36's disclosure requirements about recoverable amounts with IASB's original intentions.

## Notes

### 2. Accounting policies (continued)

IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting on novation of a derivative designated as a hedging instrument.

The implementation of these requirements has not had a material effect on the Group's financial statements.

#### Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The judgements and assumptions that are considered to be the most important to the portrayal of the Group's financial condition are those relating to pensions; goodwill; provisions for liabilities; deferred tax; loan impairment provisions and fair value of financial instruments. These critical accounting policies and judgments are described on pages 378 to 381 of the Group's 2013 Annual Report on Form 20-F.

#### Recent developments in IFRS

In July 2014 the IASB published IFRS 9 'Financial Instruments'. IFRS 9 replaces the current financial instruments standard IAS 39, setting out new accounting requirements in a number of areas. First, there are revisions to the classification and measurement of financial instruments. There are new restrictions on the ability to account for financial assets at amortised cost and a prohibition on the bifurcation of embedded derivatives from financial assets. Accounting for financial liabilities is largely unchanged except for the treatment of changes in the fair value of liabilities designated as at fair value through profit or loss attributable to own credit risk; these are recognised in other comprehensive income. Secondly, there are amended requirements for hedge accounting designed to align the accounting more closely to the risk management framework and remove or simplify some of the rule-based requirements of IAS 39. The basic mechanics of hedge accounting: fair value, cash flow and net investment hedges are retained. Finally, there is a new approach to credit impairment provisions moving from IAS 39's incurred loss model to an expected loss model. An expected loss model will result in the recognition of credit impairment losses earlier than an incurred loss model. IFRS 9 is effective for periods beginning on or after 1 January 2018.

IFRS 9 makes major and fundamental changes to accounting for financial instruments. The Group is continuing its assessment of its effect on the Group's financial statements.

The IASB also published:

in January 2014 IFRS 14 'Regulatory Deferral Accounts' which permits costs that can be deferred in the presentation of regulatory accounts to be deferred also in accordance with IFRS.

in May 2014 IFRS 15 'Revenue from Contracts with Customers' effective from 1 January 2017 replacing IAS 11 'Construction Contracts', IAS 18 'Revenue' and several Interpretations. Contracts are bundled or unbundled into distinct performance obligations with revenue recognised as the obligations are met.

in May 2014 'Accounting for Acquisitions of interests in Joint Operations', an amendment to IFRS 11 'Joint Arrangements' to clarify that the donor of assets and liabilities to a joint operation should hold its continuing interest in them at the lower of cost and recoverable amount.

in May 2014 'Clarification of Acceptable Methods of Depreciation and Amortisation' amending IAS 16 'Property, Plant and Equipment and IAS 38 'Intangible Assets' to require any policy less prudent than straight line to be justified.

The Group is reviewing these requirements to determine their effect, if any, on its financial reporting.

## Notes

| <b>3. Analysis of income, expenses and impairment losses</b> |                 |         |                |          |         |
|--|-----------------|---------|----------------|----------|---------|
|  | Half year ended |         | Quarter ended  |          |         |
|  | <b>30 June</b>  | 30 June | <b>30 June</b> | 31 March | 30 June |
|  | <b>2014</b>     | 2013    | <b>2014</b>    | 2014     | 2013    |
|  | <b>£m</b>       | £m      | <b>£m</b>      | £m       | £m      |
| Loans and advances to customers                              | <b>7,061</b>    | 7,640   | <b>3,543</b>   | 3,518    | 3,809   |
| Loans and advances to banks                                  | <b>178</b>      | 222     | <b>89</b>      | 89       | 114     |
| Debt securities  | <b>382</b>      | 698     | <b>189</b>     | 193      | 358     |
| <b>Interest receivable</b>                                   | <b>7,621</b>    | 8,560   | <b>3,821</b>   | 3,800    | 4,281   |
| Customer accounts  | <b>987</b>      | 1,577   | <b>471</b>     | 516      | 740     |
| Deposits by banks  | <b>95</b>       | 223     | <b>41</b>      | 54       | 107     |
| Debt securities in issue                                     | <b>557</b>      | 698     | <b>270</b>     | 287      | 345     |
| Subordinated liabilities                                     | <b>432</b>      | 447     | <b>220</b>     | 212      | 225     |
| Internal funding of trading businesses                       | <b>57</b>       | 178     | <b>21</b>      | 36       | 97      |
| <b>Interest payable</b>                                      | <b>2,128</b>    | 3,123   | <b>1,023</b>   | 1,105    | 1,514   |
| <b>Net interest income</b>                                   | <b>5,493</b>    | 5,437   | <b>2,798</b>   | 2,695    | 2,767   |
| Fees and commissions receivable                              |                 |         |                |          |         |
| - payment services   | <b>647</b>      | 688     | <b>325</b>     | 322      | 355     |
| - credit and debit card fees                                 | <b>500</b>      | 529     | <b>245</b>     | 255      | 275     |
| - lending (credit facilities)                                | <b>703</b>      | 698     | <b>371</b>     | 332      | 345     |
| - brokerage  | <b>207</b>      | 252     | <b>102</b>     | 105      | 143     |
| - investment management                                      | <b>206</b>      | 210     | <b>100</b>     | 106      | 97      |
| - trade finance  | <b>138</b>      | 153     | <b>71</b>      | 67       | 75      |
| - other  | <b>204</b>      | 178     | <b>100</b>     | 104      | 102     |
|  | <b>2,605</b>    | 2,708   | <b>1,314</b>   | 1,291    | 1,392   |
| Fees and commissions payable                                 | <b>(487)</b>    | (460)   | <b>(251)</b>   | (236)    | (250)   |

|  |              |       |              |       |       |
|--|--------------|-------|--------------|-------|-------|
| <b>Net fees and commissions</b>  | <b>2,118</b> | 2,248 | <b>1,063</b> | 1,055 | 1,142 |
| Foreign exchange   | 420          | 450   | 202          | 218   | 255   |
| Interest rate  | 672          | 402   | 424          | 248   | 203   |
| Credit   | 397          | 880   | 41           | 356   | 328   |
| Own credit adjustments   | 11           | 175   | (84)         | 95    | 76    |
| Other  | (7)          | 157   | (42)         | 35    | 87    |
| <b>Income from trading activities</b>  | <b>1,493</b> | 2,064 | <b>541</b>   | 952   | 949   |
| <b>Gain on redemption of own debt</b>  | <b>20</b>    | 191   | -            | 20    | 242   |
| Operating lease and other rental income  | 178          | 256   | 87           | 91    | 118   |
| Own credit adjustments   | (62)         | 201   | (106)        | 44    | 51    |
| Other changes in the fair value of financial assets and liabilities designated as at fair value through profit or loss and related derivatives | 29           | 29    | 9            | 20    | 17    |
| Changes in fair value of investment properties   | (43)         | (16)  | (31)         | (12)  | (7)   |
| Profit on sale of:   |              |       |              |       |       |
| - securities   | 343          | 572   | 132          | 211   | 419   |
| - property, plant and equipment  | 40           | 23    | 16           | 24    | 5     |
| - subsidiaries, networks and associates  | 363          | 18    | 171          | 192   | 24    |
| Dividend income  | 30           | 35    | 17           | 13    | 21    |
| Share of results of associates   | 55           | 204   | 28           | 27    | 27    |
| Other income   | 103          | 10    | 22           | 81    | 45    |
| <b>Other operating income</b>  | <b>1,036</b> | 1,332 | <b>345</b>   | 691   | 720   |



## Notes

## 3. Analysis of income, expenses and impairment losses (continued)

|                                       | Half year ended |         | Quarter ended  |          |         |
|---------------------------------------|-----------------|---------|----------------|----------|---------|
|                                       | 30 June         | 30 June | 30 June        | 31 March | 30 June |
|                                       | 2014            | 2013    | 2014           | 2014     | 2013    |
|                                       | £m              | £m      | £m             | £m       | £m      |
| <b>Total non-interest income</b>      | <b>4,667</b>    | 5,835   | <b>1,949</b>   | 2,718    | 3,053   |
| <b>Total income</b>                   | <b>10,160</b>   | 11,272  | <b>4,747</b>   | 5,413    | 5,820   |
| Staff costs                           | (3,536)         | (3,727) | (1,845)        | (1,691)  | (1,840) |
| Premises and equipment                | (1,275)         | (1,104) | (622)          | (653)    | (548)   |
| Other (1)                             | (1,662)         | (2,181) | (951)          | (711)    | (1,418) |
| <b>Administrative expenses</b>        | <b>(6,473)</b>  | (7,012) | <b>(3,418)</b> | (3,055)  | (3,806) |
| Depreciation and amortisation         | (554)           | (736)   | (282)          | (272)    | (349)   |
| Write down of goodwill                | (130)           | -       | (130)          | -        | -       |
| Write down of other intangible assets | (82)            | -       | -              | (82)     | -       |
| <b>Operating expenses</b>             | <b>(7,239)</b>  | (7,748) | <b>(3,830)</b> | (3,409)  | (4,155) |
| Loan impairment losses/(recoveries)   | 271             | 2,161   | (89)           | 360      | 1,125   |
| Securities                            | (2)             | (11)    | (4)            | 2        | (8)     |
| <b>Impairment losses/(recoveries)</b> | <b>269</b>      | 2,150   | <b>(93)</b>    | 362      | 1,117   |

Note:

- (1) Includes Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs and regulatory and legal actions costs - see below for further details.

Payment Protection Insurance (PPI)

Highlights

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An additional charge of £150 million has been recognised for PPI in Q2 2014 (Q1 2014 - nil; Q2 2013 - £185 million) as a result of higher customer response rates and higher average redress costs. The cumulative charge in respect of PPI is £3.2 billion, of which £2.6 billion (82%) in redress and expenses had been utilised by 30 June 2014. Of the £3.2 billion cumulative charge, £2.9 billion relates to redress and £0.3 billion to administrative expenses.

|                            | Half year ended |         | Quarter ended |          |         |
|----------------------------|-----------------|---------|---------------|----------|---------|
|                            | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                            | 2014            | 2013    | 2014          | 2014     | 2013    |
|                            | £m              | £m      | £m            | £m       | £m      |
| At beginning of period     | 926             | 895     | 708           | 926      | 705     |
| Charge to income statement | 150             | 185     | 150           | -        | 185     |
| Utilisations               | (490)           | (376)   | (272)         | (218)    | (186)   |
| At end of period           | 586             | 704     | 586           | 708      | 704     |

The remaining provision provides coverage for approximately seven months for redress and administrative expenses, based on the current average monthly utilisation.

## Notes

### 3. Analysis of income, expenses and impairment losses (continued)

The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

| Assumption                        | Actual to date | Current assumption | Sensitivity            |                                      |
|-----------------------------------|----------------|--------------------|------------------------|--------------------------------------|
|                                   |                |                    | Change in assumption % | Consequential change in provision £m |
| Past business review take up rate | 47%            | 52%                | +/-5                   | +/-56                                |
| Uphold rate (1)                   | 89%            | 88%                | +/-5                   | +/-17                                |
| Average redress                   | £1,741         | £1,722             | +/-5                   | +/-15                                |

Note:

(1) Uphold rate excludes claims where no PPI policy was held.

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. The Group expects the majority of the cash outflows associated with this provision to have occurred by the end of 2014. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different than the amount provided. The Group will continue to monitor the position closely and refresh its assumptions.

#### Interest Rate Hedging Products (IRHP) redress and related costs

Following an industry-wide review conducted in conjunction with the Financial Services Authority (now being dealt with by the Financial Conduct Authority (FCA)), the Group agreed to provide redress to customers in relation to certain interest rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. An additional charge of £100 million has been recognised in Q2 2014 (Q1 2014 and Q2 2013 - nil), principally reflecting the marginal increase in our redress experience compared to expectations. We have now agreed outcomes with the independent reviewer relating to over 95% of cases. A cumulative charge of £1.4 billion has been recognised, of which £1.1 billion relates to

redress and £0.3 billion relates to administrative expenses.

|                            | Half year ended |         | Quarter ended |          |         |
|----------------------------|-----------------|---------|---------------|----------|---------|
|                            | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|                            | 2014            | 2013    | 2014          | 2014     | 2013    |
|                            | £m              | £m      | £m            | £m       | £m      |
| At beginning of period     | 1,077           | 676     | 878           | 1,077    | 702     |
| Charge to income statement | 100             | 50      | 100           | -        | -       |
| Utilisations               | (417)           | (56)    | (218)         | (199)    | (32)    |
| At end of period           | 760             | 670     | 760           | 878      | 670     |

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## Notes

### 3. Analysis of income, expenses and impairment losses (continued)

The Group is progressing with its review of sales of IRHP and providing basic redress to all customers who are entitled to it. Customers may also be entitled to be compensated for any consequential losses they may have suffered. The Group is not able to measure reliably any liability it may have and has accordingly not made any provision. Customers will receive redress monies without having to wait for the assessment of any additional consequential loss claims which are outside the allowance for such claims included in the 8% interest on redress due.

The Group continues to monitor the level of provision given the uncertainties over the number of transactions that will qualify for redress and the nature and cost of that redress.

### Regulatory and legal actions

The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. No additional charge has been booked in 2014 (Q2 2013 - £385 million). A charge of £1,910 million in Q4 2013 was primarily in respect of matters related to mortgage-backed securities and securities related litigation following recent third party litigation settlements and regulatory decisions.

### 4. Pensions

Pension costs for the half year ended 30 June 2014 amounted to £281 million (H1 2013 - £297 million; Q2 2014 - £138 million; Q1 2014 - £143 million and Q2 2013 - £149 million). Defined benefit schemes' charges are based on the actuarially determined pension cost rates at 31 December 2013.

In May 2014, the triennial funding valuation of The Royal Bank of Scotland Group Pension Fund was agreed which showed that the value of the liabilities exceeded the value of assets by £5.6 billion at 31 March 2013, a ratio of 82%. To eliminate this deficit, RBS will pay annual contributions of £650 million from 2014 to 2016 and £450 million (indexed in line with inflation) from 2017 to 2023. These contributions are in

addition to regular annual contributions of approximately £270 million in respect of the ongoing accrual of benefits as well as contributions to meet the expenses of running the scheme.

## Notes

## 5. Loan impairment provisions and REIL

## Loan impairments

Operating profit is stated after charging loan impairment losses of £271 million (H1 2013 - £2,161 million). The balance sheet loan impairment provisions decreased in the half year ended 30 June 2014 from £25,216 million to £22,446 million and the movements thereon were:

|  | Half year ended     |         |         |              |          |         |
|--|---------------------|---------|---------|--------------|----------|---------|
|  | 30 June 2014        |         |         | 30 June 2013 |          |         |
|  | RBS<br>excl.<br>RCR | RCR     | Total   | RBS excl.    | Non-Core | Total   |
|  | £m                  | £m      | £m      | £m           | £m       | £m      |
| At beginning of period (1)                         | 8,716               | 16,500  | 25,216  | 10,062       | 11,188   | 21,250  |
| Currency translation and other adjustments         | (118)               | (395)   | (513)   | 207          | 341      | 548     |
| Amounts written-off                                | (868)               | (1,619) | (2,487) | (1,155)      | (968)    | (2,123) |
| Recoveries of amounts previously written-off       | 84                  | 14      | 98      | 90           | 31       | 121     |
| Charge to income statement                         |                     |         |         |              |          |         |
| - continuing operations                            | 290                 | (19)    | 271     | 1,258        | 903      | 2,161   |
| Unwind of discount (recognised in interest income) | (63)                | (76)    | (139)   | (104)        | (100)    | (204)   |
| At end of period                                   | 8,041               | 14,405  | 22,446  | 10,358       | 11,395   | 21,753  |

|  | Quarter ended       |        |        |                     |        |        |              |          |        |
|--|---------------------|--------|--------|---------------------|--------|--------|--------------|----------|--------|
|  | 30 June 2014        |        |        | 31 March 2014       |        |        | 30 June 2013 |          |        |
|  | RBS<br>excl.<br>RCR | RCR    | Total  | RBS<br>excl.<br>RCR | RCR    | Total  | RBS excl.    | Non-Core | Total  |
|  | £m                  | £m     | £m     | £m                  | £m     | £m     | £m           | £m       | £m     |
|  | 8,516               | 15,719 | 24,235 | 8,716               | 16,500 | 25,216 | 10,266       | 11,228   | 21,494 |

|  |              |               |               |  |       |        |         |  |        |        |        |
|--|--------------|---------------|---------------|--|-------|--------|---------|--|--------|--------|--------|
| At beginning of period (1)                         |              |               |               |  |       |        |         |  |        |        |        |
| Currency translation and other adjustments         | (75)         | (333)         | (408)         |  | (43)  | (62)   | (105)   |  | 71     | 75     | 146    |
| Amounts written-off                                | (447)        | (827)         | (1,274)       |  | (421) | (792)  | (1,213) |  | (626)  | (341)  | (967)  |
| Recoveries of amounts previously written-off       | 43           | 3             | 46            |  | 41    | 11     | 52      |  | 41     | 15     | 56     |
| Charge to income statement                         |              |               |               |  |       |        |         |  |        |        |        |
| - continuing operations                            | 36           | (125)         | (89)          |  | 254   | 106    | 360     |  | 659    | 466    | 1,125  |
| Unwind of discount (recognised in interest income) | (32)         | (32)          | (64)          |  | (31)  | (44)   | (75)    |  | (53)   | (48)   | (101)  |
| At end of period                                   | <b>8,041</b> | <b>14,405</b> | <b>22,446</b> |  | 8,516 | 15,719 | 24,235  |  | 10,358 | 11,395 | 21,753 |

Note:

- (1) As a result of the creation of RCR on 1 January 2014, £855 million of provisions were transferred from Non-Core to the original donating divisions and £16,500 million of provisions were transferred to RCR, £12,984 million from Non-Core and £3,516 million from other divisions.

Provisions at 30 June 2014 include £50 million in respect of loans and advances to banks (31 March 2014 - £62 million; 31 December 2013 - £63 million; 30 June 2013 - £83 million).



## Notes

## 5. Loan impairment provisions and REIL (continued)

## Risk elements in lending

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

REIL decreased by £5,311 million in the half year ended 30 June 2014 to £34,081 million and the movements thereon were:

|  | Half year ended |         |         |              |          |         |
|--|-----------------|---------|---------|--------------|----------|---------|
|  | 30 June 2014    |         |         | 30 June 2013 |          |         |
|  | RBS             |         |         | RBS excl.    |          |         |
|  | excl.<br>RCR    | RCR     | Total   | Non-Core     | Non-Core | Total   |
| £m   | £m              | £m      | £m      | £m           | £m       |         |
| At beginning of period (1)                 | 15,276          | 24,116  | 39,392  | 19,766       | 21,374   | 41,140  |
| Currency translation and other adjustments | (167)           | (658)   | (825)   | 458          | 642      | 1,100   |
| Additions                                  | 2,273           | 1,887   | 4,160   | 4,878        | 1,978    | 6,856   |
| Transfers (2)                              | (121)           | 52      | (69)    | 292          | (4)      | 288     |
| Transfer to performing book                | (111)           | (74)    | (185)   | (55)         | (25)     | (80)    |
| Repayments and disposals                   | (2,629)         | (3,276) | (5,905) | (2,858)      | (2,140)  | (4,998) |
| Amounts written-off                        | (868)           | (1,619) | (2,487) | (1,155)      | (968)    | (2,123) |
| At end of period                           | 13,653          | 20,428  | 34,081  | 21,326       | 20,857   | 42,183  |

|  | Quarter ended |
|--|---------------|
|--|---------------|

|  | 30 June 2014 |         |         | 31 March 2014 |         |         | 30 June 2013 |          |         |
|--|--------------|---------|---------|---------------|---------|---------|--------------|----------|---------|
|  | RBS          |         |         | RBS           |         |         | RBS excl.    |          |         |
|  | excl.        | RCR     | Total   | excl.         | RCR     | Total   | Non-Core     | Non-Core | Total   |
|  | RCR          | RCR     | Total   | RCR           | RCR     | Total   | Non-Core     | Non-Core | Total   |
|  | £m           | £m      | £m      | £m            | £m      | £m      | £m           | £m       | £m      |
| At beginning of period (1)                 | 14,351       | 23,002  | 37,353  | 15,276        | 24,116  | 39,392  | 20,286       | 20,756   | 41,042  |
| Currency translation and other adjustments | (102)        | (560)   | (662)   | (65)          | (98)    | (163)   | 82           | 114      | 196     |
| Additions                                  | 810          | 564     | 1,374   | 1,463         | 1,323   | 2,786   | 2,781        | 1,039    | 3,820   |
| Transfers (2)                              | (65)         | 36      | (29)    | (56)          | 16      | (40)    | 203          | (35)     | 168     |
| Transfer to performing book                | (8)          | (71)    | (79)    | (103)         | (3)     | (106)   | (14)         | 8        | (6)     |
| Repayments and disposals                   | (886)        | (1,716) | (2,602) | (1,743)       | (1,560) | (3,303) | (1,386)      | (684)    | (2,070) |
| Amounts written-off                        | (447)        | (827)   | (1,274) | (421)         | (792)   | (1,213) | (626)        | (341)    | (967)   |
| At end of period                           | 13,653       | 20,428  | 34,081  | 14,351        | 23,002  | 37,353  | 21,326       | 20,857   | 42,183  |

## Notes:

- (1) As a result of the creation of RCR on 1 January 2014, £1,328 million of REIL were transferred from Non-Core to the original donating divisions and £24,116 million of REIL were transferred to RCR, £17,686 million from Non-Core and £6,430 million from other divisions.
- (2) Represents transfers between REIL and potential problem loans.

Provision coverage of REIL was 66% at 30 June 2014 (31 March 2014 - 65%; 31 December 2013 - 64%; 30 June 2013 - 52%).

Refer to Appendix 1 for analyses of loan impairments and REIL by segment, sector and geographical region.

## Notes

## 6. Tax

The actual tax charge differs from the expected tax charge computed by applying the standard UK corporation tax rate of 21.5% (2013 - 23.25%).

|   | Half year ended |         | Quarter ended |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| Operating profit before tax                           | 2,652           | 1,374   | 1,010         | 1,642    | 548     |
| Expected tax charge                                   | (570)           | (319)   | (217)         | (353)    | (127)   |
| Losses in year where no deferred tax asset recognised | (22)            | (116)   | (9)           | (13)     | (44)    |
| Foreign profits taxed at other rates                  | (87)            | (120)   | (30)          | (57)     | (32)    |
| Unrecognised timing differences                       | 13              | (12)    | 9             | 4        | (15)    |
| Non-deductible goodwill impairment                    | (28)            | -       | (28)          | -        | -       |
| Items not allowed for tax                             |                 |         |               |          |         |
| - losses on disposals and write-downs                 | (5)             | -       | (5)           | -        | -       |
| - UK bank levy  | (30)            | (29)    | (11)          | (19)     | (9)     |
| - regulatory and legal actions                        | -               | (90)    | -             | -        | (90)    |
| - employee share schemes                              | (5)             | (14)    | (2)           | (3)      | (7)     |
| - other disallowable items                            | (64)            | (82)    | (39)          | (25)     | (45)    |
| Non-taxable items                                     |                 |         |               |          |         |
| - gain on sale of Direct Line Insurance Group         | 41              | -       | -             | 41       | -       |
| - other non-taxable items                             | 13              | 86      | (1)           | 14       | 31      |
| Taxable foreign exchange movements                    | 4               | (2)     | 3             | 1        | (4)     |
| Losses brought forward and utilised                   | 45              | 27      | 9             | 36       | 22      |
| Reduction in carrying value of deferred tax asset     |                 |         |               |          |         |
| in respect of losses in US                            | (76)            | -       | (76)          | -        | -       |
| Adjustments in respect of prior periods               | 38              | (7)     | 26            | 12       | (8)     |
| Actual tax charge                                     | (733)           | (678)   | (371)         | (362)    | (328)   |

At 30 June 2014, the Group has recognised a deferred tax asset of £3,107 million (31 March 2014 - £3,289 million; 31 December 2013 - £3,478 million) and a deferred tax liability of £605 million (31 March 2014 - £583 million; 31 December 2013 - £507 million). These include amounts recognised in respect of UK trading losses of £2,135 million (31 March 2014 - £2,240 million; 31 December 2013 - £2,411 million). Under UK tax legislation, these UK losses can be carried forward indefinitely to be utilised against profits arising in the future. The Group has considered the carrying value of this asset as at 30 June 2014 and concluded that it is recoverable based on future profit projections.

## Notes

| <b>7. Profit/(loss) attributable to non-controlling interests</b> |                 |         |               |          |         |
|---|-----------------|---------|---------------|----------|---------|
|   | Half year ended |         | Quarter ended |          |         |
|   | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|   | 2014            | 2013    | 2014          | 2014     | 2013    |
|   | £m              | £m      | £m            | £m       | £m      |
| RBS Sempra Commodities JV   | -               | (2)     | -             | -        | -       |
| RFS Holdings BV Consortium Members                                | 38              | 113     | 21            | 17       | -       |
| Direct Line Group   | -               | 19      | -             | -        | -       |
| Other   | 4               | (13)    | 2             | 2        | (14)    |
| Profit/(loss) attributable to non-controlling interests           | 42              | 117     | 23            | 19       | (14)    |

## 8. Dividends

Dividends paid to preference shareholders and paid-in equity holders, and the dividend on the Dividend Access Share are as follows:

|  | Half year ended |         | Quarter ended |          |         |
|--|-----------------|---------|---------------|----------|---------|
|  | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|  | 2014            | 2013    | 2014          | 2014     | 2013    |
|  | £m              | £m      | £m            | £m       | £m      |
| <b>Preference shareholders</b>               |                 |         |               |          |         |
| Non-cumulative preference shares of US\$0.01 | 105             | 116     | 40            | 65       | 45      |
| Non-cumulative preference shares of €0.01    | 34              | 35      | 34            | -        | 35      |
| Non-cumulative preference shares of £1       | 1               | 1       | 1             | -        | 1       |
| <b>Paid-in equity holders</b>                |                 |         |               |          |         |
|  | 27              | 30      | 17            | 10       | 20      |

|   |            |     |            |    |     |
|---|------------|-----|------------|----|-----|
| Interest on securities classified as equity, net of tax |            |     |            |    |     |
| Dividend Access Share dividend                          | <b>320</b> | -   | <b>320</b> | -  | -   |
|   | <b>487</b> | 182 | <b>412</b> | 75 | 101 |

The Group has resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012 for RBS and 2013 for RBS N.V. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

The Board has decided to continue partially neutralising the Common Equity 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, of which £100 million was issued in May 2014 and a further £51 million in July 2014.

Following approval of the DAS Retirement Agreement by independent shareholders at a General Meeting in June 2014, provision has been made for the DAS retirement initial dividend of £320 million.

## Notes

### 9. Earnings per ordinary and equivalent B share

At a General Meeting on 25 June 2014, the Company's independent shareholders approved an agreement between RBS and Her Majesty's Treasury for the retirement of the Dividend Access Share (the DAS retirement agreement).

Prior to the DAS retirement agreement, the DAS was entitled to a dividend amounting to the greater of 7% of the aggregate issue price of B shares and 250% of the ordinary dividend rate multiplied by the number of B shares issued, less any dividends paid on the B shares and on ordinary shares issued on their conversion. When calculating earnings per share, IFRS requires profit or loss to be allocated to participating equity instruments as if all of the profit or loss for the period had been distributed. Consequently, earnings for all periods presented ending on or before 31 March 2014 are allocated solely to the dividend access share and earnings per ordinary and equivalent B share are nil for all periods. Adjusted earnings per ordinary and equivalent B share excludes the rights of the dividend access share for periods prior to 25 June 2014 and has been calculated on the basis tabulated on the following page.

After the DAS retirement agreement came into effect, once RBS has paid dividends on the DAS totalling £1.5 billion (subject to increases after 1 January 2016), the DAS will lose its preferential dividend rights and will become a single B share. The dividends are payable at the discretion of the directors. The first DAS dividend of £320 million payable within 45 business days of approval of the agreement, has been recognised as a liability at 30 June 2014. Unpaid DAS dividends will be subject to an increase of 5% per annum from 1 January 2016 and an increase of 10% per annum from 1 January 2021.

These changes to the DAS agreement have re-characterised the DAS such that it is no longer a participating share; it is only entitled to total dividends of £1.5 billion, subject to increases after 1 January 2016. Consequently earnings per share for periods ended after 25 June 2014 only reflect DAS dividends recognised before the end of a reporting period; this amounted to £320 million in respect of the half year and quarter ended 30 June 2014. Dividends can be paid on ordinary and B shares only once the total remaining amount of retirement dividend of £1,180 million, subject to increases as above, has been paid.

## Notes

## 9. Earnings per ordinary and equivalent B share (continued)

|  | Half year ended |         | Quarter ended |          |         |
|--|-----------------|---------|---------------|----------|---------|
|  | 30 June         | 30 June | 30 June       | 31 March | 30 June |
|  | 2014            | 2013*   | 2014          | 2014     | 2013*   |
| <b>Earnings</b>  |                 |         |               |          |         |
| Profit from continuing operations attributable to ordinary and B shareholders (£m)   | 1,408           | 425     | 215           | 1,193    | 140     |
| Profit from discontinued operations attributable to ordinary and B shareholders (£m)                                       | 17              | 110     | 15            | 2        | 2       |
| Profit attributable to ordinary and B shareholders (£m)  | 1,425           | 535     | 230           | 1,195    | 142     |
| Ordinary shares outstanding during the period (millions)   | 6,208           | 6,052   | 6,235         | 6,181    | 6,073   |
| Equivalent B shares in issue during the period (millions)  | 5,100           | 5,100   | 5,100         | 5,100    | 5,100   |
| <b>Weighted average number of ordinary shares and equivalent B shares outstanding during the period (millions)</b>         | <b>11,308</b>   | 11,152  | <b>11,335</b> | 11,281   | 11,173  |
| Effect of dilutive share options and convertible securities (millions)   | 97              | 114     | 89            | 110      | 114     |
| <b>Diluted weighted average number of ordinary shares and equivalent B shares outstanding during the period (millions)</b> | <b>11,405</b>   | 11,266  | <b>11,424</b> | 11,391   | 11,287  |
| <b>Basic and diluted earnings/(loss) per ordinary and equivalent B share (EPS)</b>   |                 |         |               |          |         |



|  |               |        |             |        |        |
|--|---------------|--------|-------------|--------|--------|
| Basic EPS from continuing operations             | <b>12.5p</b>  | -      | <b>1.9p</b> | -      | -      |
| Earnings allocated to DAS                        | -             | 3.8p   | -           | 10.6p  | 1.2p   |
| Own credit adjustments                           | <b>0.4p</b>   | (2.6p) | <b>1.3p</b> | (0.9p) | (0.8p) |
| Gain on redemption of own debt                   | <b>(0.2p)</b> | (1.7p) | -           | (0.2p) | (2.1p) |
| Write-down of goodwill                           | <b>1.1p</b>   | -      | <b>1.1p</b> | -      | -      |
| Strategic disposals                              | <b>(1.7p)</b> | -      | -           | (1.7p) | (0.1p) |
|  |               |        |             |        |        |
| <b>Adjusted EPS from continuing operations</b>   | <b>12.1p</b>  | (0.5p) | <b>4.3p</b> | 7.8p   | (1.8p) |
| <b>Basic EPS from discontinued operations</b>    | <b>0.2p</b>   | -      | <b>0.1p</b> | -      | -      |
| Earnings allocated to DAS                        | -             | 1.0p   | -           | -      | -      |
|  |               |        |             |        |        |
| <b>Adjusted EPS from discontinued operations</b> | <b>0.2p</b>   | 1.0p   | <b>0.1p</b> | -      | -      |

\* Basic EPS for the half year and quarter ended 30 June 2013 have been restated to reflect the terms of the DAS.

Notes:

- (1) Diluted EPS from continuing operations in the half year ended 30 June 2014 and the quarter ended 30 June 2014 were 0.1p lower than basic EPS.
- (2) Adjusted EPS has been restated to reflect the change in presentation of one-off and other items set out on page 4.

## Notes

### 10. Segmental analysis

On 27 February 2014, RBS announced the reorganisation of the previously reported operating divisions into three franchises:

Personal & Business Banking (PBB), comprising two reportable segments, UK Personal & Business Banking, including Williams & Glyn, (UK PBB) and Ulster Bank.

Commercial & Private Banking (CPB), comprising two reportable segments, Commercial Banking and Private Banking.

Corporate & Institutional Banking (CIB); a single reportable segment.

RBS Capital Resolution (RCR) was established with effect from 1 January 2014 by the transfer of capital intensive and higher risk assets from existing divisions. Non-Core was dissolved on 31 December 2013. No business lines moved to RCR and so comparative data has not been restated.

RBS will continue to manage and report Citizens Financial Group (CFG) and RBS Capital Resolution (RCR) separately until disposal or wind-down. Residual unallocated costs will continue to be reported within central items.

As part of its internal reorganisation, RBS has also centralised all services and functions. The costs relating to Services and Functions previously reported as direct expenses in the divisions are now reallocated to businesses using appropriate drivers and reported as indirect expenses in the segmental income statements.

In addition, a number of previously reported reconciling items (Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, restructuring costs, amortisation of purchased intangible assets and bank levy) have now been allocated to the reportable segments.

Comparatives have been restated accordingly.

### **Analysis of operating profit**

The following tables provide a segmental analysis of operating profit/(loss) by main income statement captions.

## Notes

## 10. Segmental analysis (continued)

## Analysis of operating profit (continued)

|                                   | Net      | Non-     | Total  | Operating | Impairment | Operating     |
|-----------------------------------|----------|----------|--------|-----------|------------|---------------|
|                                   | interest | interest | income | expenses  | (losses)/  | profit/(loss) |
|                                   | income   | income   | income | expenses  | recoveries | profit/(loss) |
| Half year ended 30 June 2014      | £m       | £m       | £m     | £m        | £m         | £m            |
| UK Personal & Business Banking    | 2,276    | 686      | 2,962  | (1,820)   | (148)      | 994           |
| Ulster Bank                       | 323      | 89       | 412    | (300)     | (57)       | 55            |
| Personal & Business Banking       | 2,599    | 775      | 3,374  | (2,120)   | (205)      | 1,049         |
| Commercial Banking                | 999      | 569      | 1,568  | (902)     | (31)       | 635           |
| Private Banking                   | 344      | 201      | 545    | (400)     | -          | 145           |
| Commercial & Private Banking      | 1,343    | 770      | 2,113  | (1,302)   | (31)       | 780           |
| Corporate & Institutional Banking | 365      | 2,062    | 2,427  | (2,158)   | 39         | 308           |
| Central items                     | 203      | 146      | 349    | (270)     | 12         | 91            |
| Citizens Financial Group          | 987      | 620      | 1,607  | (1,082)   | (104)      | 421           |
| RCR                               | (1)      | 109      | 108    | (176)     | 20         | (48)          |
| Non-statutory basis               | 5,496    | 4,482    | 9,978  | (7,108)   | (269)      | 2,601         |
| Reconciling items:                |          |          |        |           |            |               |
| Own credit adjustments (1)        | -        | (51)     | (51)   | -         | -          | (51)          |
| Gain on redemption of own debt    | -        | 20       | 20     | -         | -          | 20            |
| Write down of goodwill            | -        | -        | -      | (130)     | -          | (130)         |
| Strategic disposals               | -        | 191      | 191    | -         | -          | 191           |
| RFS Holdings minority interest    | (3)      | 25       | 22     | (1)       | -          | 21            |
| Statutory basis                   | 5,493    | 4,667    | 10,160 | (7,239)   | (269)      | 2,652         |

Note:

Highlights

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- (1) Comprises £11 million gain included in 'Income from trading activities' and £62 million loss included in 'Other operating income' on a statutory basis.

## Notes

## 10. Segmental analysis (continued)

## Analysis of operating profit (continued)

|                                   | Net<br>interest<br>income | Non-<br>interest<br>income | Total<br>income | Operating<br>expenses | Impairment<br>(losses)/<br>recoveries | Operating<br>profit/(loss) |
|-----------------------------------|---------------------------|----------------------------|-----------------|-----------------------|---------------------------------------|----------------------------|
| Half year ended 30 June 2013*     | £m                        | £m                         | £m              | £m                    | £m                                    | £m                         |
| UK Personal & Business Banking    | 2,200                     | 629                        | 2,829           | (1,885)               | (256)                                 | 688                        |
| Ulster Bank                       | 302                       | 142                        | 444             | (322)                 | (503)                                 | (381)                      |
| Personal & Business Banking       | 2,502                     | 771                        | 3,273           | (2,207)               | (759)                                 | 307                        |
| Commercial Banking                | 936                       | 613                        | 1,549           | (854)                 | (282)                                 | 413                        |
| Private Banking                   | 317                       | 214                        | 531             | (436)                 | (7)                                   | 88                         |
| Commercial & Private Banking      | 1,253                     | 827                        | 2,080           | (1,290)               | (289)                                 | 501                        |
| Corporate & Institutional Banking | 313                       | 2,395                      | 2,708           | (2,682)               | (223)                                 | (197)                      |
| Central items                     | 453                       | 219                        | 672             | (122)                 | 3                                     | 553                        |
| Citizens Financial Group          | 939                       | 570                        | 1,509           | (1,105)               | (51)                                  | 353                        |
| Non-Core                          | (18)                      | 384                        | 366             | (344)                 | (831)                                 | (809)                      |
| Non-statutory basis               | 5,442                     | 5,166                      | 10,608          | (7,750)               | (2,150)                               | 708                        |
| Reconciling items:                |                           |                            |                 |                       |                                       |                            |
| Own credit adjustments (1)        | -                         | 376                        | 376             | -                     | -                                     | 376                        |
| Gain on redemption of own debt    | -                         | 191                        | 191             | -                     | -                                     | 191                        |
| RFS Holdings minority interest    | (5)                       | 102                        | 97              | 2                     | -                                     | 99                         |
| Statutory basis                   | 5,437                     | 5,835                      | 11,272          | (7,748)               | (2,150)                               | 1,374                      |

\*Restated

Note:

- (1) Comprises £175 million gain included in 'Income from trading activities' and £201 million gain included in 'Other operating income' on a statutory basis.

## Notes

## 10. Segmental analysis (continued)

## Analysis of operating profit (continued)

|                                   | Net      | Non-     |        |           | Impairment |               |
|-----------------------------------|----------|----------|--------|-----------|------------|---------------|
|                                   | interest | interest | Total  | Operating | (losses)/  | Operating     |
|                                   | income   | income   | income | expenses  | recoveries | profit/(loss) |
| Quarter ended 30 June 2014        | £m       | £m       | £m     | £m        | £m         | £m            |
| UK Personal & Business Banking    | 1,152    | 347      | 1,499  | (955)     | (60)       | 484           |
| Ulster Bank                       | 169      | 42       | 211    | (155)     | (10)       | 46            |
| Personal & Business Banking       | 1,321    | 389      | 1,710  | (1,110)   | (70)       | 530           |
| Commercial Banking                | 511      | 287      | 798    | (493)     | 9          | 314           |
| Private Banking                   | 174      | 98       | 272    | (201)     | (1)        | 70            |
| Commercial & Private Banking      | 685      | 385      | 1,070  | (694)     | 8          | 384           |
| Corporate & Institutional Banking | 186      | 890      | 1,076  | (1,146)   | 45         | (25)          |
| Central items                     | 100      | 44       | 144    | (71)      | 13         | 86            |
| Citizens Financial Group          | 499      | 391      | 890    | (582)     | (31)       | 277           |
| RCR                               | 7        | 28       | 35     | (97)      | 128        | 66            |
| Non-statutory basis               | 2,798    | 2,127    | 4,925  | (3,700)   | 93         | 1,318         |
| Reconciling items:                |          |          |        |           |            |               |
| Own credit adjustments (1)        | -        | (190)    | (190)  | -         | -          | (190)         |
| Write down of goodwill            | -        | -        | -      | (130)     | -          | (130)         |
| RFS Holdings minority interest    | -        | 12       | 12     | -         | -          | 12            |
| Statutory basis                   | 2,798    | 1,949    | 4,747  | (3,830)   | 93         | 1,010         |

Note:



- (1) Comprises £84 million loss included in 'Income from trading activities' and £106 million loss included in 'Other operating income' on a statutory basis.

## Notes

## 10. Segmental analysis (continued)

## Analysis of operating profit (continued)

|                                   | Net      | Non-     |        |           | Impairment |               |
|-----------------------------------|----------|----------|--------|-----------|------------|---------------|
|                                   | interest | interest | Total  | Operating | (losses)/  | Operating     |
|                                   | income   | income   | income | expenses  | recoveries | profit/(loss) |
| Quarter ended 31 March 2014*      | £m       | £m       | £m     | £m        | £m         | £m            |
| UK Personal & Business Banking    | 1,124    | 339      | 1,463  | (865)     | (88)       | 510           |
| Ulster Bank                       | 154      | 47       | 201    | (145)     | (47)       | 9             |
| Personal & Business Banking       | 1,278    | 386      | 1,664  | (1,010)   | (135)      | 519           |
| Commercial Banking                | 488      | 282      | 770    | (409)     | (40)       | 321           |
| Private Banking                   | 170      | 103      | 273    | (199)     | 1          | 75            |
| Commercial & Private Banking      | 658      | 385      | 1,043  | (608)     | (39)       | 396           |
| Corporate & Institutional Banking | 179      | 1,172    | 1,351  | (1,012)   | (6)        | 333           |
| Central items                     | 103      | 102      | 205    | (199)     | (1)        | 5             |
| Citizens Financial Group          | 488      | 229      | 717    | (500)     | (73)       | 144           |
| RCR                               | (8)      | 81       | 73     | (79)      | (108)      | (114)         |
| Non-statutory basis               | 2,698    | 2,355    | 5,053  | (3,408)   | (362)      | 1,283         |
| Reconciling items:                |          |          |        |           |            |               |
| Own credit adjustments (1)        | -        | 139      | 139    | -         | -          | 139           |
| Gain on redemption of own debt    | -        | 20       | 20     | -         | -          | 20            |
| Strategic disposals               | -        | 191      | 191    | -         | -          | 191           |
| RFS Holdings minority interest    | (3)      | 13       | 10     | (1)       | -          | 9             |
| Statutory basis                   | 2,695    | 2,718    | 5,413  | (3,409)   | (362)      | 1,642         |

\*Restated

Note:

- (1) Comprises £95 million gain included in Income from trading activities and £44 million gain included in Other operating income on a statutory basis.

## Notes

## 10. Segmental analysis (continued)

## Analysis of operating profit (continued)

|                                   | Net      | Non-     |        |           | Impairment |               |
|-----------------------------------|----------|----------|--------|-----------|------------|---------------|
|                                   | interest | interest | Total  | Operating | (losses)/  | Operating     |
|                                   | income   | income   | income | expenses  | recoveries | profit/(loss) |
| Quarter ended 30 June 2013*       | £m       | £m       | £m     | £m        | £m         | £m            |
| UK Personal & Business Banking    | 1,118    | 320      | 1,438  | (1,044)   | (126)      | 268           |
| Ulster Bank                       | 152      | 88       | 240    | (187)     | (263)      | (210)         |
| Personal & Business Banking       | 1,270    | 408      | 1,678  | (1,231)   | (389)      | 58            |
| Commercial Banking                | 484      | 325      | 809    | (425)     | (155)      | 229           |
| Private Banking                   | 159      | 110      | 269    | (220)     | (2)        | 47            |
| Commercial & Private Banking      | 643      | 435      | 1,078  | (645)     | (157)      | 276           |
| Corporate & Institutional Banking | 141      | 1,095    | 1,236  | (1,487)   | (144)      | (395)         |
| Central items                     | 228      | 207      | 435    | (86)      | 3          | 352           |
| Citizens Financial Group          | 469      | 278      | 747    | (548)     | (32)       | 167           |
| Non-Core                          | 19       | 254      | 273    | (159)     | (398)      | (284)         |
| Non-statutory basis               | 2,770    | 2,677    | 5,447  | (4,156)   | (1,117)    | 174           |
| Reconciling items:                |          |          |        |           |            |               |
| Own credit adjustments (1)        | -        | 127      | 127    | -         | -          | 127           |
| Gain on redemption of own debt    | -        | 242      | 242    | -         | -          | 242           |
| Strategic disposals               | -        | 6        | 6      | -         | -          | 6             |
| RFS Holdings minority interest    | (3)      | 1        | (2)    | 1         | -          | (1)           |
| Statutory basis                   | 2,767    | 3,053    | 5,820  | (4,155)   | (1,117)    | 548           |

\*Restated

Note:

- (1) Comprises £76 million gain included in 'Income from trading activities' and £51 million gain included in 'Other operating income' on a statutory basis.

## Notes

## 10. Segmental analysis (continued)

| Total revenue                           | Half year ended |               |         |               |               |         |
|---|-----------------|---------------|---------|---------------|---------------|---------|
|   | 30 June 2014    |               |         | 30 June 2013* |               |         |
|   | External        | Inter segment | Total   | External      | Inter segment | Total   |
|   | £m              | £m            | £m      | £m            | £m            | £m      |
| UK Personal & Business Banking          | 3,583           | 7             | 3,590   | 3,620         | 7             | 3,627   |
| Ulster Bank                             | 408             | 40            | 448     | 549           | 36            | 585     |
| Personal & Business Banking             | 3,991           | 47            | 4,038   | 4,169         | 43            | 4,212   |
| Commercial Banking                      | 1,729           | 13            | 1,742   | 1,778         | 16            | 1,794   |
| Private Banking                         | 470             | 258           | 728     | 503           | 340           | 843     |
| Commercial & Private Banking            | 2,199           | 271           | 2,470   | 2,281         | 356           | 2,637   |
| Corporate & Institutional Banking       | 3,033           | 2,028         | 5,061   | 3,461         | 2,691         | 6,152   |
| Central items                           | 1,200           | 2,051         | 3,251   | 1,550         | 4,665         | 6,215   |
| Citizens Financial Group                | 1,724           | 5             | 1,729   | 1,644         | 50            | 1,694   |
| RCR                                     | 443             | 254           | 697     | n/a           | n/a           | n/a     |
| Non-Core                                | n/a             | n/a           | n/a     | 1,081         | 223           | 1,304   |
| Non-statutory basis                     | 12,590          | 4,656         | 17,246  | 14,186        | 8,028         | 22,214  |
| Reconciling items:                      |                 |               |         |               |               |         |
| Own credit adjustments                  | (51)            | -             | (51)    | 376           | -             | 376     |
| Gain on redemption of own debt          | 20              | -             | 20      | 191           | -             | 191     |
| Strategic disposals                     | 191             | -             | 191     | -             | -             | -       |
| RFS Holdings minority interest          | 25              | -             | 25      | 102           | -             | 102     |
| Elimination of intra-group transactions | -               | (4,656)       | (4,656) | -             | (8,028)       | (8,028) |
| Statutory basis                         | 12,775          | -             | 12,775  | 14,855        | -             | 14,855  |

\*Restated

## Notes

## 10. Segmental analysis (continued)

## Total revenue (continued)

|                                   | Quarter ended |       |       |                |       |       |               |       |        |
|-----------------------------------|---------------|-------|-------|----------------|-------|-------|---------------|-------|--------|
|                                   | 30 June 2014  |       |       | 31 March 2014* |       |       | 30 June 2013* |       |        |
|                                   | External      | Inter | Total | External       | Inter | Total | External      | Inter | Total  |
|                                   | £m            | £m    | £m    | £m             | £m    | £m    | £m            | £m    | £m     |
| <b>Total revenue</b>              |               |       |       |                |       |       |               |       |        |
| UK Personal & Business Banking    | 1,806         | 3     | 1,809 | 1,777          | 4     | 1,781 | 1,821         | (7)   | 1,814  |
| Ulster Bank                       | 210           | 20    | 230   | 198            | 20    | 218   | 289           | 27    | 316    |
| Personal & Business Banking       | 2,016         | 23    | 2,039 | 1,975          | 24    | 1,999 | 2,110         | 20    | 2,130  |
| Commercial Banking                | 875           | (18)  | 857   | 854            | 31    | 885   | 909           | 8     | 917    |
| Private Banking                   | 234           | 127   | 361   | 236            | 131   | 367   | 255           | 162   | 417    |
| Commercial & Private Banking      | 1,109         | 109   | 1,218 | 1,090          | 162   | 1,252 | 1,164         | 170   | 1,334  |
| Corporate & Institutional Banking | 1,383         | 1,128 | 2,511 | 1,650          | 900   | 2,550 | 1,628         | 1,470 | 3,098  |
| Central items                     | 552           | 1,019 | 1,571 | 648            | 1,032 | 1,680 | 873           | 2,319 | 3,192  |
| Citizens Financial Group          | 947           | 2     | 949   | 777            | 3     | 780   | 813           | 25    | 838    |
| RCR                               | 193           | 97    | 290   | 250            | 157   | 407   | n/a           | n/a   | n/a    |
| Non-Core                          | n/a           | n/a   | n/a   | n/a            | n/a   | n/a   | 620           | 144   | 764    |
| Non-statutory basis               | 6,200         | 2,378 | 8,578 | 6,390          | 2,278 | 8,668 | 7,208         | 4,148 | 11,356 |
| Reconciling items:                | (190)         | -     | (190) | 139            | -     | 139   | 127           | -     | 127    |



|   |       |         |         |       |         |         |  |       |         |         |
|---|-------|---------|---------|-------|---------|---------|--|-------|---------|---------|
| Own credit adjustments                  |       |         |         |       |         |         |  |       |         |         |
| Gain on redemption of own debt          | -     | -       | -       | 20    | -       | 20      |  | 242   | -       | 242     |
| Strategic disposals                     | -     | -       | -       | 191   | -       | 191     |  | 6     | -       | 6       |
| RFS Holdings minority interest          | 11    | -       | 11      | 14    | -       | 14      |  | 1     | -       | 1       |
| Elimination of intra-group transactions | -     | (2,378) | (2,378) | -     | (2,278) | (2,278) |  | -     | (4,148) | (4,148) |
| Statutory basis                         | 6,021 | -       | 6,021   | 6,754 | -       | 6,754   |  | 7,584 | -       | 7,584   |

### Total assets and liabilities

|                                   | 30 June 2014 |             | 31 March 2014* |             | 31 December 2013* |             |
|-----------------------------------|--------------|-------------|----------------|-------------|-------------------|-------------|
|                                   | Assets       | Liabilities | Assets         | Liabilities | Assets            | Liabilities |
| Total assets                      | £m           | £m          | £m             | £m          | £m                | £m          |
| UK Personal & Business Banking    | 133,559      | 147,650     | 132,802        | 146,264     | 132,153           | 146,255     |
| Ulster Bank                       | 26,734       | 24,718      | 26,160         | 26,055      | 28,183            | 27,047      |
| Personal & Business Banking       | 160,293      | 172,368     | 158,962        | 172,319     | 160,336           | 173,302     |
| Commercial Banking                | 88,573       | 90,272      | 89,608         | 90,158      | 87,900            | 93,201      |
| Private Banking                   | 20,794       | 36,379      | 21,227         | 37,173      | 21,168            | 37,564      |
| Commercial & Private Banking      | 109,367      | 126,651     | 110,835        | 127,331     | 109,068           | 130,765     |
| Corporate & Institutional Banking | 537,563      | 493,282     | 546,968        | 503,189     | 551,200           | 512,691     |
| Central items                     | 92,392       | 81,308      | 91,219         | 82,839      | 103,450           | 84,279      |
| Citizens Financial Group          | 76,090       | 63,661      | 76,063         | 63,547      | 71,738            | 61,289      |
| RCR                               | 34,449       | 12,731      | 38,793         | 13,475      | n/a               | n/a         |
| Non-Core                          | n/a          | n/a         | n/a            | n/a         | 31,177            | 6,100       |
| Non-statutory basis               | 1,010,154    | 950,001     | 1,022,840      | 962,700     | 1,026,969         | 968,426     |
| Reconciling item:                 |              |             |                |             |                   |             |
| RFS Holdings minority interest    | 954          | 144         | 930            | 134         | 909               | 237         |
| Statutory basis                   | 1,011,108    | 950,145     | 1,023,770      | 962,834     | 1,027,878         | 968,663     |

|           |  |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|--|
| *Restated |  |  |  |  |  |  |  |
|-----------|--|--|--|--|--|--|--|

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## Notes

## 11. Financial instruments

## Classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39 with assets and liabilities outside the scope of IAS 39 shown separately.

|                                    | Financial instruments |         |        |         |         |        |      |           | Non                    | Total   |           |
|------------------------------------|-----------------------|---------|--------|---------|---------|--------|------|-----------|------------------------|---------|-----------|
|                                    |                       |         |        |         |         |        |      | Amortised | Finance                |         | financial |
|                                    | HFT (1)               | DFV (2) | HD (3) | AFS (4) | LAR (5) | HTM(6) | cost | leases    | assets/<br>liabilities |         |           |
| 30 June 2014                       | £m                    | £m      | £m     | £m      | £m      | £m     | £m   | £m        | £m                     | £m      |           |
| <b>Assets</b>                      |                       |         |        |         |         |        |      |           |                        |         |           |
| Cash and balances at central banks | -                     | -       |        | -       | 68,670  | -      |      |           |                        | 68,670  |           |
| Loans and advances to banks        |                       |         |        |         |         |        |      |           |                        |         |           |
| - reverse repos                    | 25,139                | -       |        | -       | 3,024   | -      |      |           |                        | 28,163  |           |
| - other                            | 9,907                 | -       |        | -       | 18,997  | -      |      |           |                        | 28,904  |           |
| Loans and advances to customers    |                       |         |        |         |         |        |      |           |                        |         |           |
| - reverse repos                    | 53,142                | -       |        | -       | 400     | -      |      |           |                        | 53,542  |           |
| - other                            | 18,171                | 50      |        | -       | 360,790 | -      |      | 6,543     |                        | 385,554 |           |
| Debt securities                    | 55,893                | 121     |        | 48,698  | 3,526   | 4,556  |      |           |                        | 112,794 |           |
| Equity shares                      | 6,444                 | 338     |        | 1,052   | -       | -      |      |           |                        | 7,834   |           |
| Settlement balances                | -                     | -       |        | -       | 19,682  | -      |      |           |                        | 19,682  |           |
| Derivatives                        | 270,807               |         | 4,099  |         |         |        |      |           |                        | 274,906 |           |

|   |         |        |       |        |         |       |         |       |        |           |
|---|---------|--------|-------|--------|---------|-------|---------|-------|--------|-----------|
| Intangible assets                               |         |        |       |        |         |       |         |       | 12,173 | 12,173    |
| Property, plant and equipment                   |         |        |       |        |         |       |         |       | 7,115  | 7,115     |
| Deferred tax                                    |         |        |       |        |         |       |         |       | 3,107  | 3,107     |
| Prepayments, accrued income and other assets    | -       | -      | -     | -      | -       | -     |         |       | 7,418  | 7,418     |
| Assets of disposal groups                       |         |        |       |        |         |       |         |       | 1,246  | 1,246     |
|   | 439,503 | 509    | 4,099 | 49,750 | 475,089 | 4,556 |         | 6,543 | 31,059 | 1,011,108 |
|   |         |        |       |        |         |       |         |       |        |           |
| <b>Liabilities</b>                              |         |        |       |        |         |       |         |       |        |           |
| Deposits by banks                               |         |        |       |        |         |       |         |       |        |           |
| - repos   | 28,931  | -      |       |        |         |       | 2,791   |       |        | 31,722    |
| - other   | 22,168  | -      |       |        |         |       | 17,011  |       |        | 39,179    |
| Customer accounts                               |         |        |       |        |         |       |         |       |        |           |
| - repos   | 46,861  | -      |       |        |         |       | 4,679   |       |        | 51,540    |
| - other   | 9,287   | 5,248  |       |        |         |       | 386,691 |       |        | 401,226   |
| Debt securities in issue                        | 7,339   | 12,967 |       |        |         |       | 38,781  |       |        | 59,087    |
| Settlement balances                             | -       | -      |       |        |         |       | 15,128  |       |        | 15,128    |
| Short positions                                 | 39,019  | -      |       |        |         |       |         |       |        | 39,019    |
| Derivatives                                     | 266,544 |        | 3,543 |        |         |       |         |       |        | 270,087   |
| Accruals, deferred income and other liabilities | -       | -      |       |        |         |       | 1,744   | 15    | 13,117 | 14,876    |
| Retirement benefit liabilities                  |         |        |       |        |         |       |         |       | 2,742  | 2,742     |
| Deferred tax                                    |         |        |       |        |         |       |         |       | 605    | 605       |
| Subordinated liabilities                        | -       | 846    |       |        |         |       | 23,963  |       |        | 24,809    |
| Liabilities of disposal groups                  |         |        |       |        |         |       |         |       | 125    | 125       |
|   | 420,149 | 19,061 | 3,543 |        |         |       | 490,788 | 15    | 16,589 | 950,145   |
|   |         |        |       |        |         |       |         |       |        |           |

|               |  |  |  |  |  |  |  |  |  |                  |
|---------------|--|--|--|--|--|--|--|--|--|------------------|
| <b>Equity</b> |  |  |  |  |  |  |  |  |  | <b>60,963</b>    |
|               |  |  |  |  |  |  |  |  |  |                  |
|               |  |  |  |  |  |  |  |  |  | <b>1,011,108</b> |

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

## Notes

## 11. Financial instruments: Classification (continued)

|  | Financial instruments |         |        |         |         |                |                | Non                    | Total     |
|--|-----------------------|---------|--------|---------|---------|----------------|----------------|------------------------|-----------|
|  |                       |         |        |         |         |                |                | financial              |           |
|  | HFT (1)               | DFV (2) | HD (3) | AFS (4) | LAR (5) | Amortised cost | Finance leases | assets/<br>liabilities |           |
| 31 December 2013                             | £m                    | £m      | £m     | £m      | £m      | £m             | £m             | £m                     |           |
| <b>Assets</b>                                |                       |         |        |         |         |                |                |                        |           |
| Cash and balances at central banks           | -                     | -       | -      | -       | 82,659  |                |                |                        | 82,659    |
| Loans and advances to banks                  |                       |         |        |         |         |                |                |                        |           |
| - reverse repos                              | 25,795                | -       | -      | -       | 721     |                |                |                        | 26,516    |
| - other                                      | 9,952                 | -       | -      | -       | 17,603  |                |                |                        | 27,555    |
| Loans and advances to customers              |                       |         |        |         |         |                |                |                        |           |
| - reverse repos                              | 49,897                | -       | -      | -       | -       |                |                |                        | 49,897    |
| - other                                      | 19,170                | 49      |        |         | 364,772 |                | 6,834          |                        | 390,825   |
| Debt securities                              | 56,582                | 122     |        | 53,107  | 3,788   |                |                |                        | 113,599   |
| Equity shares                                | 7,199                 | 400     |        | 1,212   |         |                |                |                        | 8,811     |
| Settlement balances                          | -                     | -       |        | -       | 5,591   |                |                |                        | 5,591     |
| Derivatives                                  | 283,508               |         | 4,531  |         |         |                |                |                        | 288,039   |
| Intangible assets                            |                       |         |        |         |         |                |                | 12,368                 | 12,368    |
| Property, plant and equipment                |                       |         |        |         |         |                |                | 7,909                  | 7,909     |
| Deferred tax                                 |                       |         |        |         |         |                |                | 3,478                  | 3,478     |
| Prepayments, accrued income and other assets | -                     | -       |        | -       | -       |                |                | 7,614                  | 7,614     |
| Assets of disposal groups                    |                       |         |        |         |         |                |                | 3,017                  | 3,017     |
|  | 452,103               | 571     | 4,531  | 54,319  | 475,134 |                | 6,834          | 34,386                 | 1,027,878 |
| <b>Liabilities</b>                           |                       |         |        |         |         |                |                |                        |           |
| Deposits by banks                            |                       |         |        |         |         |                |                |                        |           |
| - repos                                      | 23,127                | -       |        |         |         | 5,523          |                |                        | 28,650    |

|   |         |        |       |  |         |    |        |           |
|---|---------|--------|-------|--|---------|----|--------|-----------|
| - other   | 19,764  | -      |       |  | 15,565  |    |        | 35,329    |
| Customer accounts                               |         |        |       |  |         |    |        |           |
| - repos   | 52,300  | -      |       |  | 4,184   |    |        | 56,484    |
| - other   | 10,236  | 5,862  |       |  | 398,298 |    |        | 414,396   |
| Debt securities in issue                        | 8,560   | 15,848 |       |  | 43,411  |    |        | 67,819    |
| Settlement balances                             | -       | -      |       |  | 5,313   |    |        | 5,313     |
| Short positions                                 | 28,022  | -      |       |  |         |    |        | 28,022    |
| Derivatives                                     | 281,299 |        | 4,227 |  |         |    |        | 285,526   |
| Accruals, deferred income and other liabilities | -       | -      |       |  | 1,764   | 19 | 14,234 | 16,017    |
| Retirement benefit liabilities                  |         |        |       |  |         |    | 3,210  | 3,210     |
| Deferred tax                                    |         |        |       |  |         |    | 507    | 507       |
| Subordinated liabilities                        | -       | 868    |       |  | 23,144  |    |        | 24,012    |
| Liabilities of disposal groups                  |         |        |       |  |         |    | 3,378  | 3,378     |
|   | 423,308 | 22,578 | 4,227 |  | 497,202 | 19 | 21,329 | 968,663   |
| <b>Equity</b>                                   |         |        |       |  |         |    |        | 59,215    |
|   |         |        |       |  |         |    |        | 1,027,878 |

Notes:

- (1) Held-for-trading.
- (2) Designated as at fair value.
- (3) Hedging derivatives.
- (4) Available-for-sale.
- (5) Loans and receivables.
- (6) Held to maturity

Apart from the reclassification of £3.6 billion of Treasury debt securities from AFS to HTM in Q1 2014, there were no other reclassifications in the first half of 2014.

## Notes

### 11. Financial instruments (continued)

#### Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. The table below shows credit valuation adjustments (CVA) and other valuation reserves. CVA represent an estimate of the adjustment to fair value that a market participant would make to incorporate the risk inherent in derivative exposures.

|  | 30 June<br>2014 | 31<br>December<br>2013 |
|--|-----------------|------------------------|
|  | £m              | £m                     |
| <b>Credit valuation adjustments</b>                                |                 |                        |
| - monoline insurers and credit derivative product companies (CDPC) | 57              | 99                     |
| - other counterparties   | 1,433           | 1,667                  |
|  | 1,490           | 1,766                  |
| <b>Other valuation reserves</b>                                    |                 |                        |
| - bid-offer  | 405             | 513                    |
| - funding valuation adjustment                                     | 522             | 424                    |
| - product and deal specific  | 718             | 745                    |
| - other  | 27              | 8                      |
|  | 1,672           | 1,690                  |
| <b>Valuation reserves</b>  | <b>3,162</b>    | <b>3,456</b>           |

|   |  |  |
|---|--|--|
| The table below analyses CVA relating to other counterparties by rating and sector. |  |  |
|---|--|--|



|                              | <b>30 June</b> | 31<br>December |
|------------------------------|----------------|----------------|
|                              | <b>2014</b>    | 2013           |
| <b>Ratings:</b>              | <b>£m</b>      | <b>£m</b>      |
| AAA                          | <b>85</b>      | 104            |
| AA to AA+                    | <b>25</b>      | 13             |
| A to AA-                     | <b>111</b>     | 168            |
| BBB- to A-                   | <b>336</b>     | 446            |
| Non-investment grade         | <b>876</b>     | 936            |
|                              | <b>1,433</b>   | 1,667          |
|                              |                |                |
| <b>Counterparty:</b>         |                |                |
| Banks                        | <b>38</b>      | 89             |
| Other financial institutions | <b>196</b>     | 199            |
| Corporate                    | <b>1,013</b>   | 1,126          |
| Government                   | <b>186</b>     | 253            |
|                              |                |                |
|                              | <b>1,433</b>   | 1,667          |

### Key points

The decrease in CVA was primarily driven by tightening of credit spreads.

Other valuation reserves were broadly flat with balance sheet reduction impacts being offset by additional funding related reserves.

## Notes

## 11. Financial instruments: Valuation reserves (continued)

## Own credit

The cumulative own credit adjustment (OCA) recorded on held-for-trading (HFT) and designated as at fair value through profit or loss (DFV) debt securities in issue, subordinated liabilities and derivative liabilities are set out below.

| Cumulative OCA (CR)/DR<br>(1)                        | Debt securities in issue (2) |             |              | Subordinated |              |             |              |    |
|--|------------------------------|-------------|--------------|--------------|--------------|-------------|--------------|----|
|  | HFT                          | DFV         | Total        | liabilities  | Total        | Derivatives | Total (3)    |    |
|  | £m                           | £m          | £m           | DFV<br>£m    | £m           | £m          | £m           | £m |
| <b>30 June 2014</b>                                  | <b>(395)</b>                 | <b>(87)</b> | <b>(482)</b> | <b>237</b>   | <b>(245)</b> | <b>54</b>   | <b>(191)</b> |    |
| 31 December 2013                                     | (467)                        | (33)        | (500)        | 256          | (244)        | 96          | (148)        |    |
| 30 June 2013   | (488)                        | 244         | (244)        | 380          | 136          | 309         | 445          |    |
| <b>Carrying values of<br/>underlying liabilities</b> | <b>£bn</b>                   | <b>£bn</b>  | <b>£bn</b>   | <b>£bn</b>   | <b>£bn</b>   |             |              |    |
| <b>30 June 2014</b>                                  | <b>7.3</b>                   | <b>13.0</b> | <b>20.3</b>  | <b>0.8</b>   | <b>21.1</b>  |             |              |    |
| 31 December 2013                                     | 8.6                          | 15.8        | 24.4         | 0.9          | 25.3         |             |              |    |
| 30 June 2013   | 9.3                          | 20.7        | 30.0         | 0.9          | 30.9         |             |              |    |

## Notes:

- (1) The OCA does not alter cash flows and is not used for performance management.
- (2) Includes wholesale and retail note issuances.
- (3) The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserve is stated by conversion of underlying currency balances at spot rates for each period, whereas the income statement includes intra-period foreign exchange sell-offs.

## Key points

The cumulative OCA decreased during the first half of 2014 due to tightening of RBS credit spreads in the second quarter of 2014 partially offset by the impact of time decay (e.g. the reduction in the remaining time to maturity of the trades reduces the impact of changes in RBS credit spreads).

Senior issued debt OCA is determined by reference to secondary debt issuance spreads, the five year spread tightened to 72 basis points (31 December 2013 - 92 basis points; 30 June 2013 - 140 basis points).

RBS CDS spreads tightened to 85 basis points (31 December 2013 - 114 basis points; 30 June 2013 - 228 basis points).

## Notes

## 11. Financial instruments (continued)

## Financial instruments carried at fair value - valuation hierarchy

Commentary on the control environment, valuation techniques and related aspects pertaining to financial instruments measured at fair value are included in the Group's 2013 Annual Report on Form 20-F. There have been no material changes to valuation or levelling approaches in the half year to 30 June 2014.

The tables below show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy – level 1, level 2 and level 3 and valuation sensitivities for level 3 balances.

|                                 | Level 1 | Level 2 | Level 3 | Total  | Level 3 sensitivity |              |
|---------------------------------|---------|---------|---------|--------|---------------------|--------------|
|                                 |         |         |         |        | Favourable          | Unfavourable |
| 30 June 2014                    | £bn     | £bn     | £bn     | £bn    | £m                  | £m           |
| <b>Assets</b>                   |         |         |         |        |                     |              |
| Loans and advances to banks     | -       | 34.7    | 0.3     | 35.0   | 20                  | (10)         |
| Loans and advances to customers | -       | 71.2    | 0.2     | 71.4   | 20                  | (30)         |
| Debt securities                 | 58.3    | 44.6    | 1.8     | 104.7  | 130                 | (60)         |
| Equity shares                   | 6.1     | 1.1     | 0.6     | 7.8    | 100                 | (80)         |
| Derivatives                     | 0.1     | 271.8   | 3.1     | 275.0  | 330                 | (190)        |
|                                 | 64.5    | 423.4   | 6.0     | 493.9  | 600                 | (370)        |
| <b>Proportion</b>               | 13.1%   | 85.7%   | 1.2%    | 100.0% |                     |              |
| <b>Of which</b>                 |         |         |         |        |                     |              |
| RBS excluding RCR               | 64.4    | 409.5   | 4.4     | 478.3  |                     |              |
| RCR                             | 0.1     | 13.9    | 1.6     | 15.6   |                     |              |
|                                 | 64.5    | 423.4   | 6.0     | 493.9  |                     |              |

| 31 December 2013                |       |       |      |        |  |     |       |
|---------------------------------|-------|-------|------|--------|--|-----|-------|
| <b>Assets</b>                   |       |       |      |        |  |     |       |
| Loans and advances to banks     | -     | 35.5  | 0.3  | 35.8   |  | 30  | (10)  |
| Loans and advances to customers | -     | 68.9  | 0.2  | 69.1   |  | 20  | (30)  |
| Debt securities                 | 58.0  | 49.7  | 2.1  | 109.8  |  | 160 | (100) |
| Equity shares                   | 7.0   | 1.1   | 0.7  | 8.8    |  | 120 | (110) |
| Derivatives                     | 0.1   | 284.4 | 3.5  | 288.0  |  | 390 | (250) |
|                                 |       |       |      |        |  |     |       |
|                                 | 65.1  | 439.6 | 6.8  | 511.5  |  | 720 | (500) |
|                                 |       |       |      |        |  |     |       |
| <b>Proportion</b>               | 12.7% | 86.0% | 1.3% | 100.0% |  |     |       |
|                                 |       |       |      |        |  |     |       |
| <b>Of which</b>                 |       |       |      |        |  |     |       |
| RBS excluding Non-Core          | 64.9  | 436.2 | 4.9  | 506.0  |  |     |       |
| Non-Core                        | 0.2   | 3.4   | 1.9  | 5.5    |  |     |       |
|                                 |       |       |      |        |  |     |       |
|                                 | 65.1  | 439.6 | 6.8  | 511.5  |  |     |       |

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## Notes

## 11. Financial instruments: Valuation hierarchy (continued)

|                          | Level 1 | Level 2 | Level 3 | Total  | Level 3 sensitivity |              |
|--------------------------|---------|---------|---------|--------|---------------------|--------------|
|                          |         |         |         |        | Favourable          | Unfavourable |
| 30 June 2014             | £bn     | £bn     | £bn     | £bn    | £m                  | £m           |
| <b>Liabilities</b>       |         |         |         |        |                     |              |
| Deposits by banks        | -       | 51.0    | 0.1     | 51.1   | 10                  | -            |
| Customer accounts        | -       | 61.2    | 0.2     | 61.4   | -                   | (10)         |
| Debt securities in issue | -       | 19.0    | 1.3     | 20.3   | 30                  | (50)         |
| Short positions          | 34.3    | 4.7     | -       | 39.0   | -                   | -            |
| Derivatives              | 0.1     | 267.6   | 2.5     | 270.2  | 130                 | (120)        |
| Subordinated liabilities | -       | 0.8     | -       | 0.8    | -                   | -            |
|                          | 34.4    | 404.3   | 4.1     | 442.8  | 170                 | (180)        |
| Proportion               | 7.8%    | 91.3%   | 0.9%    | 100.0% |                     |              |
| Of which                 |         |         |         |        |                     |              |
| RBS excluding RCR        | 34.4    | 393.5   | 3.7     | 431.6  |                     |              |
| RCR                      | -       | 10.8    | 0.4     | 11.2   |                     |              |
|                          | 34.4    | 404.3   | 4.1     | 442.8  |                     |              |

| 31 December 2013         |      |       |     |       |     |       |
|--------------------------|------|-------|-----|-------|-----|-------|
| <b>Liabilities</b>       |      |       |     |       |     |       |
| Deposits by banks        | -    | 42.8  | 0.1 | 42.9  | 10  | -     |
| Customer accounts        | -    | 68.2  | 0.2 | 68.4  | -   | (10)  |
| Debt securities in issue | -    | 23.1  | 1.3 | 24.4  | 50  | (70)  |
| Short positions          | 23.9 | 4.1   | -   | 28.0  | -   | -     |
| Derivatives              | 0.1  | 282.4 | 3.0 | 285.5 | 130 | (120) |
| Subordinated liabilities | -    | 0.9   | -   | 0.9   | -   | -     |

|                        |      |       |      |        |  |     |       |
|------------------------|------|-------|------|--------|--|-----|-------|
|                        |      |       |      |        |  |     |       |
|                        | 24.0 | 421.5 | 4.6  | 450.1  |  | 190 | (200) |
|                        |      |       |      |        |  |     |       |
| Proportion             | 5.3% | 93.7% | 1.0% | 100.0% |  |     |       |
|                        |      |       |      |        |  |     |       |
| Of which               |      |       |      |        |  |     |       |
| RBS excluding Non-Core | 24.0 | 420.1 | 4.5  | 448.6  |  |     |       |
| Non-Core               | -    | 1.4   | 0.1  | 1.5    |  |     |       |
|                        |      |       |      |        |  |     |       |
|                        | 24.0 | 421.5 | 4.6  | 450.1  |  |     |       |
|                        |      |       |      |        |  |     |       |

## Notes

### 11. Financial instruments (continued)

#### Valuation techniques

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of Level 3 financial instruments. The table excludes unobservable inputs where the impact on valuation is less significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example an increase in the credit spread of a bond would be favourable for the issuer and unfavourable for the note holder. Whilst we indicate where we consider that there are significant relationships between the inputs, these inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.

| Financial instruments  | Level 3 (£bn) |             | Valuation technique        | Unobservable inputs                    | Range  |         |
|------------------------|---------------|-------------|----------------------------|--|--------|---------|
|                        | Assets        | Liabilities |                            |  | Low    | High    |
| <b>Loans</b>           | 0.3           | 0.1         | Discounted cash flow (DCF) | Credit spreads (2)                     | 285bps | 1211bps |
| <b>Deposits</b>        | 0.2           | 0.2         | Option pricing             | Volatility (3)                         | 27%    | 30%     |
|                        |               |             | DCF                        | Credit spreads (2)                     | 0bps   | 25bps   |
|                        |               |             |                            | Recovery rates (4)                     | 0%     | 71%     |
|                        |               |             | Price based                | Price (5)                              | 80%    | 100%    |
| <b>Debt securities</b> |               |             |                            |  |        |         |
| RMBS                   | 0.2           |             | Price based                | Price (5)                              | 0%     | 99%     |
|                        |               |             | DCF                        | Probability of default (6)             | 3%     | 12%     |
|                        |               |             |                            | Yield (5)                              | 10%    | 40%     |
|                        |               |             |                            | Conditional prepayment rates (CPR) (7) | 0%     | 10%     |



|                          |     |     |                       |                            |        |        |
|--------------------------|-----|-----|-----------------------|----------------------------|--------|--------|
| CDO and CLO              | 0.8 |     | Price based           | Price (5)                  | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
|                          |     |     | DCF                   | Yield (5)                  | 0%     | 40%    |
|                          |     |     |                       | Probability of default (6) | 2%     | 10%    |
| Other ABS                | 0.4 |     | Price based           | Price (5)                  | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
| Other debt securities    | 0.4 |     | DCF                   | Credit spreads (2)         | 100bps | 109bps |
|                          |     |     | Price based           | Price (5)                  | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
| <b>Equity securities</b> | 0.6 |     | Price based           | Price (5)                  | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
|                          |     |     | EBITDA multiple       | EBITDA multiple (8)        | 12x    | 40x    |
|                          |     |     | DCF                   | Yield (5)                  | 10%    | 30%    |
|                          |     |     |                       |                            |        |        |
|                          |     |     |                       | Recovery rates (4)         | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
| <b>Derivatives</b>       |     |     |                       |                            |        |        |
| Foreign exchange         | 1.0 | 0.6 | Option pricing model  | Correlation (9)            | (41%)  | 100%   |
|                          |     |     |                       | Volatility (3)             | 6%     | 23%    |
|                          |     |     |                       |                            |        |        |
| Interest rate            | 1.3 | 0.5 | Option pricing model  | Correlation (9)            | (40%)  | 100%   |
|                          |     |     |                       |                            |        |        |
|                          |     |     | DCF                   | CPR (7)                    | 2%     | 20%    |
|                          |     |     |                       |                            |        |        |
| Equities and commodities | 0.1 | 0.6 | Option pricing model  | Volatility (3)             | 27%    | 30%    |
|                          |     |     |                       |                            |        |        |
| Credit                   | 0.7 | 0.8 | Price based           | Price (5)                  | 0%     | 100%   |
|                          |     |     |                       |                            |        |        |
|                          |     |     | DCF based on defaults | Recovery rates (4)         | 0%     | 100%   |
|                          |     |     | and recoveries        | Credit spreads (2)         | 25bps  | 410bps |

## Notes

### 11. Financial instruments: Valuation techniques (continued)

#### Notes:

- (1) Level 3 structured issued debt securities of £1.3 billion are not included in the table above as valuation is consistent with the valuation of the embedded derivative component.
- (2) Credit spreads and discount margins: Credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
- (3) Volatility: A measure of the tendency of a price to change with time.
- (4) Recovery rate: Reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
- (5) Price and yield: There may be a range of price based information used for evaluating the value of an instrument. This may be a direct comparison of one instrument or portfolio with another or movements in a more liquid instrument may be used to indicate the movement in the value of less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected payouts. Similarly to price, an instrument's yield may be compared to other instruments either directly or indirectly. Prices move inversely to yields.
- (6) Probability of default: This is a measure of the expected rate of losses in an underlying portfolio of mortgages or other receivables. The higher the probability of default the lower the value of the underlying portfolio. The cumulative losses tend to move conversely to prepayment rates and in line with constant default rates. The higher the rate, the higher the expected number of defaults and therefore the expected losses. An increase in the default rate is likely to reduce the value of an asset.
- (7) Conditional prepayment rate: The measure of the rate at which underlying mortgages or loans are prepaid. An increase in prepayment rates in a portfolio may increase or decrease its value depending upon the credit quality and payment terms of the underlying loans. For example an increase in prepayment rate of a portfolio of high credit quality underlying assets may reduce the value and size of the portfolio whereas for lower credit quality underlyings it may increase the value.
- (8) EBITDA (earnings before interest, tax, depreciation and amortisation) multiple: This is a commonly used valuation technique for equity holdings. The EBITDA of a company is used as a proxy for the future cash flows and when multiplied by an appropriate factor gives an estimate for the value of the company.
- (9) Correlation: Measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite

directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.

- (10) Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.
- (11) Improvements in price discovery resulted in transfers of £0.2 billion and £0.1 billion of asset and liabilities respectively from level 3 to level 2. Transfers from level 2 to level 3 mainly comprised debt securities in issue of £0.2 billion, derivative assets and liabilities of £0.1 billion each and debt securities of £0.1 billion due to increased unobservability of inputs used in the valuation of these instruments. There were no significant transfers between level 1 and level 2.

## Notes

## 11. Financial instruments: Movement in level 3 portfolios

|                                 | At 1 January 2014 | Amount recorded in Income statement (1) |     | Level 3 transfers |       | Purchases and issuances (3) | Settlements | Sales | Foreign exchange and other | At 30 June 2014 |
|---------------------------------|-------------------|---|-----|-------------------|-------|-----------------------------|-------------|-------|----------------------------|-----------------|
|                                 | £m                | £m                                      | £m  | £m                | £m    | £m                          | £m          | £m    | £m                         | £m              |
| <b>Assets</b>                   |                   |   |     |                   |       |                             |             |       |                            |                 |
| FVTPL (4)                       |                   |   |     |                   |       |                             |             |       |                            |                 |
| Loans and advances              |                   |   |     |                   |       |                             |             |       |                            |                 |
| - banks                         | 310               | (12)                                    | -   | -                 | -     | -                           | -           | (5)   | -                          | 293             |
| - customers                     | 172               | (1)                                     | -   | 13                | (3)   | 48                          | (14)        | (10)  | (3)                        | 202             |
| Debt securities                 | 906               | 77                                      | -   | 77                | (52)  | 238                         | (41)        | (225) | (5)                        | 975             |
| Equity shares                   | 286               | 83                                      | -   | -                 | (38)  | 40                          | (31)        | (46)  | (3)                        | 291             |
| Derivatives                     | 3,493             | (282)                                   | -   | 99                | (55)  | 100                         | (212)       | (65)  | (14)                       | 3,064           |
| FVTPL assets                    | 5,167             | (135)                                   | -   | 189               | (148) | 426                         | (298)       | (351) | (25)                       | 4,825           |
| <b>Of which ABS:</b>            |                   |   |     |                   |       |                             |             |       |                            |                 |
| - FVTPL (4)                     | 591               | 84                                      | -   | 24                | (29)  | 181                         | (17)        | (222) | (3)                        | 609             |
| - AFS                           | 1,108             | 8                                       | (9) | 3                 | -     | -                           | (195)       | (111) | 1                          | 805             |
| <b>Available-for-sale (AFS)</b> |                   |   |     |                   |       |                             |             |       |                            |                 |
| Debt securities                 | 1,194             | 8                                       | (9) | 3                 | -     | 1                           | (297)       | (53)  | 1                          | 848             |
| Equity shares                   | 400               | 4                                       | 26  | -                 | (61)  | 5                           | (24)        | (61)  | (7)                        | 282             |
| AFS assets                      | 1,594             | 12                                      | 17  | 3                 | (61)  | 6                           | (321)       | (114) | (6)                        | 1,130           |
|                                 | 6,761             | (123)                                   | 17  | 192               | (209) | 432                         | (619)       | (465) | (31)                       | 5,955           |
| <b>Liabilities</b>              |                   |   |     |                   |       |                             |             |       |                            |                 |

|                          |       |       |    |     |       |    |       |      |      |       |
|--------------------------|-------|-------|----|-----|-------|----|-------|------|------|-------|
| Deposits                 | 253   | 13    | -  | 10  | -     | -  | (2)   | -    | 1    | 275   |
| Debt securities in issue | 1,354 | (60)  | -  | 236 | (34)  | 36 | (230) | (5)  | (1)  | 1,296 |
| Short positions          | 17    | (1)   | -  | -   | (11)  | 7  | -     | (4)  | -    | 8     |
| Derivatives              | 3,007 | (124) | 3  | 79  | (84)  | 53 | (334) | (69) | (11) | 2,520 |
|                          |       |       |    |     |       |    |       |      |      |       |
|                          | 4,631 | (172) | 3  | 325 | (129) | 96 | (566) | (78) | (11) | 4,099 |
|                          |       |       |    |     |       |    |       |      |      |       |
| Net gains/(losses)       |       | 49    | 14 |     |       |    |       |      |      |       |

## Notes:

- (1) Net losses on HFT instruments of £94 million (31 December 2013 - £143 million) were recorded in income from trading activities. Net gains on other instruments of £143 million (31 December 2013 - £11 million) were recorded in other operating income, interest income as appropriate.
- (2) Consolidated statement of comprehensive income.
- (3) Includes £36 million of debt securities in issue and £7 million derivative liabilities relating to issuances.
- (4) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit and loss.

## Notes

### 11. Financial instruments (continued)

#### Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

|                                 | 30 June 2014   |            | 31 December 2013 |            |
|---------------------------------|----------------|------------|------------------|------------|
|                                 | Carrying value | Fair value | Carrying value   | Fair value |
|                                 | £bn            | £bn        | £bn              | £bn        |
| <b>Financial assets</b>         |                |            |                  |            |
| Loans and advances to banks     | 20.5           | 20.5       | 16.8             | 16.8       |
| Loans and advances to customers | 367.7          | 357.9      | 371.6            | 360.0      |
| Debt securities                 | 8.1            | 7.8        | 3.8              | 3.2        |
|                                 |                |            |                  |            |
| <b>Financial liabilities</b>    |                |            |                  |            |
| Deposits by banks               | 19.3           | 19.3       | 20.3             | 20.3       |
| Customer accounts               | 140.8          | 141.0      | 133.8            | 134.0      |
| Debt securities in issue        | 38.8           | 40.4       | 43.4             | 44.7       |
| Subordinated liabilities        | 24.0           | 24.4       | 23.1             | 22.5       |

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore, there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

For the following short-term financial instruments fair value approximates to carrying value: cash and balances at central banks, items in the course of collection from and transmission to other banks, settlement balances, customer demand deposits and notes in circulation. These are excluded from the table above.



## Notes

## 12. Provisions for liabilities and charges

|   |            |            | Other      |          | Other      |              |            |            |              |
|---|------------|------------|------------|----------|------------|--------------|------------|------------|--------------|
|   | PPI        | IRHP       | customer   | LIBOR    | regulatory | Litigation   | Property   | Other      | Total        |
|   | £m         | £m         | redress    | £m       | provisions | £m           | £m         | £m         | £m           |
|   |            |            | £m         |          | £m         |              |            |            |              |
| <b>At 1 January 2014</b>                | 926        | 1,077      | 337        | 416      | 150        | 2,018        | 379        | 186        | 5,489        |
| Currency translation and other movement | -          | -          | -          | (2)      | -          | (15)         | -          | -          | (17)         |
| Charge to income statement              |            |            |            |          |            |              |            |            |              |
| - continuing operations                 | -          | -          | 23         | -        | -          | 34           | 2          | 81         | 140          |
| Releases to income statement            |            |            |            |          |            |              |            |            |              |
| - continuing operations                 | -          | -          | (5)        | -        | -          | (4)          | (5)        | -          | (14)         |
| Provisions utilised                     | (218)      | (199)      | (26)       | (414)    | -          | (13)         | (59)       | (32)       | (961)        |
| <b>At 31 March 2014</b>                 | <b>708</b> | <b>878</b> | <b>329</b> | <b>-</b> | <b>150</b> | <b>2,020</b> | <b>317</b> | <b>235</b> | <b>4,637</b> |
| Currency translation and other movement | -          | -          | -          | -        | (2)        | (46)         | (2)        | -          | (50)         |
| Charge to income statement              |            |            |            |          |            |              |            |            |              |
| - continuing operations                 | 150        | 100        | 28         | -        | -          | 34           | 149        | 93         | 554          |
| Releases to income statement            |            |            |            |          |            |              |            |            |              |
| - continuing operations                 | -          | -          | (3)        | -        | -          | (31)         | (10)       | -          | (44)         |
| Provisions utilised                     | (272)      | (218)      | (53)       | -        | (5)        | (67)         | (70)       | (39)       | (724)        |
| <b>At 30 June 2014</b>                  | <b>586</b> | <b>760</b> | <b>301</b> | <b>-</b> | <b>143</b> | <b>1,910</b> | <b>384</b> | <b>289</b> | <b>4,373</b> |

| <b>13. Contingent liabilities and commitments</b> |              |  |  |               |  |  |                  |  |  |
|---|--------------|--|--|---------------|--|--|------------------|--|--|
|   |              |  |  |               |  |  |                  |  |  |
|   | 30 June 2014 |  |  | 31 March 2014 |  |  | 31 December 2013 |  |  |
|   |              |  |  |               |  |  |                  |  |  |



|   | RBS          |       |         | RBS          |       |         | RBS excl. |          |         |
|---|--------------|-------|---------|--------------|-------|---------|-----------|----------|---------|
|   | excl.<br>RCR | RCR   | Total   | excl.<br>RCR | RCR   | Total   | Non-Core  | Non-Core | Total   |
|   | £m           | £m    | £m      | £m           | £m    | £m      | £m        | £m       | £m      |
| <b>Contingent liabilities</b>   |              |       |         |              |       |         |           |          |         |
| Guarantees and assets pledged as collateral security                          | 19,542       | 220   | 19,762  | 19,634       | 270   | 19,904  | 19,563    | 616      | 20,179  |
| Other   | 6,145        | 187   | 6,332   | 6,039        | 236   | 6,275   | 5,893     | 98       | 5,991   |
|   | 25,687       | 407   | 26,094  | 25,673       | 506   | 26,179  | 25,456    | 714      | 26,170  |
| <b>Commitments</b>  |              |       |         |              |       |         |           |          |         |
| Undrawn formal standby facilities, credit lines and other commitments to lend | 208,299      | 2,076 | 210,375 | 208,550      | 2,482 | 211,032 | 210,766   | 2,280    | 213,046 |
| Other   | 2,616        | 36    | 2,652   | 2,590        | 13    | 2,603   | 2,793     | -        | 2,793   |
|   | 210,915      | 2,112 | 213,027 | 211,140      | 2,495 | 213,635 | 213,559   | 2,280    | 215,839 |
| <b>Contingent liabilities and commitments</b>                                 | 236,602      | 2,519 | 239,121 | 236,813      | 3,001 | 239,814 | 239,015   | 2,994    | 242,009 |

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material loss will arise from these transactions.

## Notes

### 14. Litigation, investigations and reviews

Arising out of their normal business operations, the Company and certain members of the Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the United Kingdom, the European Union, the United States and other jurisdictions.

The Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of the legal proceedings, investigations and regulatory and governmental matters in which the Group is involved is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory and governmental matters as at 30 June 2014 (see Note 12). The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the Group has recognised.

In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can be reasonably estimated for any claim. The Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

There are also situations where the Group may enter into a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, even for those matters for which the Group believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are material individually or in aggregate.

## Litigation

### *Shareholder litigation*

RBS and certain of its subsidiaries, together with certain current and former officers and directors were named as defendants in a purported class action filed in the United States District Court for the Southern District of New York involving holders of American Depositary Receipts (the ADR claims).

A consolidated amended complaint asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934 and Sections 11, 12 and 15 of the Securities Act was filed in November 2011 on behalf of all persons who purchased or otherwise acquired the Group's American Depositary Receipts (ADRs) from issuance through 20 January 2009. In September 2012, the Court dismissed the ADR claims with prejudice. On 5 August 2013, the Court denied the plaintiffs' motions for reconsideration and for leave to re-plead their case. The plaintiffs appealed the dismissal of this case to the Second Circuit Court of Appeals and that appeal was heard on 19 June 2014. A decision in respect of the appeal is awaited.

## Notes

### **14. Litigation, investigations and reviews (continued)**

Additionally, between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against the Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions were made in connection with the rights issue announced by the Group on 22 April 2008 in breach of the Financial Services and Markets Act 2000. On 30 July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The Group's defence to the claims was filed on 13 December 2013. Since then, further High Court claims have been issued against the Group under the Group Litigation Order. There are likely to be further case management conferences which, in due course, will lead to a trial date being set.

### ***Other securitisation and securities related litigation in the United States***

Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the pending individual and class action cases involve the issuance of more than US\$64 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007. Although the allegations vary by claim, in general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued. Group companies remain as defendants in more than 40 lawsuits and arbitrations brought by purchasers of MBS, including the purported class actions identified below.

Among these MBS lawsuits are two cases filed on 2 September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The primary FHFA lawsuit remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US\$32 billion of MBS for which Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of these approximately US\$10 billion were outstanding at 30 June 2014 with cumulative losses of approximately US\$1.03 billion (being the loss of principal value suffered by security holders). On 30 September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. Discovery is ongoing.

The other remaining FHFA lawsuit that involves the Group (in which the primary defendant is Nomura) names RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. This case is part of a coordinated proceeding in the United States District Court for the Southern District of New York in which discovery is underway. Three other FHFA lawsuits (against JP Morgan, Morgan Stanley and Countrywide) in which RBS Securities Inc. was an underwriter defendant were settled without any contribution from RBS Securities Inc. On 19 June 2014, another FHFA lawsuit in which RBS Securities Inc. was an underwriter defendant (against Ally Financial Group) was settled by RBS Securities Inc. for US\$99.5 million. This amount is fully provided for.

Other MBS lawsuits against Group companies include three cases filed by the National Credit Union Administration Board (on behalf of US Central Federal Credit Union, Western Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Members United Corporate Federal Credit Union) and six cases filed by the Federal Home Loan Banks of Boston, Chicago, Indianapolis, Seattle and San Francisco.

## Notes

### 14. Litigation, investigations and reviews (continued)

The purported MBS class actions in which Group companies are defendants include New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al. and In re IndyMac Mortgage-Backed Securities Litigation, the latter of which has been settled in principle subject to documentation and court approval. A third MBS class action, New Jersey Carpenters Vacation Fund et al. v. The Royal Bank of Scotland plc et al., has been settled in principle for US\$275 million subject to court approval. There is a provision that fully covers this settlement amount. The case relates to more than US\$15 billion of the issued MBS that are the subject of MBS claims pending against Group companies. The outcome in this case should not be seen as indicative of how other MBS lawsuits may be resolved.

RBS Securities Inc. was also a defendant in Luther v. Countrywide Financial Corp. et al. and related class action cases. On 5 December 2013, the court granted final approval of a US\$500 million settlement of plaintiffs' claims to be paid by Countrywide without contribution from RBS Securities Inc. Several members of the settlement class are appealing the court-approved settlement to the United States Court of Appeals for the Ninth Circuit.

Certain other institutional investors have threatened to bring claims against the Group in connection with various mortgage-related offerings. The Group cannot predict whether any of these individual investors will pursue these threatened claims (or their outcome), but expects that several may. If such claims are asserted and were successful, the amounts involved may be material.

In many of these actions, the Group has or will have contractual claims to indemnification from the issuers of the securities (where a Group company is underwriter) and/or the underlying mortgage originator (where a Group company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party.

### *London Interbank Offered Rate (LIBOR)*

Certain members of the Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws,

and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

## Notes

### **14. Litigation, investigations and reviews (continued)**

Most of the USD LIBOR-related actions in which Group companies are defendants, including all purported class actions relating to USD LIBOR, have been transferred to a coordinated proceeding in the United States District Court for the Southern District of New York. In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. In orders dated 29 March 2013 and 23 June 2014, the Court dismissed plaintiffs' antitrust claims and claims under RICO (Racketeer Influenced and Corrupt Organizations Act), but declined to dismiss (a) certain Commodities Exchange Act claims on behalf of persons who transacted in Eurodollar futures contracts and options on futures contracts on the Chicago Mercantile Exchange (on the theory that defendants' alleged persistent suppression of USD LIBOR caused loss to plaintiffs), and (b) certain contract and unjust enrichment claims on behalf of over-the-counter purchaser plaintiffs who transacted directly with a defendant. Discovery is stayed. Over 35 other USD LIBOR-related actions involving RBS have been stayed pending further order from the Court. On 30 June 2014, the U.S. Supreme Court announced that it would consider an appeal by plaintiffs whose claims have been dismissed in their entirety to decide whether those plaintiffs have the procedural right to appeal the dismissals to the U.S. Court of Appeals for the Second Circuit on an interlocutory basis instead of waiting until there is a final judgment in the coordinated proceeding.

Certain members of the Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (the "Yen action") and (ii) Euribor (the "Euribor action"), both of which are pending in the United States District Court for the Southern District of New York. On 28 March 2014, the Court in the Yen action dismissed the plaintiffs' antitrust claims, but refused to dismiss their claims under the Commodity Exchange Act for price manipulation.

Details of LIBOR investigations and their outcomes affecting the Group are set out under 'Investigations and reviews' on page 114.

#### ***Credit default swap antitrust litigation***

Certain members of the Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that defendants violated the U.S. antitrust laws by restraining competition in the market for credit default swaps through various means and thereby causing inflated bid-ask spreads for credit default swaps.



***FX antitrust litigation***

Certain members of the Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action on behalf of U.S.-based plaintiffs and two similar complaints on behalf of non-U.S. plaintiffs in Norway and South Korea. The three cases are all pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that the defendants violated the U.S. antitrust laws, state statutes, and the common law by conspiring to manipulate the foreign exchange market by manipulating benchmark foreign exchange rates. On 30 May 2014, the defendants filed motions to dismiss the complaints in these actions.

## Notes

### 14. Litigation, investigations and reviews (continued)

#### *Madoff*

In December 2010, Irving Picard, as trustee for the bankruptcy estates of Bernard L. Madoff and Bernard L. Madoff Investment Securities LLC., filed a clawback claim against The Royal Bank of Scotland N.V. (RBS N.V.) in New York bankruptcy court. In the operative complaint, filed in August 2012, the trustee seeks to recover US\$75.8 million in redemptions that RBS N.V. allegedly received from certain Madoff feeder funds and US\$162.1 million that RBS N.V. allegedly received from its swap counterparties at a time when RBS N.V. allegedly 'knew or should have known of Madoff's possible fraud'. The Trustee alleges that those transfers were preferences or fraudulent conveyances under the US bankruptcy code and New York law and he asserts the purported right to claw them back for the benefit of Madoff's estate. A further claim, for US\$21.8 million, was filed in October 2011. These matters remain at the motion to dismiss stage of litigation.

#### *Thornburg adversary proceeding*

RBS Securities Inc. and certain other Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the U.S. bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers.

#### *Complex Systems*

RBS N.V. is a defendant in an action being heard in the United States District Court for the Southern District of New York filed by Complex Systems, Inc (CSI). The plaintiff alleges that RBS N.V. has since late 2007 been using the plaintiff's back-office trade finance processing software without a valid licence, in violation of the US Copyright Act. After granting summary judgment to CSI on the issue of liability, the Court on 9 May 2014 issued an injunction that requires RBS N.V. to cease using the disputed software. RBS N.V. has appealed the injunction and the underlying liability determination to the U.S. Court of Appeals for the Second Circuit. On 26 June 2014, that court denied RBS N.V.'s request that the injunction be stayed pending the outcome of the appeal. RBS N.V. and CSI have reached a settlement of the action which, subject to final documentation and the Court's entry of an agreed stipulation of dismissal, will bring an end to the proceedings and provide RBS Group companies with an on-going, perpetual licence to use the software at issue.

### ***CPDO Litigation***

CPDO claims have been served on RBS N.V. in England, the Netherlands and Australia relating to the sale of a type of structured financial product known as a constant proportion debt obligation (CPDO). In November 2012, the Federal Court of Australia issued a judgment against RBS N.V. and others in one such case. It held that RBS N.V. and others committed certain wrongful acts in connection with the rating and sale of the CPDO. In March 2013, RBS N.V. was ordered to pay A\$19.7 million. RBS N.V. appealed this decision and the appeal court found against RBS N.V. in May 2014. RBS N.V. has made the required payment of A\$19.7 million. The judgment may potentially have significance to the other claims served and to any future similar claims.

## Notes

### 14. Litigation, investigations and reviews (continued)

#### *Investigations and reviews*

The Group's businesses and financial condition can be affected by the fiscal or other policies and actions of various governmental and regulatory authorities in the United Kingdom, the European Union, the United States and elsewhere. The Group has engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the United Kingdom, the European Union, the United States and elsewhere, on an ongoing and regular basis regarding operational, systems and control evaluations and issues including those related to compliance with applicable regulatory, anti-bribery, anti-money laundering and sanctions regimes. It is possible that any matters discussed or identified may result in investigatory or other action being taken by governmental and regulatory authorities, increased costs being incurred by the Group, remediation of systems and controls, public or private censure, restriction of the Group's business activities or fines. Any of the events or circumstances mentioned below could have a material adverse effect on the Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The Group is co-operating fully with the investigations and reviews described below.

#### *LIBOR, other trading rates and foreign exchange trading*

On 6 February 2013, the Group announced settlements with the Financial Services Authority in the United Kingdom, the United States Commodity Futures Trading Commission and the United States Department of Justice (DOJ) in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). RBS agreed to pay penalties of £87.5 million, US\$325 million and US\$150 million to these authorities respectively to resolve the investigations. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. In addition, on 12 April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and on 6 January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement. On 12 April 2013, RBS Securities Japan Limited received a business improvement order from Japan's Financial Services Agency requiring RBS to take remedial steps to address certain matters, including inappropriate conduct in relation to Yen LIBOR. Since such date, RBS Securities Japan Limited has been taking steps to address the issues raised in compliance with that order. In June 2013, RBS was listed amongst the 20 banks found by the Monetary Authority of Singapore (MAS) to have

deficiencies in the governance, risk management, internal controls and surveillance systems relating to benchmark submissions following a finding by the MAS that certain traders made inappropriate attempts to influence benchmarks in the period 2007 - 2011. RBS was ordered at that time to set aside additional statutory reserves with MAS of SGD1-1.2 billion and to comply with certain directives set by MAS with oversight by an independent reviewer, including instituting proper benchmark rate governance, providing training and ensuring robust surveillance systems and proper management of conflicts of interest. RBS complied with all directives to the satisfaction of MAS and the statutory reserves amount has been repaid by MAS.

## Notes

### 14. Litigation, investigations and reviews (continued)

In February 2014, the Group paid settlement penalties of approximately EUR 260 million and EUR 131 million to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements respectively.

In July 2014, RBS entered into an Enforceable Undertaking (EU) with the Australian Securities and Investments Commission (ASIC) in relation to potential misconduct involving the Australian Bank Bill Swap Rate. RBS undertakes in the EU to (a) comply with its existing undertakings arising out of the February 2013 settlement with the United States Commodity Futures Trading Commission as they relate to Australian Benchmark Interest Rates, (b) implement remedial measures with respect to its trading in Australian reference bank bills and (c) appoint an independent compliance expert to review and report on RBS's implementation of such remedial measures. The remediation measures include ensuring appropriate records retention, training, communications surveillance and trading reviews are in place. As part of the EU, RBS also agreed to make a voluntary contribution of A\$1.6 million to fund independent financial literacy projects in Australia.

The Group is co-operating with investigations and new and ongoing requests for information by various other governmental and regulatory authorities, including in the UK, US and Asia, into its submissions, communications and procedures relating to a number of trading rates, including LIBOR and other interest rate settings, ISDAFIX and non-deliverable forwards. The Group is also under investigation by competition authorities in a number of jurisdictions stemming from the actions of certain individuals in the setting of LIBOR and other trading rates, as well as interest rate-related trading.

In addition, various governmental and regulatory authorities have commenced investigations into foreign exchange trading and sales activities apparently involving multiple financial institutions. The Group has received enquiries from certain of these authorities including the FCA. The Group is reviewing communications and procedures relating to certain currency exchange benchmark rates as well as foreign exchange trading and sales activity. It is not possible to estimate reliably what effect the outcome of these investigations, any regulatory findings and any related developments may have on the Group, including the timing and amount of fines or settlements, which may be material.

On 21 July 2014, the Serious Fraud Office announced that it was launching a criminal investigation into allegations of fraudulent conduct in the foreign exchange market, apparently involving multiple financial

institutions.

***Technology incident in June 2012***

On 19 June 2012, the Group was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The cause of the incident has been investigated by independent external counsel with the assistance of third party advisors. The Group agreed to reimburse customers for any loss suffered as a result of the incident and the Group made a provision of £175 million in 2012.

The incident, the Group's handling of the incident, and the systems and controls surrounding the processes affected, are the subject of regulatory investigations in the UK and in the Republic of Ireland.

## Notes

### 14. Litigation, investigations and reviews (continued)

On 9 April 2013, the UK Financial Conduct Authority (FCA) announced that it had commenced an enforcement investigation into the incident. This is a joint investigation conducted by the FCA together with the UK Prudential Regulation Authority (PRA). The FCA and PRA will reach their conclusions in due course and will decide whether or not to initiate enforcement action following that investigation. While the outcomes of the FCA and PRA investigations will be separate, the regulators have indicated that they will endeavour to co-ordinate the timescales of their respective investigations. Separately the Central Bank of Ireland has initiated an investigation.

#### *Interest rate hedging products*

In June 2012, following an industry wide review, the FSA announced that the Group and other UK banks had agreed to a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses who were classified as retail clients or private customers under FSA rules. On 31 January 2013, the FSA issued a report outlining the principles to which it wished the Group and other UK banks to adhere in conducting the review and redress exercise. This exercise is being scrutinised by an independent reviewer, who is reviewing and approving any redress, and the FCA is overseeing this.

As part of the redress exercise, the Group undertook to provide fair and reasonable redress to non-sophisticated customers classified as retail clients or private customers, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients or private customers who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the Group was required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients or private customers who purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 are entitled to approach the Group and request a review. The Group has reached agreement with the independent reviewer in relation to redress outcomes for almost all in scope customers. The Group and the independent reviewer are now focused on completing the few remaining review outcomes, as well as assessing ancillary issues such as consequential loss claims.

In addition to the redress exercise that is being overseen by the FCA, the Group is also dealing with a large number of active litigation claims by customers who are also being considered under the FCA redress



programme as well as customers who are outside of scope for the review due to their sophistication. The Group is encouraging those customers that are eligible to seek redress under the FCA scheme. To the extent that claims are brought, the Group believes it has strong grounds for defending these claims.

The Group is voluntarily undertaking a similar exercise and past business review in relation to the sale of interest rate hedging products to retail designated small and medium sized businesses in the Republic of Ireland and to relevant customers of RBS International. Current expectations are that these will be completed by 31 December 2014.

The Group has made provisions in relation to all of the above totalling £1.4 billion to date for this matter, including £100 million in the six months ended 30 June 2014, of which £0.6 billion had been utilised at 30 June 2014.

## Notes

### 14. Litigation, investigations and reviews (continued)

#### *FSA mystery shopping review*

On 13 February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The Group was one of the firms involved.

The action required included a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers).

Subsequent to the FSA announcing the results of its mystery shopping review, the FCA has required the Group to carry out a past business review and customer contact exercise on a sample of historic customers that received investment advice on certain lump sum products through the Financial Planning channel of the Personal and Business Banking division of the Group, which includes The Royal Bank of Scotland plc and National Westminster Bank Plc, during the period from March 2012 until December 2012. This review is being conducted under section 166 of the Financial Services and Markets Act, under which a skilled person has been appointed to monitor such exercise. Alongside this review, the Personal and Business Banking business of the Group is also carrying out self-initiated reviews of certain parts of its advice back book and discussions are taking place with the FCA in relation to a remediation exercise for a specific customer segment who may have been mis-sold a structured product.

#### *Card Protection Plan Limited*

On 22 August 2013, the FCA announced 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 and payments are now being made. 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.

### ***Tomlinson Report***

On 25 November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK government's Department for Business Innovation and Skills, was published (Tomlinson Report). The Tomlinson Report was critical of the Group's Global Restructuring Group's treatment of SMEs. The Tomlinson Report was passed to the PRA and FCA. On 29 November 2013, the FCA announced that an independent skilled person would be appointed under Section 166 of the Financial Services and Markets Act to review the allegations in the Tomlinson Report. On 17 January 2014, Promontory Financial Group and Mazars were appointed as the skilled person. The Group is fully cooperating with the FCA in its investigation.

## Notes

### 14. Litigation, investigations and reviews (continued)

Separately, in November 2013 the Bank instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the Group's Global Restructuring Group was alleged to be culpable of systematic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford Chance published its report on 17 April 2014 and concluded that there was no evidence to support the principal allegation.

A separate independent review of the principal allegation, led by Mason Hayes & Curran, Solicitors, has been commenced in the Republic of Ireland. The Group's current expectation is that this review will be completed by 30 September 2014.

### *Multilateral interchange fees*

In 2007, the EC issued a decision that, while interchange is not illegal per se, MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA were in breach of competition law. MasterCard was required to withdraw (i.e. set to zero) the relevant cross-border MIF by 21 June 2008. MasterCard appealed against the decision to the General Court in March 2008, with the Group intervening in the appeal proceedings. The General Court heard MasterCard's appeal in July 2011 and issued its judgment in May 2012, upholding the EC's original decision. MasterCard has appealed further to the Court of Justice and the Group has intervened in these appeal proceedings. The appeal hearing took place on 4 July 2013 and the Advocate General's (AG) opinion (which is a non binding opinion and provided to the Court in advance of its final decision) was published on 30 January 2014. The AG opinion proposes that the Court should dismiss MasterCard's appeal. The Court's decision is currently expected on 11 September 2014. MasterCard negotiated interim cross border MIF levels to apply for the duration of the General Court proceedings. These MIF levels remain in place during the appeal before the Court of Justice.

On 9 April 2013, the EC announced it was opening a new investigation into interbank fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries.

In March 2008, the EC opened a formal inquiry into Visa's MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the EEA. In April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. In April 2010 Visa announced it

had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. In July 2012 Visa made a request to re-open the settlement in order to modify the fee. The EC rejected the request and in October 2012 Visa filed an appeal to the General Court seeking to have that decision annulled. That appeal is ongoing. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions. On 31 July 2012 the EC announced that it had issued Visa with a supplementary Statement of Objections regarding consumer credit cards in the EEA. On 14 May 2013, the EC announced it had reached an agreement with Visa regarding immediate cross border credit card MIF rates. This agreement has now been market tested and was made legally binding on 26 February 2014. The agreement is to last for four years.

## Notes

### 14. Litigation, investigations and reviews (continued)

In addition, the EC has proposed a draft regulation on interchange fees for card payments. The draft regulation is subject to a consultation process, prior to being finalised and enacted. It is currently expected that the regulation will be enacted during early 2015 at the earliest. The draft regulation proposes the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The draft regulation also sets out other proposals for reform including to the Honour All Cards Rule so merchants will be required to accept all cards with the same level of MIF but not cards with different MIF levels.

In the UK, the Office of Fair Trading (OFT) had previously opened investigations into domestic interchange fees applicable in respect of Visa and MasterCard consumer and commercial credit and debit card transactions. The OFT has not made a finding of an infringement of competition law and has not issued a Statement of Objections to any party in connection with those investigations. In February 2013 the OFT confirmed that while reserving its right to do so, it did not expect to issue Statements of Objections in respect of these investigations (if at all) prior to the handing down of the judgment of the Court of Justice in the matter of MasterCard's appeal against the EC's 2007 infringement decision.

The outcomes of these ongoing investigations, proceedings and proposed regulation are not yet known, but they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the Group's business in this sector.

### ***Payment Protection Insurance***

The FSA conducted a broad industry thematic review of Payment Protection Insurance (PPI) sales practices and in September 2008, the FSA announced an escalation of its level of regulatory intervention. Substantial numbers of customer complaints alleging the mis-selling of PPI policies had been made to banks and to the Financial Ombudsman Service (FOS) and many of these were being upheld by the FOS against the banks.

The FSA published a final policy statement in August 2010 imposing significant changes with respect to the handling of complaints about the mis-selling of PPI. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. In April 2011 the High Court issued judgment in favour of the FSA and the FOS and in May 2011 the BBA announced that it would not appeal that judgment. The Group then reached agreement with the FSA

on a process for implementation of its policy statement and for the future handling of PPI complaints. Implementation of the agreed processes has been under way since 2011. The Group has made provisions totalling £3.2 billion to date for this matter, including £150 million in the six months ended 30 June 2014, of which £2.6 billion has been utilised at 30 June 2014.

***Retail banking – EC***

Since initiating an inquiry into retail banking in the European Union (EU) in 2005, the European Commission (EC) continues to keep retail banking under review. In late 2010 the EC launched an initiative pressing for greater transparency of bank fees and is currently proposing to legislate for increased harmonisation of terminology across Member States. The Group cannot predict the outcome of these actions at this stage.

## Notes

### 14. Litigation, investigations and reviews (continued)

#### *UK personal current accounts/retail banking*

In July 2008, the OFT published a market study report into Personal Current Accounts (PCAs) raising concerns as regards the way the market was functioning. In October 2009 the OFT summarised initiatives agreed with industry to address these concerns. In December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the PCA market in the UK, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes were required for the market to work in the best interests of bank customers. In March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives designed to address its concerns, namely minimum standards on the operation of opt-outs from unarranged overdrafts, new working groups on information sharing with customers, best practice for PCA customers in financial difficulties and incurring charges, and PCA providers to publish their policies on dealing with PCA customers in financial difficulties. The OFT also announced that it would conduct six-monthly reviews and would also review the market again fully in 2012 and undertake a brief analysis on barriers to entry.

The first six-monthly review was completed in September 2010. The OFT noted progress in switching, transparency and unarranged overdrafts for the period March to September 2010 and highlighted further changes it wanted to see in the market. In March 2011, the OFT published the next update report in relation to PCAs. This noted further progress in improving consumer control over the use of unarranged overdrafts. In particular, the Lending Standards Board had led on producing standards and guidance to be included in a revised Lending Code. The OFT stated it would continue to monitor the market and would consider the need for, and appropriate timing of, further update reports in light of other developments, in particular the work of the UK Government's Independent Commission on Banking (ICB).

Additionally, in May 2010, the OFT announced its review of barriers to entry. The review concerned retail banking and banking for small and medium sized enterprises (SMEs) (up to £25 million turnover). The OFT published its report in November 2010. It advised that it expected its review to be relevant to the ICB, the FSA, HM Treasury and the Department for Business, Innovation and Skills and to the devolved governments in the UK. The OFT did not indicate whether it would undertake any further work. The report maintained that barriers to entry remain, in particular regarding switching, branch networks and brands.



On 13 July 2012, the OFT launched its planned full review of the PCA market. The review was intended to consider whether the initiatives agreed by the OFT with banks to date had been successful and whether the market should be referred to the Competition Commission (CC) for a fuller market investigation.

The OFT's PCA report was published on 25 January 2013. The OFT acknowledged some specific improvements in the market since its last review but concluded that further changes are required to tackle ongoing concerns, including a lack of switching, the ability of consumers to compare products and the complexity of overdraft charges. However, the OFT recognised at the time it published the report that a number of major developments were expected over the coming months including divestment of branches, improvements in account switching and assistance to customers to compare products and services. Therefore the OFT decided not to refer the market to the CC but said that it expected to return to the question of a referral to the CC in 2015, or before. The OFT also announced that it would be carrying out behavioural economic research on the way consumers make decisions and engage with retail banking service, and would study the operation of payment systems as well as the SME banking market.

## Notes

### **14. Litigation, investigations and reviews (continued)**

On 11 March 2014, the successor body to the OFT and CC, the Competition & Markets Authority (CMA), announced that in addition to its pending SME review (see below), it would be undertaking an update of the OFT's 2013 PCA review. On 18 July 2014 the CMA published its preliminary findings in respect of both the PCA and SME market studies. The CMA provisionally decided to make a market investigation reference (MIR) for both the PCA and SME market studies. The provisional decision on both PCAs and SMEs is now subject to a consultation period which runs until 17 September 2014. Following this period of consultation the CMA will make its final decision on a MIR in late autumn 2014. Should the CMA decide to proceed with a MIR this would result in a wide-ranging 18-24 month Phase 2 inquiry. At this stage it is not possible to estimate potential impacts on the Group.

#### ***SME banking market study***

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 and also announced that its successor body, the CMA, would continue the review. As discussed above, the CMA has provisionally decided to make a MIR for the SME market study in addition to the PCA study. As regards SMEs, the CMA is consulting on both the provisional decision and its provisional conclusion that it would be more appropriate to make a MIR than accept a set of undertakings in lieu put forward by RBS, Barclays, HSBC and Lloyds. The CMA is also consulting on whether a review is required of the previous undertakings given following the CC's investigation into SME banking in 2002 and has asked for comments on whether these undertakings need to be varied. At this stage it is not possible to estimate potential impacts on the Group.

#### ***FCA Wholesale Sector Competition Review***

On 9 July 2014, the FCA launched a review of competition in the wholesale sector to identify any areas which may merit further investigation through an in-depth market study.

The initial review is an exploratory exercise and will focus primarily on competition in wholesale securities and investment markets, and related activities such as corporate banking. It will commence with a three month consultation exercise, including a call for inputs from stakeholders. Following this consultation period, the FCA intends to publish a feedback statement later in 2014 and any market study is expected to be launched in early 2015.

***Credit default swaps (CDS) investigation***

The Group is a party to the EC's antitrust investigation into the CDS information market. The Group has received and responded to a Statement of Objections from the EC and continues to co-operate fully with the EC's ongoing investigation. In general terms, the EC has raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. At this stage, the Group cannot estimate reliably what effect the outcome of the investigation may have on the Group, which may be material.

## Notes

### 14. Litigation, investigations and reviews (continued)

#### *Securitisation and collateralised debt obligation business*

In the United States, the Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations, including among others various members of the RMBS Working Group of the Financial Fraud Enforcement Task Force relating to, among other things, issuance, underwriting and trading in mortgage-backed securities, collateralised debt obligations (CDOs), and synthetic products. In connection with these inquiries, Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and repurchase requests.

On 7 November 2013, the Group announced that it had settled with the US Securities and Exchange Commission ('the SEC') over its investigation of RBS Securities Inc. relating to due diligence conducted in connection with a 2007 offering of residential mortgage-backed securities and corresponding disclosures. Pursuant to the settlement, RBS Securities Inc., without admitting or denying the SEC's allegations, consented to the entry of a final judgment ordering certain relief, including an injunction and the payment of approximately US\$153 million in disgorgement, penalties, and interest. The settlement was subsequently approved by the United States District Court for the District of Connecticut. The Group co-operated fully with the SEC throughout the investigation.

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction. In May 2011, the New York State Attorney General requested additional information about the Group's mortgage securitisation business and, following the formation of the RMBS Working Group, has focused on the same or similar issues as the other state and federal RMBS Working Group investigations described above. The investigation is ongoing and the Group continues to respond to requests for information.

***US mortgages - loan repurchase matters***

The Group's Markets business in North America has been a purchaser of non-agency US residential mortgages in the secondary market, and an issuer and underwriter of non-agency residential mortgage-backed securities (RMBS). Markets did not originate or service any US residential mortgages and it was not a significant seller of mortgage loans to government sponsored enterprises (GSEs) (e.g. the Federal National Mortgage Association and the Federal Home Loan Mortgage Association).

## Notes

### 14. Litigation, investigations and reviews (continued)

In issuing RMBS, Markets generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, Markets made such representations and warranties itself. Where Markets has given those or other representations and warranties (whether relating to underlying loans or otherwise), Markets may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. In certain instances where it is required to repurchase loans or related securities, Markets may be able to assert claims against third parties who provided representations or warranties to Markets when selling loans to it, although the ability to recover against such parties is uncertain. Between the start of 2009 and 30 June 2014, Markets received approximately US\$741 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by Markets. However, repurchase demands presented to Markets are subject to challenge and rebuttal by Markets.

Citizens Financial Group, Inc (Citizens) has not been an issuer or underwriter of non-agency RMBS. However, Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. Between the start of 2009 and 30 June 2014, Citizens received US\$243 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to Citizens are subject to challenge and rebuttal by Citizens.

Although there has in recent times been disruption in the ability of certain financial institutions operating in the United States to complete foreclosure proceedings in respect of US mortgage loans in a timely manner or at all (including as a result of interventions by certain states and local governments), to date, Citizens has not been materially impacted by such disruptions and the Group has not ceased making foreclosures.

The Group cannot currently estimate what the ultimate exposure may be with respect to repurchase demands. Furthermore, the Group is unable to estimate the extent to which the matters described above will impact it, and future developments may have an adverse impact on the Group's net assets, operating results or cash flows in any particular period.

***Citizens consent orders***

The activities of Citizens' two US bank subsidiaries - Citizens Bank, N.A. and Citizens Bank of Pennsylvania - are subject to extensive US laws and regulations concerning unfair or deceptive acts or practices in connection with customer products. Certain of the bank subsidiaries' practices with respect to overdraft protection and other consumer products have not met applicable standards. The bank subsidiaries have implemented and are continuing to implement changes to bring their practices in conformity with applicable laws and regulations. In April 2013, the bank subsidiaries consented to the issuance of orders by their respective primary federal banking regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (the Consent Orders). In the Consent Orders (which are publicly available and will remain in effect until terminated by the regulators), the bank subsidiaries neither admitted nor denied the regulators' findings that they had engaged in deceptive marketing and implementation of the bank's overdraft protection programme, checking rewards programmes, and stop-payment process for pre-authorized recurring electronic fund transfers.

## Notes

### 14. Litigation, investigations and reviews (continued)

In connection with the Consent Orders, the bank subsidiaries paid a total of US\$10 million in civil monetary penalties. The Consent Orders also require the bank subsidiaries to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately US\$8 million), to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders.

In addition, Citizens Bank, N.A. agreed to take certain remedial actions to improve its compliance risk management systems and to create a comprehensive action plan designed to achieve compliance with the Consent Order. Restitution plans have been prepared and submitted for approval, and Citizens Bank, N.A. has submitted for approval and is in the process of implementing its action plan for compliance with the Consent Order, as well as updated policies, procedures and programmes related to its compliance risk management systems. In addition to the above, the bank subsidiaries could face further formal administrative enforcement actions from their federal supervisory agencies, including the assessment of civil monetary penalties and restitution, relating to issues arising from other consumer products.

#### ***Governance and risk management consent order***

On 27 July 2011, the Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (the Order) to address deficiencies related to governance, risk management and compliance systems and controls in RBS plc and RBS N.V. branches. In the Order, the Group agreed to create the following written plans or programmes:

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the Group's U.S. operations on an enterprise-wide and business line basis,
- an enterprise-wide risk management programme for the Group's U.S. operations,
- a plan to oversee compliance by the Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,
- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,
- a plan to improve the U.S. Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve,



a customer due diligence programme designed to reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations, and  
a plan designed to enhance the U.S. Branches' compliance with OFAC requirements.

## Notes

### 14. Litigation, investigations and reviews (continued)

The Order (which is publicly available) identified specific items to be addressed, considered, and included in each proposed plan or programme. The Group also agreed in the Order to adopt and implement the plans and programmes after approval by the regulators, to fully comply with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Order. The Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the Group's U.S. operations. The Group continues to test the effectiveness of the remediation efforts undertaken by the Group to ensure they are sustainable and meet regulators' expectations. Furthermore, the Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Order, which will remain in effect until terminated by the regulators.

The Group may be subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The Group's activities in the United States may be subject to significant limitations and/or conditions.

#### *US dollar processing consent order*

The Group's operations include businesses outside the United States that are responsible for processing US dollar payments. On 11 December 2013 the Group and The Royal Bank of Scotland plc announced that they had reached a settlement with the Board of Governors of the Federal Reserve System (Fed), the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to The Royal Bank of Scotland plc's historical compliance with US economic sanction regulations outside the US. In settlement with the above authorities, The Royal Bank of Scotland plc agreed to pay US\$100 million in total, including US\$50 million to the Fed, of which US\$33 million was deemed to satisfy the OFAC penalty, and US\$50 million to DFS.

As part of the settlement, the Group and The Royal Bank of Scotland plc entered into a consent Cease and Desist Order with the Fed (the Order) indicating, among other things, that: (a) the Group and The Royal Bank of Scotland plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the United States comply with applicable OFAC regulations; (b) from at least 2005 to 2008, certain business lines within The Royal Bank of Scotland plc developed and

implemented policies and procedures for processing U.S. dollar-denominated funds transfers through unaffiliated U.S. financial institutions involving parties subject to OFAC Regulations that omitted relevant information from payment messages necessary for the U.S. financial institutions to determine whether these transactions were carried out in a manner consistent with U.S. law; and (c) the Group continues to implement improvements in its oversight and compliance programme for activities involving offices outside the United States that impact the ability of U.S. financial institutions to comply with applicable OFAC sanctions. In the Order (which is publicly available), the Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the Group's global business lines outside of the United States, and to adopt, implement, and comply with the programme. The programme has now been submitted to the Federal Reserve Bank of Boston (Reserve Bank) for approval.

## Notes

### **14. Litigation, investigations and reviews (continued)**

Sixty days after the programme submitted to the Federal Reserve Bank of Boston (Reserve Bank) is approved, the Group is to complete a global OFAC risk assessment and submit it to the Reserve Bank and the FCA. The Group also agreed in the Order to hire an independent consultant (subject to approval by the Reserve Bank and the FCA) to conduct an annual OFAC compliance review involving a review of compliance policies and their implementation and an appropriate risk-focused sampling of U.S. dollar payments. The Order further requires the Group to submit quarterly written progress reports to the Reserve Bank detailing the form and manner of all actions taken to secure compliance with the Order. It was also announced that the US Department of Justice and the New York County District Attorney's Office had concluded their parallel criminal investigations and do not intend to take any action against The Royal Bank of Scotland plc.

#### ***US/Swiss tax programme***

In August 2013, the DOJ announced a programme for Swiss banks (the Programme), to settle the long-running dispute between the US tax authorities and Switzerland regarding the role of Swiss banks in concealing the assets of US tax payers in offshore accounts. The Programme provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, concerning their status in connection with the DOJ's investigations.

Coutts & Co Ltd, a member of the Group incorporated in Switzerland, notified the DOJ that it intended to participate in the Programme based on the possibility that some of its clients may not have declared their assets in compliance with US tax laws. The Programme required a detailed review of all US related accounts. The results of Coutts & Co Ltd's review were presented to the DOJ in June 2014. The DOJ has extended, until 31 July 2014, the deadline for Programme participants to complete the collection of evidence of the tax status of their US related account holders. The DOJ has also extended, until 15 September 2014, the deadline to collect evidence of those US related account holders also participating in an offshore voluntary disclosure programme.

#### ***Review of suitability of advice provided by Coutts & Co***

In 2013 the FCA conducted a thematic review of the advice processes across the UK wealth management industry. As a result of this review, Coutts & Co, a member of the Group incorporated in England and Wales, decided to undertake a past business review into the suitability of investment advice provided to its clients. This review is ongoing. Coutts & Co is in the process of contacting clients and redress will be

offered in appropriate cases. A provision has been taken to cover any potential liability arising from this review.

## Notes

### 15. Other developments

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

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 and realising a gain of £191 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.

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

RBS 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 approval by the Company's independent shareholders, which was received at a General Meeting of the Company on 25 June 2014. The DAS Retirement Agreement sets out the process for removal of the DAS - a key element of the Government's 2009 capital injection into RBS and the associated European Commission ("EC") approval of the state aid package for the bank. Among other benefits, the retirement of the DAS will in future allow the Board 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 RBS'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 RBS's divestment of the Williams & Glyn business (by Initial Public Offering (IPO), whole business sale or tendering procedure for its entire interest) has been extended. In the expected event of divestment by IPO, RBS 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 RBS's planned and publicly stated divestment timetable and already reflected in its capital and strategic planning.

RBS 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.

## Notes

### 15. Other developments (continued)

#### Board changes

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

Morten Friis was appointed as a non-executive director with effect from 10 April 2014.

Anthony Di Iorio, a non-executive director, stepped down from the Board on 26 March 2014.

Ewen Stevenson was appointed as an executive director and RBS Chief Financial Officer with effect from 19 May 2014.

#### Cap on variable remuneration

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

On 25 April 2014, the Board announced it was not seeking approval from shareholders at the 2014 Annual General Meeting for the 2:1 ratio. Instead, the Company has taken steps to work within the constraints of the 1:1 ratio (of variable to fixed remuneration) for employees subject to the Prudential Regulation Authority's Remuneration Code to deliver a remuneration structure that is aligned with shareholders' interests and compliant with the requirements of CRD IV.

#### EU financial transaction tax



On 30 April 2014, the European Court rejected a challenge from the UK Government of the initial proposal for the EU financial transaction tax on procedural grounds. A further challenge on substantive grounds may follow, depending on the nature of any subsequent Directive enacted in the future. RBS continues to monitor developments.

### **Citizens Financial Group (CFG)**

On 13 May 2014, CFG filed an S-1 registration statement with the Securities and Exchange Commission in the United States to undertake an initial public offering. The intention to fully divest CFG was announced in November 2013.

The filing of an S-1 Registration Statement is a regulatory requirement in the United States as part of the IPO process. This draft submission will initiate a 12-14 week process where the SEC can provide their comments. A formal prospectus will then be published which will include a price range and offering size range.

The submission of this statement is in line with the stated plan to launch an IPO of CFG by Q4 2014 - and complete RBS's selldown of CFG in 2016 - as part of the RBS Capital Plan.

## Notes

### 15. Other developments (continued)

#### Rating agencies

##### Moody's Investors Service

On 13 March 2014, Moody's Investors Service ('Moody's') lowered its credit ratings of RBS Group plc and certain subsidiaries by one notch. The long term ratings of RBS Group plc were 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, a negative ratings outlook was assigned.

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

Moody's rating actions were prompted by its concerns over the execution risks relating to the effective roll-out of the Group's strategic plans, its concerns over the impact of restructuring costs on profitability and its concern that the Group's capitalisation is vulnerable to short-term shocks. Despite these short to medium term concerns, Moody's expects RBS Group's capitalisation to improve in the medium to long term as the recovery plan is progressed. The agency also considers that, if executed according to plan, the intended restructuring will ultimately be positive for creditors as it will deliver a more efficient UK-focused bank with lower risk operations.

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

##### Fitch Ratings

On 24 March 2014 Fitch Ratings ('Fitch') affirmed as unchanged the long term ratings of RBS Group plc and subsidiaries, RBS plc and National Westminster Bank Plc, retaining the rating outlooks of these entities at negative.

On 25 March 2014 Fitch affirmed the ratings of Ulster Bank Ltd. At the same time, the long-term rating of Ulster Bank Ireland Ltd was revised down one notch to 'BBB+' from 'A-' and the short-term rating was revised to 'F2' from 'F1'. The outlooks on the ratings of both Ulster Bank Ltd and Ulster Bank Ireland Ltd remain negative.

The decision to downgrade the rating of Ulster Bank Ireland Ltd was based on the view that this entity's role within RBS Group may become less important over the next three to five years. Fitch also believe that the potential for disposal of Ulster Bank Ireland Ltd is higher than that of Ulster Bank Ltd, a Northern Irish business. These opinions caused Fitch to reduce the amount of support uplift in the ratings of Ulster Bank Ireland Ltd by one notch.

## Notes

### 15. Other developments (continued)

#### Rating agencies (continued)

##### Standard & Poor's

During the quarter, Standard & Poor's affirmed as unchanged its ratings on the Group and notable subsidiaries. Negative rating outlooks were maintained.

### 16. Related party transactions

#### *UK Government*

The UK Government and bodies controlled or jointly controlled by the UK Government and bodies over which it has significant influence are related parties of the Group. The Group enters into transactions with many of these bodies on an arm's length basis.

#### *Bank of England facilities*

In the ordinary course of business, the Group may from time to time access market-wide facilities provided by the Bank of England.

The Group's other transactions with the UK Government include the payment of taxes, principally UK corporation tax and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy and FSCS levies).

#### *Other related parties*

(a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.

(b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

Full details of the Group's related party transactions for the year ended 31 December 2013 are included in the Group's 2013 Annual Report on Form 20-F.

### **17. Post balance sheet events**

There have been no significant events between 30 June 2014 and the date of approval of this announcement which would require a change to or additional disclosure in the announcement.

## Notes

### 18. Trust preferred securities

The Group has issued trust preferred securities through trusts 100% owned by the Group (through partnership interests held by RBSG Capital Corporation and RBS) which meet the definition of a finance subsidiary in Regulation S-X, Rule 3-10. The securities represent undivided beneficial interests in the assets of the trusts, which consist of partnership preferred securities representing non-cumulative perpetual preferred limited partnership interests issued by Delaware limited partnerships. The Royal Bank of Scotland Group plc has provided subordinated guarantees for the benefit of the holders of the trust preferred securities and the partnership preferred securities. Under the terms of the guarantees, the Group has fully and unconditionally guaranteed on a subordinated basis, payments on such trust preferred securities and partnership preferred securities, to the extent they are due to be paid and have not been paid by, or on behalf of the trusts and the partnerships, as the case may be.

### 19. Consolidating financial information

The Royal Bank of Scotland plc ('RBS plc') is a 100% owned subsidiary of The Royal Bank of Scotland Group plc ('RBSG plc') and is able to offer and sell certain securities in the US from time to time pursuant to a registration statement on Form F-3 filed with the SEC with a full and unconditional guarantee from RBSG plc.

RBS plc utilizes an exception provided in Rule 3-10 of Regulation S-X, and therefore does not file its financial statements with the SEC. In accordance with the requirements to qualify for the exception, presented below is condensed consolidating financial information for:

- RBSG plc on a stand-alone basis as guarantor;
- RBS plc on a stand-alone basis as issuer;
- Non-guarantor Subsidiaries of RBSG plc and RBS plc on a combined basis ('Subsidiaries');
- Consolidation adjustments; and
- RBSG plc consolidated amounts ('RBSG Group').

Under IAS 27, RBSG plc and RBS plc account for investments in their subsidiary undertakings at cost less impairment. Rule 3-10 of Regulation S-X requires a company to account for its investments in subsidiary undertakings using the equity method, which would decrease the results for the period of RBSG plc and RBS plc in the information below by £150 million and £1,455 million respectively for the six months ended 30 June 2014 (£133 million and £183 million for the six months ended 30 June 2013). The net assets of RBSG plc and RBS plc in the information below would also be increased by £6,111 million and £2,933 million respectively at 30 June 2014 (increased by £5,536 million and £1,575 million at 31 December 2013).

## Notes

## 19. Consolidating financial information (continued)

## Income statement

|   | RBSG | RBS     |              | Consolidation | RBSG    |
|---|------|---------|--------------|---------------|---------|
|   | plc  | plc     | Subsidiaries | adjustments   | Group   |
|   | £m   | £m      | £m           | £m            | £m      |
| <b>For the six months ended 30 June 2014</b>    |      |         |              |               |         |
| Net interest income                             | 127  | 1,465   | 3,829        | 72            | 5,493   |
| Non-interest income                             | 408  | 3,479   | 1,815        | (1,035)       | 4,667   |
| Total income                                    | 535  | 4,944   | 5,644        | (963)         | 10,160  |
| Operating expenses                              | (4)  | (3,881) | (3,328)      | (26)          | (7,239) |
| Impairment losses                               | -    | (30)    | (259)        | 20            | (269)   |
| Operating profit before tax                     | 531  | 1,033   | 2,057        | (969)         | 2,652   |
| Tax   | (70) | (204)   | (487)        | 28            | (733)   |
| Profit from continuing operations               | 461  | 829     | 1,570        | (941)         | 1,919   |
| Profit from discontinued operations, net of tax | -    | -       | 35           | -             | 35      |
| Profit for the period                           | 461  | 829     | 1,605        | (941)         | 1,954   |

## Statement of comprehensive income

|  | RBSG | RBS  |              | Consolidation | RBSG  |
|--|------|------|--------------|---------------|-------|
|  | plc  | plc  | Subsidiaries | Adjustments   | Group |
|  | £m   | £m   | £m           | £m            | £m    |
| <b>For the six months ended 30 June 2014</b> |      |      |              |               |       |
| Profit/(loss) for the period                 | 461  | 829  | 1,605        | (941)         | 1,954 |
| Items that qualify for reclassification      |      |      |              |               |       |
| Available-for-sale financial assets          | -    | (38) | 448          | 119           | 529   |
| Cash flow hedges                             | -    | 79   | 141          | 28            | 248   |
| Currency translation                         | -    | 33   | (164)        | (602)         | (733) |
| Tax  | -    | (8)  | (97)         | (55)          | (160) |
|  | -    | 66   | 328          | (510)         | (116) |
| Other comprehensive income/(loss) after tax  | -    | 66   | 328          | (510)         | (116) |
| Total comprehensive income for the period    | 461  | 895  | 1,933        | (1,451)       | 1,838 |



Total comprehensive income is attributable to:

|                             |      |     |       |         |       |
|-----------------------------|------|-----|-------|---------|-------|
| Non-controlling interests   | -    | -   | (18)  | 48      | 30    |
| Preference shareholders     | 140  | 36  | -     | (36)    | 140   |
| Paid-in equity holders      | 14   | -   | -     | 13      | 27    |
| Dividend access share       | 320  | -   | -     | -       | 320   |
| Ordinary and B shareholders | (13) | 859 | 1,951 | (1,476) | 1,321 |
|                             | 461  | 895 | 1,933 | (1,451) | 1,838 |

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## Notes

### 19. Consolidating financial information (continued)

#### Income statement

|   | RBSG | RBS              | Consolidation | RBSG           |
|---|------|------------------|---------------|----------------|
|   | plc  | plc Subsidiaries | adjustments   | Group          |
| For the six months ended 30 June 2013           | £m   | £m               | £m            | £m             |
| Net interest income                             | 134  | 1,650            | 3,541         | 112 5,437      |
| Non-interest income                             | 616  | 4,192            | 2,224         | (1,197) 5,835  |
| Total income                                    | 750  | 5,842            | 5,765         | (1,085) 11,272 |
| Operating expenses                              | 43   | (3,987)          | (3,779)       | (25) (7,748)   |
| Impairment losses                               | -    | (603)            | (1,497)       | (50) (2,150)   |
| Operating profit before tax                     | 793  | 1,252            | 489           | (1,160) 1,374  |
| Tax   | 42   | (414)            | (311)         | 5 (678)        |
| Profit from continuing operations               | 835  | 838              | 178           | (1,155) 696    |
| Profit from discontinued operations, net of tax | -    | -                | 138           | - 138          |
| Profit/(loss) for the period                    | 835  | 838              | 316           | (1,155) 834    |

#### Statement of comprehensive income

|   | RBSG | RBS              | Consolidation | RBSG          |
|---|------|------------------|---------------|---------------|
|   | plc  | plc Subsidiaries | Adjustments   | Group         |
| For the six months ended 30 June 2013             | £m   | £m               | £m            | £m            |
| Profit/(loss) for the period                      | 835  | 838              | 316           | (1,155) 834   |
| Items that do not qualify for reclassification    | -    | -                | (1)           | 1 -           |
| Actuarial gains/(losses) on defined benefit plans | -    | -                | 4             | (4) -         |
|   | -    | -                | 3             | (3) -         |
| Items that qualify for reclassification           |      |                  |               |               |
| Available-for-sale financial assets               | (50) | (924)            | 96            | 145 (733)     |
| Cash flow hedges                                  | -    | (1,222)          | (119)         | (195) (1,536) |
| Currency translation                              | -    | (48)             | 496           | 862 1,310     |
| Tax   | 10   | 493              | 149           | 74 726        |
|   | (40) | (1,701)          | 622           | 886 (233)     |
| Other comprehensive (loss)/income after tax       | (40) | (1,701)          | 625           | 883 (233)     |
| Total comprehensive income/(loss) for the period  | 795  | (863)            | 941           | (272) 601     |

Total comprehensive income/(loss) is attributable to:

|                             |     |       |     |       |     |
|-----------------------------|-----|-------|-----|-------|-----|
| Non-controlling interests   | -   | -     | 17  | 117   | 134 |
| Preference shareholders     | 152 | 39    | -   | (39)  | 152 |
| Paid-in equity holders      | 15  | -     | -   | 15    | 30  |
| Ordinary and B shareholders | 628 | (902) | 924 | (365) | 285 |
|                             | 795 | (863) | 941 | (272) | 601 |

## Notes

## 19. Consolidating financial information (continued)

## Balance sheet

|   | RBSG   | RBS              | Consolidation | RBSG      |           |
|---|--------|------------------|---------------|-----------|-----------|
|   | plc    | plc Subsidiaries | adjustments   | Group     |           |
| At 30 June 2014                                 | £m     | £m               | £m            | £m        |           |
| <b>Assets</b>                                   |        |                  |               |           |           |
| Cash and balances at central banks              | -      | 60,978           | 7,692         | -         | 68,670    |
| Loans and advances to banks                     | 27,433 | 74,311           | 190,427       | (235,104) | 57,067    |
| Loans and advances to customers                 | 378    | 226,804          | 263,089       | (51,175)  | 439,096   |
| Debt securities                                 | 1,455  | 90,703           | 65,679        | (45,043)  | 112,794   |
| Equity shares                                   | 11     | 6,471            | 2,102         | (750)     | 7,834     |
| Investments in Group undertakings               | 54,797 | 43,781           | 13,016        | (111,594) | -         |
| Settlement balances                             | -      | 15,371           | 6,413         | (2,102)   | 19,682    |
| Derivatives                                     | 130    | 279,274          | 8,027         | (12,525)  | 274,906   |
| Intangible assets                               | -      | 1,122            | 5,161         | 5,890     | 12,173    |
| Property, plant and equipment                   | -      | 2,034            | 5,072         | 9         | 7,115     |
| Deferred tax                                    | -      | 1,765            | 2,096         | (754)     | 3,107     |
| Prepayments, accrued income and other assets    | 34     | 2,884            | 4,936         | (436)     | 7,418     |
| Assets of disposals groups                      | -      | 25               | 1,221         | -         | 1,246     |
| Total assets                                    | 84,238 | 805,523          | 574,931       | (453,584) | 1,011,108 |
| <b>Liabilities</b>                              |        |                  |               |           |           |
| Deposits by banks                               | 1,505  | 179,469          | 106,541       | (216,614) | 70,901    |
| Customer accounts                               | -      | 183,954          | 338,688       | (69,876)  | 452,766   |
| Debt securities in issue                        | 7,741  | 43,223           | 30,846        | (22,723)  | 59,087    |
| Settlement balances                             | -      | 11,654           | 5,419         | (1,945)   | 15,128    |
| Short positions                                 | -      | 24,256           | 15,311        | (548)     | 39,019    |
| Derivatives                                     | 37     | 272,429          | 10,146        | (12,525)  | 270,087   |
| Accruals, deferred income and other liabilities | 434    | 6,379            | 8,230         | (167)     | 14,876    |
| Retirement benefit liabilities                  | -      | 54               | 2,666         | 22        | 2,742     |
| Deferred tax                                    | -      | -                | 1,176         | (571)     | 605       |
| Subordinated liabilities                        | 13,900 | 28,957           | 5,529         | (23,577)  | 24,809    |
| Liabilities of disposal groups                  | -      | -                | 125           | -         | 125       |
| Total liabilities                               | 23,617 | 750,375          | 524,677       | (348,524) | 950,145   |
| Non-controlling interests                       | -      | -                | 1,314         | (696)     | 618       |

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|                              |        |         |         |           |           |
|------------------------------|--------|---------|---------|-----------|-----------|
| Owners' equity               | 60,621 | 55,148  | 48,940  | (104,364) | 60,345    |
| Total equity                 | 60,621 | 55,148  | 50,254  | (105,060) | 60,963    |
| Total liabilities and equity | 84,238 | 805,523 | 574,931 | (453,584) | 1,011,108 |

## Notes

## 19. Consolidating financial information (continued)

## Balance sheet

|   | RBSG          | RBS              | Consolidation  | RBSG             |                  |
|---|---------------|------------------|----------------|------------------|------------------|
|   | plc           | plc Subsidiaries | adjustments    | Group            |                  |
| At 31 December 2013                             | £m            | £m               | £m             | £m               |                  |
| <b>Assets</b>                                   |               |                  |                |                  |                  |
| Cash and balances at central banks              | -             | 75,792           | 6,867          | -                | 82,659           |
| Loans and advances to banks                     | 24,574        | 77,768           | 193,024        | (241,295)        | 54,071           |
| Loans and advances to customers                 | 153           | 225,374          | 269,326        | (54,131)         | 440,722          |
| Debt securities                                 | 1,517         | 92,327           | 52,316         | (32,561)         | 113,599          |
| Equity shares                                   | -             | 7,301            | 2,274          | (764)            | 8,811            |
| Investments in Group undertakings               | 54,813        | 42,328           | 13,233         | (110,374)        | -                |
| Settlement balances                             | -             | 3,492            | 2,417          | (318)            | 5,591            |
| Derivatives                                     | 164           | 292,880          | 9,638          | (14,643)         | 288,039          |
| Intangible assets                               | -             | 1,127            | 5,033          | 6,208            | 12,368           |
| Property, plant and equipment                   | -             | 2,284            | 5,616          | 9                | 7,909            |
| Deferred tax                                    | -             | 2,298            | 1,402          | (222)            | 3,478            |
| Prepayments, accrued income and other assets    | 36            | 3,246            | 7,263          | (2,931)          | 7,614            |
| Assets of disposals groups                      | 842           | -                | 2,136          | 39               | 3,017            |
| <b>Total assets</b>                             | <b>82,099</b> | <b>826,217</b>   | <b>570,545</b> | <b>(450,983)</b> | <b>1,027,878</b> |
| <b>Liabilities</b>                              |               |                  |                |                  |                  |
| Deposits by banks                               | 1,490         | 180,293          | 108,129        | (225,933)        | 63,979           |
| Customer accounts                               | 740           | 193,553          | 328,090        | (51,503)         | 470,880          |
| Debt securities in issue                        | 7,015         | 51,538           | 36,147         | (26,881)         | 67,819           |
| Settlement balances                             | -             | 2,274            | 3,328          | (289)            | 5,313            |
| Short positions                                 | -             | 17,898           | 10,815         | (691)            | 28,022           |
| Derivatives                                     | 62            | 288,507          | 11,600         | (14,643)         | 285,526          |
| Accruals, deferred income and other liabilities | 49            | 7,201            | 10,006         | (1,239)          | 16,017           |
| Retirement benefit liabilities                  | -             | 65               | (336)          | 3,481            | 3,210            |
| Deferred tax                                    | -             | -                | 1,617          | (1,110)          | 507              |
| Subordinated liabilities                        | 12,426        | 30,566           | 6,009          | (24,989)         | 24,012           |
| Liabilities of disposal groups                  | -             | -                | 3,378          | -                | 3,378            |
| <b>Total liabilities</b>                        | <b>21,782</b> | <b>771,895</b>   | <b>518,783</b> | <b>(343,797)</b> | <b>968,663</b>   |
| Non-controlling interests                       | -             | -                | 1,194          | (721)            | 473              |

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|                              |        |         |         |           |           |
|------------------------------|--------|---------|---------|-----------|-----------|
| Owners' equity               | 60,317 | 54,322  | 50,568  | (106,465) | 58,742    |
| Total equity                 | 60,317 | 54,322  | 51,762  | (107,186) | 59,215    |
| Total liabilities and equity | 82,099 | 826,217 | 570,545 | (450,983) | 1,027,878 |

## Notes

## 19. Consolidating financial information (continued)

## Cash flow statement

|   | RBSG    | RBS              | Consolidation |           |
|---|---------|------------------|---------------|-----------|
|   | plc     | plc Subsidiaries | adjustments   |           |
|   | £m      | £m               | £m            | £m        |
| <b>For the six months ended 30 June 2014</b>                  |         |                  |               |           |
| Net cash flows from operating activities                      | (2,827) | (12,688)         | 6,181         | 3,536     |
| Net cash flows from investing activities                      | 1,183   | 2,224            | (5,548)       | 1,500     |
| Net cash flows from financing activities                      | 1,782   | (1,868)          | 1,041         | (34)      |
| Effects of exchange rate changes on cash and cash equivalents | (26)    | (2,278)          | (1,398)       | 1,311     |
| Net increase/(decrease) in cash and cash equivalents          | 112     | (14,610)         | 276           | 6,313     |
| Cash and cash equivalents at 1 January 2014                   | 1,345   | 124,628          | 113,504       | (118,300) |
| Cash and cash equivalents at 30 June 2014                     | 1,457   | 110,018          | 113,780       | (111,987) |
| <b>For the six months ended 30 June 2013</b>                  |         |                  |               |           |
| Net cash flows from operating activities                      | (730)   | (6,369)          | 2,818         | (1,391)   |
| Net cash flows from investing activities                      | 1,381   | 14,040           | (666)         | (2,462)   |
| Net cash flows from financing activities                      | 235     | (2,254)          | (2,589)       | 3,200     |
| Effects of exchange rate changes on cash and cash equivalents | 46      | 4,372            | 2,758         | (2,228)   |
| Net increase in cash and cash equivalents                     | 932     | 9,789            | 2,321         | (2,881)   |
| Cash and cash equivalents at 1 January 2013                   | 997     | 126,243          | 125,045       | (119,444) |
| Cash and cash equivalents at 30 June 2013                     | 1,929   | 136,032          | 127,366       | (122,325) |



## Disposal of Direct Line Group

In November 2009, the Group entered into a state aid commitment deed with the Commissioners of Her Majesty's Treasury requiring the Group to: (1) divest its interest in Direct Line Group (DLG) to a level below that at which it would be considered to exercise control by 31 December 2013 and (2) dispose of its entire interest by 31 December 2014. Pursuant to its obligations, the Group sold 34.7% of DLG in an initial public offering (IPO) in October 2012 and subsequently sold 16.8% in March 2013, 20.0% in September 2013, and 28.5% in February 2014 through institutional placings.

The Group ceased to consolidate DLG after the second share sale in March 2013 when its shareholding fell to 48.5% thereafter treating it as an associate until the final share sale in February 2014. The Group has been in discussions with the Conduct Committee of the UK Financial Reporting Council (the Conduct Committee) about when DLG should have been deconsolidated. Based on full consideration of the facts and circumstances, the Group's assessment is that it no longer controlled DLG after the second share sale in March 2013. The Conduct Committee considers that the Group retained control owing to its dominant voting interest, notwithstanding the reduction of its shareholding to below 50%, the relationship agreement and the state aid commitment deed; therefore, in accordance with the provisions in IFRS 10 *Consolidated Financial Statements* regarding de facto control, DLG should have been consolidated by the Group in its interim accounts for the six months ended 30 June 2013.

At the request of the Conduct Committee, the effect on the Group's financial statements for 30 June 2013 and 31 December 2013 of consolidating DLG up until September 2013 is set out below:

|                                    | Half year ended<br>30 June 2013 |  | Year ended<br>31 December 2013 |  |
|------------------------------------|---------------------------------|--|--------------------------------|--|
|                                    | As published                    | DLG<br>consolidated to<br>September 2013 | As published                   | DLG<br>consolidated to<br>September 2013 |
|                                    | £m                              | £m                                       | £m                             | £m                                       |
| <b>Income statement</b>            |                                 |  |                                |  |
| Other operating income             | 1,332                           | 1,286                                    | 1,398                          | 1,331                                    |
| Operating profit/(loss) before tax | 1,374                           | 1,328                                    | (8,243)                        | (8,310)                                  |
| Discontinued operations            | 138                             | 161                                      | 148                            | 346                                      |
| Profit/(loss) for the period       | 834                             | 811                                      | (8,477)                        | (8,346)                                  |
| Total comprehensive income/(loss)  | 601                             | 649                                      | (10,189)                       | (10,051)                                 |
|                                    | <b>30 June 2013</b>             |  | <b>31 December 2013</b>        |  |

|   | <b>As published</b> | <b>DLG<br/>consolidated to<br/>September 2013</b> | <b>As published</b> | <b>DLG<br/>consolidated to<br/>September 2013</b> |
|---|---------------------|---|---------------------|---|
|   | <b>£m</b>           | <b>£m</b>   | <b>£m</b>           | <b>£m</b>   |
| <b>Balance sheet</b>                          |                     |   |                     |   |
| Prepayments, accrued income and other assets: | <b>9,063</b>        | <b>7,565</b>                                      | 7,614               | 7,614   |
| Interests in associates                       | <b>2,500</b>        | <b>1,002</b>                                      | 902                 | 902   |
| Assets of disposal groups                     | <b>1,313</b>        | <b>13,621</b>                                     | 3,017               | 3,071   |
| Total assets                                  | <b>1,216,229</b>    | <b>1,227,039</b>                                  | 1,027,878           | 1,027,932   |
| Liabilities of disposal groups                | <b>306</b>          | <b>9,477</b>                                      | 3,378               | 3,378   |
| Non-controlling interests                     | <b>475</b>          | <b>2,121</b>                                      | 473                 | 473   |
| Owners' equity                                | <b>69,183</b>       | <b>69,176</b>                                     | 58,742              | 58,796  |

The Conduct Committee is not pursuing the matter further given the amounts involved and the subsequent loss of control.

## Risk factors

Set out below is a summary of the principal 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 of the Group's 2013 Annual Report on Form 20-F. 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 in the Group's 2013 Annual Report on Form 20-F on pages 513 to 526.

The Group is implementing a new strategic plan and direction which will result in a significant downsizing of the Group, including simplifying the Group by replacing the previous divisional structure with three customer franchises. The Group is also taking steps to strengthen its capital position and has established medium term goals.

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 Citizens Financial Group (CFG). Since 2009, the Group has undertaken an extensive restructuring, including the disposal of non-core assets and businesses, such as the full divestment of Direct Line Group in March 2014, as part of the State Aid restructuring plan approved by the EC and supplemented by the agreements with HM Treasury and the EC on 9 April 2014. The Group created RBS Capital Resolution in the fourth quarter of 2013 to manage the run-down of problem assets with the clear aspiration of removing such assets from the balance sheet by the end of 2016.

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 and people 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.

Operational and reputational risks are inherent in the Group's businesses, and heightened as a result of the implementation of the new strategic plan.

The Scottish government is holding a referendum on 18 September 2014 on the question of Scottish independence from the UK. Although the outcome of the referendum is uncertain, subject to any mitigating factors, 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.

Despite the improved outlook for the global and UK economy over the near to medium-term, actual or perceived difficult global economic conditions, potential volatility in the UK housing market and

restrictions on mortgage lending as well as increased competition, particularly in the UK, create challenging economic and market conditions and a difficult operating environment for the Group's businesses. 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 adversely affected and will continue to adversely affect the Group's businesses, earnings, financial condition and prospects.

## Risk factors

The Group is subject to substantial regulation and oversight, and any further significant regulatory developments such as those which have 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 certain bank activities could result in additional costs and increased operational risks which may impact 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's ability to implement its strategy and its future success depends on its ability to attract and retain qualified personnel. 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's changing strategy has led to the departure of many talented staff. Following the implementation of CRD IV and the Government's views on variable compensation, there is now a restriction on the Group's ability to pay individual bonuses greater than salary, which may put the Group at a competitive disadvantage. An inability to attract and retain qualified personnel could have an adverse impact on the implementation of the Group's strategy and regulatory commitments.

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 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, 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. The Group's credit ratings would be likely to be negatively impacted by political events, such as an affirmative vote in favour of Scottish independence.

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 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 CFG.

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 and 2014, the Group is expected to continue to have material exposure to legacy litigation and regulatory 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 historical, new and existing laws and regulations such as anti-money laundering and anti-terrorism laws.

## Risk factors

The Group is highly dependent on its information technology systems, which are currently subject to significant investment and rationalisation as part of the Group's new strategic plan and associated transformation programme. The Group has been and expects to continue to be subject to cyber attacks which expose the Group to loss of customer data or other sensitive information and which, combined with other failures of the Group's information technology systems, may hinder its ability to service its clients which could result in long-term damage to the Group's businesses and brands.

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. 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 is able to exercise a significant degree of influence over the Group including on dividend policy, the election of directors or appointment of senior management, remuneration policy and/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 (such as the UK Financial Services Compensation Scheme). Additional or increased contributions may have an adverse impact on the Group's results of operations, cash flow and financial condition.





## Statement of directors' responsibilities

We, the directors listed below, confirm that to the best of our knowledge:

the condensed financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting';

the interim management report includes a fair review of the information required by DTR 4.2.7R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and

the interim management report includes a fair review of the information required by DTR 4.2.8R (disclosure of related parties' transactions and changes therein).

By order of the Board

|                |                 |                            |
|----------------|-----------------|----------------------------|
| Philip Hampton | Ross McEwan     | Ewen<br>Stevenson          |
| Chairman       | Chief Executive | Chief Financial<br>Officer |

31 July 2014

Board of directors

**Chairman**      **Executive directors**      **Non-executive directors**

Philip Hampton      Ross McEwan      Sandy Crombie

Ewen Stevenson      Alison Davis

Morten Friis

Robert Gillespie

Penny Hughes

Brendan Nelson

Baroness Noakes

Philip Scott

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**Additional information****Share information**

|   | <b>30 June</b> | 31 March | 31<br>December |
|---|----------------|----------|----------------|
|   | <b>2014</b>    | 2014     | 2013           |
| <b>Ordinary share price</b>                   | <b>328.4p</b>  | 311.0p   | 338.1p         |
| <b>Number of ordinary shares in issue</b>     | <b>6,300m</b>  | 6,241m   | 6,203m         |
| <b>Number of equivalent B shares in issue</b> | <b>5,100m</b>  | 5,100m   | 5,100m         |

The following table shows the Group's issued and fully paid share capital, owners' equity and indebtedness on an unaudited consolidated basis in accordance with IFRS as at 30 June 2014.

|   | <b>As at<br/>30 June</b> |
|---|--------------------------|
|   | <b>2014<br/>£m</b>       |
| <b>Share capital - allotted, called up and fully paid</b> |                          |
| Ordinary shares of £1                                     | <b>6,300</b>             |
| B shares of £0.01   | <b>510</b>               |
| Dividend access share of £0.01                            | —                        |
| Non-cumulative preference shares of US\$0.01              | <b>1</b>                 |
| Non-cumulative preference shares of €0.01                 | —                        |
| Non-cumulative preference shares of £1                    | —                        |
|   | <b>6,811</b>             |
| Retained income and other reserves                        | <b>53,534</b>            |
| Owners' equity  | <b>60,345</b>            |
| <b>Group indebtedness</b>                                 |                          |
| Subordinated liabilities                                  | <b>24,809</b>            |
| Debt securities in issue                                  | <b>59,087</b>            |

|                                       |                |
|---------------------------------------|----------------|
| Total indebtedness                    | <b>83,896</b>  |
| Total capitalisation and indebtedness | <b>144,241</b> |

Under IFRS, certain preference shares are classified as debt and are included in subordinated liabilities in the table above.

Other than as disclosed above, the information contained in the tables above has not changed materially since 30 June 2014.

## Additional information

### Other financial data

|  | Half year ended | Year ended 31 December |        |        |        |        |
|--|-----------------|------------------------|--------|--------|--------|--------|
|  | 30 June         |                        |        |        |        |        |
|  | 2014(5)         | 2013                   | 2012   | 2011   | 2010   | 2009   |
| Return on average total assets (1)   | <b>0.3%</b>     | (0.7%)                 | (0.4%) | (0.1%) | (0.1%) | (0.2%) |
| Return on average ordinary and B shareholders' equity (2)                        | <b>5.2%</b>     | (14.5%)                | (8.9%) | (3.1%) | (0.9%) | (7.4%) |
| Average owners' equity as a percentage of average total assets                   | <b>5.8%</b>     | 5.6%                   | 5.2%   | 4.9%   | 4.6%   | 2.8%   |
| Ratio of earnings to combined fixed charges and preference share dividends (3,4) |                 |                        |        |        |        |        |
| - including interest on deposits   | <b>2.04</b>     | (0.34)                 | 0.28   | 0.85   | 0.95   | 0.72   |
| - excluding interest on deposits   | <b>4.54</b>     | (4.51)                 | (2.99) | (0.37) | 0.50   | (0.47) |
| Ratio of earnings to fixed charges only (3,4)                                    |                 |                        |        |        |        |        |
| - including interest on deposits   | <b>2.19</b>     | (0.36)                 | 0.29   | 0.85   | 0.97   | 0.77   |
| - excluding interest on deposits   | <b>5.95</b>     | (6.04)                 | (3.81) | (0.37) | 0.58   | (0.71) |

#### Notes:

- (1) Return on average total assets represents profit/(loss) attributable to ordinary and B shareholders as a percentage of average total assets.
- (2) Return on average ordinary and B shareholders' equity represents profit/(loss) attributable to ordinary and B shareholders expressed as a percentage of average ordinary and B shareholders' equity.
- (3) For this purpose, earnings consist of income before tax and non-controlling interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).
- (4) The earnings for the years ended 31 December 2013, 2012, 2011, 2010 and 2009, were inadequate to cover total fixed charges and preference share dividends. The coverage deficiency for total fixed

charges and preference share dividends for the years ended 31 December 2013, 2012, 2011, 2010 and 2009 were £8,641 million, £5,578 million, £1,396 million, £422 million and £4,034 million, respectively. The coverage deficiency for fixed charges only for the years ended 31 December 2013, 2012, 2011, 2010 and 2009 were £8,243 million, £5,277 million, £1,396 million, £298 million and £3,099 million, respectively.

(5) Based on unaudited numbers.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

**The Royal Bank of Scotland Group plc**

**Registrant**

/s/ Rajan Kapoor

Rajan Kapoor

Financial Controller

30 September 2014





Appendix 1

Capital and risk management

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**Appendix 1 Capital and risk management**

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## Appendix 1 Capital and risk management

### Presentation of information

The assets of disposal groups are presented as a single line in the consolidated balance sheet as required by IFRS. The risk and balance sheet management disclosures include the balances and exposures of disposal groups.

### General overview

RBS's main risks are described in 'Risk and balance sheet management - Risk coverage' in the Group's 2013 Annual Report on Form 20-F. The following table presents a summary of the key developments for each risk during 2014.

| <b>Risk type</b>           | <b>2014 developments and summary</b>  |
|----------------------------|---|
| Capital adequacy risk      | The capital position continued to improve with CET 1 ratio at 10.1 %, up from 8.6% at the year end reflecting continuing reductions in risk-weighted assets primarily in CIB and RCR, lower regulatory capital deductions relating to deferred tax assets and expected loss, and attributable profit.   |
| Liquidity and funding risk | Liquidity metrics remained strong: the liquid portfolio of £138 billion covering short-term wholesale funding more than four times, LCR improving to 104%, NSFR at 111% and the stressed coverage ratio improved significantly to over 170%.  |
| Credit risk                | Balance sheet credit exposures after credit mitigation and enhancement, decreased by 7% to £333 billion and credit risk RWAs fell by £35 billion, 10%, reflecting risk reduction. Impairment provisions of £22 billion covered risk elements in lending of £34 billion by 66%. Favourable credit conditions resulted in impairment charges for the half year being significantly lower than in recent periods with net recoveries in RCR and CIB. |
| Market risk                | Average trading VaR for the first half of 2014 was about a third of that in the first half of 2013, reflecting risk reduction and the effect of incorporating credit valuation and funding valuation adjustments into VaR models.   |
| Country risk               | Net balance sheet exposure to eurozone periphery countries was reduced by £1.5 billion, 4%, to £40.3 billion in the first half of the year. Total exposure to Russia was £2.1 billion: limits have been cut and credit restrictions introduced.   |



## Appendix 1 Capital and risk management

### General overview (continued)

| <b>Risk type</b>  | <b>2014 developments and summary</b>   |
|-------------------|--|
| Conduct risk      | Business models, strategies and products continued to be reviewed to ensure better customer outcomes. Synergies with other risk disciplines were also developed to enable the consistent identification, assessment and mitigation of conduct risks.   |
| Pension risk      | RBS concluded discussions with the Trustee of the RBS Group Pension Fund, agreeing the technical provisions basis and a schedule of contributions for the 2013 funding valuation. Additionally, stress tests were carried out under scenarios designed to meet PRA and European Banking Authority (EBA) requirements.  |
| Operational risk  | RBS's operational risk framework was further enhanced. The main focus remained on supporting improvements in risk management, specifically strengthened risk assessments through defining and implementing an end-to-end approach for the most material operational risks.   |
| Regulatory risk   | Regulatory risk remained a high priority and RBS continued to work through a number of legacy issues. RBS also implemented an increasing number of regulatory changes such as Basel III and Dodd Frank.  |
| Reputational risk | A Reputational Risk Forum was created to identify issues involving material reputational risk. On 1 July 2014, a new Head of Reputational Risk was appointed whose responsibilities include building a new framework to manage reputational risk.  |
| Business risk     | RBS moved towards simplifying and functionalising its organisation and management structure to help reduce risk. There was also a focus on strengthening its stress testing capability. In particular, it is anticipated that finalisation of the stress testing programmes of the Bank of England and the EBA will enhance management and measurement of business risk. |
| Strategic risk    | RBS continued to develop its framework for the identification and management of the most material risks to its strategic plan. A new "Top Risk" approach assesses both the likelihood and impact of significant threats, and develops agreed mitigations. These are reviewed by the Board at least on a quarterly basis.   |



## Appendix 1 Capital and risk management

### Capital management

#### Introduction

The Group aims to maintain a level of capital to meet two objectives: (i) meeting minimum regulatory capital requirements; and (ii) ensuring the Group maintains sufficient capital to uphold customer, investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

| Capital and leverage ratios | 30 June 2014            |                  | 31 December 2013 |   |                    |
|-----------------------------|-------------------------|------------------|------------------|---|--------------------|
|                             | Current<br>transitional | CRR<br>end-point | Transitional     | Estimated<br>CRR end-<br>point basis<br>(1) | Basel 2.5<br>basis |
|                             | PRA basis<br>£bn        | basis (1)<br>£bn | PRA basis<br>£bn | point basis<br>(1)<br>£bn                   | basis<br>£bn       |
| <b>Capital</b>              |                         |                  |                  |   |                    |
| CET1                        | 39.7                    | 39.7             | 36.8             | 36.8  | 42.2               |
| Tier 1                      | 47.3                    | 39.7             | 44.3             | 36.8  | 50.6               |
| Total                       | 61.2                    | 48.7             | 58.2             | 45.5  | 63.7               |
|                             |                         |                  |                  |   |                    |
| <b>RWAs by risk</b>         |                         |                  |                  |   |                    |
|                             |                         |                  |                  |   |                    |
| Credit risk                 |                         |                  |                  |   |                    |
| - non-counterparty          | 283.3                   | 283.3            | 317.9            | 317.9                                       | 291.1              |
| - counterparty              | 38.6                    | 38.6             | 39.1             | 39.1  | 22.3               |
| Market risk                 | 33.4                    | 33.4             | 30.3             | 30.3  | 30.3               |
| Operational risk            | 36.8                    | 36.8             | 41.8             | 41.8  | 41.8               |
|                             |                         |                  |                  |   |                    |
|                             | 392.1                   | 392.1            | 429.1            | 429.1                                       | 385.5              |
|                             |                         |                  |                  |   |                    |
| <b>Risk asset ratios</b>    | %                       | %                | %                | %   | %                  |
|                             |                         |                  |                  |   |                    |
| CET1                        | 10.1                    | 10.1             | 8.6              | 8.6   | 10.9               |
| Tier 1                      | 12.1                    | 10.1             | 10.3             | 8.6   | 13.1               |



|       |      |      |      |      |      |
|-------|------|------|------|------|------|
| Total | 15.6 | 12.4 | 13.6 | 10.6 | 16.5 |
|-------|------|------|------|------|------|

|   |  | 30 June |  | 31 December |  |
|---|--|---------|--|-------------|--|
|   |  | 2014    |  | 2013        |  |
| <b>Estimated BCBS leverage ratios (2)</b> |  |         |  |             |  |
| Tier 1 capital - £bn                      |  | 39.7    |  | 36.8        |  |
| Exposure - £bn                            |  | 1,070.2 |  | 1,082.0     |  |
| Leverage ratio - %                        |  | 3.7     |  | 3.4         |  |

## Notes:

- (1) CRR as implemented by the Prudential Regulation Authority in the UK, with effect from 1 January 2014.
- (2) Leverage ratio is calculated using:
  - CRR end-point Tier 1 capital; and
  - Exposure measure based on guidance in the BCBS 270 proposal issued in January 2014, supplemented by the instructions in the March 2014 Basel III Quantitative Impact Study (QIS) and the related FAQs.

## Appendix 1 Capital and risk management

### Capital and leverage ratios (continued)

#### Key points

CET1 ratio improved by 150 basis points in the first half of the year, of which 70 basis points was in the second quarter reflecting attributable profit after charging the initial DAS dividend (£320 million), reduction in RWAs and lower regulatory deductions for deferred tax assets and expected loss.

RWAs declined by £37 billion with £22 billion in the second quarter mainly in CIB reflecting continued risk reduction and in RCR due to run-off and disposals.

Attributable profit as well as lower leverage exposure in CIB resulted in a 30 basis point improvement in the estimated BCBS leverage ratio in the first half of the year.

| Capital resources  | 30 June 2014 |           | 31 December 2013 |          |           |
|--|--------------|-----------|------------------|----------|-----------|
|  | Current      | CRR       | Estimated        |          |           |
|  | transitional | end-point | Transitional     | CRR end- | Basel 2.5 |
|  | basis        | basis     | PRA basis        | point    | basis     |
|  | £m           | £m        | £m               | £m       | £m        |
| Shareholders' equity (excluding non-controlling interests) |              |           |                  |          |           |
| Shareholders' equity                                       | 60,345       | 60,345    | 58,742           | 58,742   | 58,742    |
| Preference shares - equity                                 | (4,313)      | (4,313)   | (4,313)          | (4,313)  | (4,313)   |
| Other equity instruments                                   | (979)        | (979)     | (979)            | (979)    | (979)     |
|  | 55,053       | 55,053    | 53,450           | 53,450   | 53,450    |
| Non-controlling interests                                  | -            | -         | -                | -        | 473       |
| Regulatory adjustments and deductions                      |              |           |                  |          |           |
| Own credit   | 629          | 629       | 601              | 601      | 726       |
| Defined benefit pension fund adjustment                    | (196)        | (196)     | (172)            | (172)    | 362       |
| Net unrealised available-for-sale (AFS) losses             | -            | -         | -                | -        | 308       |

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|  |               |               |          |          |          |
|--|---------------|---------------|----------|----------|----------|
| Cash flow hedging reserve                  | (94)          | (94)          | 84       | 84       | 84       |
| Deferred tax assets                        | (1,748)       | (1,748)       | (2,260)  | (2,260)  | -        |
| Prudential valuation adjustments           | (486)         | (486)         | (781)    | (781)    | -        |
| Goodwill and other intangible assets       | (12,173)      | (12,173)      | (12,368) | (12,368) | (12,368) |
| Expected losses less impairment provisions | (1,319)       | (1,319)       | (1,731)  | (1,731)  | (19)     |
| 50% of securitisation positions            | -             | -             | -        | -        | (748)    |
| Other regulatory adjustments               | 69            | 69            | (55)     | (55)     | (103)    |
|  | (15,318)      | (15,318)      | (16,682) | (16,682) | (11,758) |
|  |               |               |          |          |          |
| <b>CET 1 capital</b>                       | <b>39,735</b> | <b>39,735</b> | 36,768   | 36,768   | 42,165   |

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## Appendix 1 Capital and risk management

## Capital resources (continued)

|   | 30 June 2014  |               | 31 December 2013 |               |               |
|---|---------------|---------------|------------------|---------------|---------------|
|   | Current       | CRR           |                  | Estimated     |               |
|   | transitional  | end-point     | Transitional     | CRR end-      | Basel 2.5     |
|   | basis         | basis         | PRA basis        | point         | basis         |
|   | £m            | £m            | £m               | £m            | £m            |
| <b>Other Tier 1 capital</b>   |               |               |                  |               |               |
| Preference shares - equity  | -             | -             | -                | -             | 4,313         |
| Preference shares - debt  | -             | -             | -                | -             | 911           |
| Innovative/hybrid Tier 1 securities   | -             | -             | -                | -             | 4,207         |
| Qualifying Tier 1 capital and related share premium subject to phase out from Additional Tier 1 (AT1) capital | 5,820         | -             | 5,831            | -             | -             |
| Qualifying Tier 1 capital included in consolidated AT1 capital  |               |               |                  |               |               |
| issued by subsidiaries and held by third parties  | 1,708         | -             | 1,749            | -             | -             |
|   | 7,528         | -             | 7,580            | -             | 9,431         |
| <b>Tier 1 deductions</b>  |               |               |                  |               |               |
| 50% of material holdings  | -             | -             | -                | -             | (976)         |
| Tax on expected losses less impairment provisions   | -             | -             | -                | -             | 6             |
|   | -             | -             | -                | -             | (970)         |
| <b>Tier 1 capital</b>   | <b>47,263</b> | <b>39,735</b> | <b>44,348</b>    | <b>36,768</b> | <b>50,626</b> |
| <b>Qualifying Tier 2 capital</b>  |               |               |                  |               |               |
| Undated subordinated debt   | -             | -             | -                | -             | 2,109         |
|   | -             | -             | -                | -             | 12,436        |

|   |        |        |        |        |         |
|---|--------|--------|--------|--------|---------|
| Dated subordinated debt - net of amortisation           |        |        |        |        |         |
| Qualifying items and related share premium              | 5,740  | 5,145  | 4,431  | 3,582  | -       |
| Qualifying own funds instruments issued by subsidiaries |        |        |        |        |         |
| and held by third parties                               | 8,222  | 3,815  | 9,374  | 5,151  | -       |
| Unrealised gains on AFS equity shares                   | -      | -      | -      | -      | 114     |
| Collectively assessed impairment provisions             | -      | -      | -      | -      | 395     |
|   | 13,962 | 8,960  | 13,805 | 8,733  | 15,054  |
|   |        |        |        |        |         |
| <b>Tier 2 deductions</b>                                |        |        |        |        |         |
| 50% of securitisation positions                         | -      | -      | -      | -      | (748)   |
| Expected losses less impairment provisions              | -      | -      | -      | -      | (25)    |
| 50% of material holdings                                | -      | -      | -      | -      | (976)   |
|   | -      | -      | -      | -      | (1,749) |
|   |        |        |        |        |         |
| <b>Tier 2 capital</b>                                   | 13,962 | 8,960  | 13,805 | 8,733  | 13,305  |
|   |        |        |        |        |         |
| <b>Supervisory deductions</b>                           |        |        |        |        |         |
| Unconsolidated investments                              | -      | -      | -      | -      | (36)    |
| Other deductions  | -      | -      | -      | -      | (236)   |
|   | -      | -      | -      | -      | (272)   |
|   |        |        |        |        |         |
|   |        |        |        |        |         |
| <b>Total regulatory capital</b>                         | 61,225 | 48,695 | 58,153 | 45,501 | 63,659  |

## Appendix 1 Capital and risk management

### Capital resources (continued)

#### Capital flow statement

The table below analyses the movement in CRR end-point CET1 and Tier 2 capital for the half year ended 30 June 2014.

|  | CET1   | Tier 2  | Total   |
|--|--------|---------|---------|
|  | £m     | £m      | £m      |
| At 1 January 2014  | 36,768 | 8,733   | 45,501  |
| Attributable profit net of movements in fair value of own credit         | 1,453  | -       | 1,453   |
| Share capital and reserve movements in respect of employee share schemes | (33)   | -       | (33)    |
| Ordinary shares issued   | 315    | -       | 315     |
| Foreign exchange reserve   | (728)  | -       | (728)   |
| AFS reserves   | 446    | -       | 446     |
| Decrease in goodwill and intangibles deduction                           | 195    | -       | 195     |
| Deferred tax assets (DTA)  | 512    | -       | 512     |
| Prudential valuation adjustments (PVA)                                   | 295    | -       | 295     |
| Excess of expected loss over impairment provisions (EL-P)                | 412    | -       | 412     |
| Dated subordinated debt issues   | -      | 2,154   | 2,154   |
| Net dated subordinated debt/grandfathered instrument                     | -      | (1,528) | (1,528) |
| Foreign exchange movement  | -      | (399)   | (399)   |
| Other movements  | 100    | -       | 100     |
| At 30 June 2014  | 39,735 | 8,960   | 48,695  |

#### Key point

RBS issued £820 million and £1,334 million of Tier 2 subordinated debt in Q1 and Q2 respectively. Following reviews, £2.1 billion of ineligible subordinated notes were removed from Tier 2 capital.





## Appendix 1 Capital and risk management

### Capital resources (continued)

Notes:

#### General:

In accordance with the PRA's Policy Statement PS7/2013 issued in December 2013 on the implementation of CRD IV, all regulatory adjustments and deductions to CET1 have been applied in full (without transition relief) with the exception of unrealised gains on AFS securities which will be included from 2015.

CRD IV and Basel III impose a minimum CET1 ratio of 4.5%. Further, CET1 requirements will be imposed through buffers in the CRD. There are three buffers that will affect the Group: the capital conservation buffer set at 2.5% of RWAs; the counter-cyclical capital buffer (up to 2.5% of RWAs), which will be calculated as the weighted average of the countercyclical capital buffer rates applied in the countries where the Group has relevant credit exposures; and the highest of Global-Systemically Important Institution (G-SII), Other-Systemically Important Institution (O-SII) or Systemic Risk Buffers set by the supervisory authorities. The Group has been provisionally allocated a G-SII buffer of 1.5%. The regulatory target capital requirements will be phased in through CRR, and are expected to apply in full from 1 January 2019. Until then, using national discretion the PRA can apply a top-up. As set out in the PRA's Supervisory Statement SS3/13, the Group and other major UK banks and building societies are required to maintain a CET1 ratio of 7%, after taking into account certain adjustments set by the PRA.

From 1 January 2015, the Group must meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 and/or Tier 2 capital. The Pillar 2A capital requirement is the additional capital that the Group must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Measures in relation to CRR end-point basis, including RWAs, are based on the current interpretation, expectations, and understanding, of the CRR requirements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities. The actual CRR end-point impact may differ when the final technical standards are interpreted and adopted.

#### Capital base:

- (1) Own funds are based on shareholders' equity.
- (2) Includes the nominal value of B shares (£0.5 billion) on the assumption that RBS will be privatised in the future and that they will count as permanent equity in some form by the end of 2017.
- (3) The prudential valuation adjustment (PVA), arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full. The PVA has been included in impairment provisions in the determination of the deduction from expected losses.

- (4) Where the deductions from AT1 capital exceed AT1 capital, the excess is deducted from CET1 capital. The excess of AT1 deductions over AT1 capital in year one of transition is due to the application of the current rules to the transitional amounts.
- (5) Insignificant investments in equities of other financial entities (net): long cash equity positions are considered to have matched maturity with synthetic short positions if the long position is held for hedging purposes and sufficient liquidity exists in the relevant market. All the trades are managed and monitored together within the equities business.
- (6) Based on our current interpretations of the Commission Delegated Regulation issued in December 2013 on credit risk adjustments, the Group's standardised latent provision has been reclassified to specific provision and is not included in Tier 2 capital.

**Risk-weighted assets:**

- (1) Current securitisation positions are shown as risk-weighted at 1,250%.
- (2) RWA uplifts include the impact of credit valuation adjustments (CVA) and asset valuation correlation (AVC) on banks and central counterparties.
- (3) RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.
- (4) Non-financial counterparties and sovereigns that meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.
- (5) The CRR final text includes a reduction in the risk-weight relating to small and medium-sized enterprises.



## Appendix 1 Capital and risk management

### Leverage exposure

#### Exposure summary

The leverage exposure below is based on the BCBS 270 proposal issued in January 2014, with additional specificity deriving from the instructions in the March 2014 QIS and related FAQs. The BCBS 270 proposal is expected to be incorporated into the CRR but the final rules may result in changes to the calculation when implemented.

| Exposure measure                                | 30 June | 31       |
|---|---------|----------|
|   | 2014    | December |
|   | £bn     | £bn      |
| Cash and balances at central banks              | 68.7    | 82.7     |
| Reverse repos                                   | 81.7    | 76.4     |
| Loans and advances                              | 414.5   | 418.4    |
| Debt securities                                 | 112.8   | 113.6    |
| Equity shares                                   | 7.8     | 8.8      |
| Derivatives                                     | 274.9   | 288.0    |
| Goodwill and other intangible assets            | 12.2    | 12.4     |
| Other assets                                    | 37.3    | 24.6     |
| Assets of disposal groups                       | 1.2     | 3.0      |
| Total assets                                    | 1,011.1 | 1,027.9  |
| Netting of derivatives (1)                      | (217.5) | (227.3)  |
| Potential future exposure on derivatives (2)    | 102.5   | 128.0    |
| SFTs (1)  | 77.5    | 59.8     |
| Regulatory deductions and other adjustments (3) | (1.4)   | (6.6)    |
| Undrawn commitments (4)                         | 98.0    | 100.2    |
| Leverage exposure measure                       | 1,070.2 | 1,082.0  |

Notes:

- (1) The BCBS proposal permits some limited netting for margin received against the replacement cost of derivatives, an additional gross securities financing transaction (SFT) calculation with more restrictive netting, but possible future benefit for trades against qualifying central counterparties. The notional amounts relating to sold credit protection are included in the exposure measure, offset by longer dated bought protection on the same contracts.
- (2) Potential future exposure (PFE) on derivatives: the regulatory add-on which is calculated by assigning percentages based on the type and residual maturity of the derivatives to nominal amounts or underlying values of derivative contracts. The element of PFE relating to credit derivatives sold is removed under the BCBS 270 proposal and replaced with the credit derivative notionals on protection sold per note (1).
- (3) Regulatory deductions: to ensure consistency between the leverage ratio numerator and the denominator, regulatory items that are deducted from capital are also deducted from the leverage exposure measure.
- (4) Undrawn commitments represent regulatory add-ons relating to off-balance sheet undrawn commitments based on the credit conversion factors of 10%, 20%, 50% and 100% being applied as applicable to the commitments. Refer to the following page for further analysis.

**Appendix 1 Capital and risk management****Leverage exposure** (continued)

## Derivative notionals

The table below analyses derivative notional values by product and maturity.

|                         | <1 year       | 1-5 years     | >5 years     | Credit<br>derivative<br>5% add on<br>factor (1) | Credit<br>derivative<br>10% add<br>on factor<br>(1) | Total         |
|-------------------------|---------------|---------------|--------------|---|---|---------------|
|                         | £bn           | £bn           | £bn          | £bn   | £bn   | £bn           |
| <b>30 June 2014</b>     |               |               |              |   |   |               |
| Interest rate           | 13,522        | 9,781         | 5,758        |   |   | 29,061        |
| Exchange rate           | 3,686         | 628           | 295          |   |   | 4,609         |
| Equity                  | 76            | 2             | -            |   |   | 78            |
| Commodities             | 1             | -             | 1            |   |   | 2             |
| Credit                  |               |               |              | 209   | 69  | 278           |
| <b>Total</b>            | <b>17,285</b> | <b>10,411</b> | <b>6,054</b> | <b>209</b>                                      | <b>69</b>   | <b>34,028</b> |
| <b>31 December 2013</b> |               |               |              |   |   |               |
| Interest rate           | 10,582        | 16,212        | 8,795        |   |   | 35,589        |
| Exchange rate           | 3,261         | 814           | 480          |   |   | 4,555         |
| Equity                  | 43            | 35            | 1            |   |   | 79            |
| Commodities             | -             | 1             | 1            |   |   | 2             |
| Credit                  |               |               |              | 189   | 64  | 253           |
| <b>Total</b>            | <b>13,886</b> | <b>17,062</b> | <b>9,277</b> | <b>189</b>                                      | <b>64</b>   | <b>40,478</b> |

Note:

(1) Credit derivatives receive a PFE of 5% where qualifying and 10% where non-qualifying.

| Off-balance sheet items               |           |        |            |         |      |      |     |        |       |
|---------------------------------------|-----------|--------|------------|---------|------|------|-----|--------|-------|
|                                       |           | Ulster | Commercial | Private |      |      |     |        |       |
|                                       | UK<br>PBB | Bank   | Banking    | Banking | CIB  | CFG  | RCR | Centre | Total |
| 30 June 2014                          | £bn       | £bn    | £bn        | £bn     | £bn  | £bn  | £bn | £bn    | £bn   |
| Unconditionally cancellable items (1) | 3.1       | 0.1    | 0.5        | 0.1     | 0.7  | 1.7  | -   | -      | 6.2   |
| Items with a 20% CCF                  | 0.4       | -      | 0.7        | 0.2     | 2.3  | 0.3  | -   | 0.1    | 4.0   |
| Items with a 50% CCF                  | 6.0       | 1.4    | 12.8       | 1.3     | 37.3 | 6.8  | 0.9 | 2.5    | 69.0  |
| Items with a 100% CCF                 | 0.1       | 0.4    | 1.7        | 0.9     | 12.7 | 1.5  | 0.4 | 1.2    | 18.9  |
|                                       | 9.6       | 1.9    | 15.7       | 2.5     | 53.0 | 10.3 | 1.3 | 3.8    | 98.1  |
| 31 December 2013                      |           |        |            |         |      |      |     |        |       |
| Unconditionally cancellable items (1) | 3.1       | 0.2    | 0.4        | 0.1     | 0.7  | 1.7  | -   | -      | 6.2   |
| Items with a 20% CCF                  | 0.4       | -      | 0.6        | 0.6     | 1.5  | 0.2  | -   | -      | 3.3   |
| Items with a 50% CCF                  | 5.8       | 1.0    | 12.5       | 1.0     | 41.9 | 7.1  | 0.7 | 2.7    | 72.7  |
| Items with a 100% CCF                 | 0.1       | 0.3    | 2.4        | 1.4     | 12.0 | 1.6  | 0.2 | -      | 18.0  |
|                                       | 9.4       | 1.5    | 15.9       | 3.1     | 56.1 | 10.6 | 0.9 | 2.7    | 100.2 |

Note:

(1) Based on a 10% credit conversion factor.

## Appendix 1 Capital and risk management

### Risk-weighted assets

The table below analyses the movement in credit risk RWAs by key drivers during the half year.

|                            | Credit risk      |              |        |
|----------------------------|------------------|--------------|--------|
|                            | Non-counterparty | Counterparty | Total  |
|                            | £bn              | £bn          | £bn    |
| At 1 January 2014          | 317.9            | 39.1         | 357.0  |
| Foreign exchange movement  | (3.8)            | -            | (3.8)  |
| Business movements         | (17.2)           | (8.2)        | (25.4) |
| Risk parameter changes (1) | (2.4)            | -            | (2.4)  |
| Methodology changes (2)    | (10.4)           | 5.1          | (5.3)  |
| Model updates              | (1.2)            | -            | (1.2)  |
| Other changes              | 0.4              | 2.6          | 3.0    |
| At 30 June 2014            | 283.3            | 38.6         | 321.9  |
| Modelled (3)               | 191.2            | 33.2         | 224.4  |
| Non-modelled               | 92.1             | 5.4          | 97.5   |
|                            | 283.3            | 38.6         | 321.9  |

The table below analyses movements in market and operational risk RWAs during the half year.

|                               | Market | Operational |
|-------------------------------|--------|-------------|
|                               | risk   | risk        |
|                               | £bn    | £bn         |
| At 1 January 2014             | 30.3   | 41.8        |
| Business and market movements | (8.8)  | (5.0)       |
| Methodology changes           | 11.9   | -           |
| At 30 June 2014               | 33.4   | 36.8        |
| Modelled (3)                  | 15.9   | -           |
| Non-modelled                  | 17.5   | 36.8        |



|  |             |             |
|--|-------------|-------------|
|  |             |             |
|  | <b>33.4</b> | <b>36.8</b> |

## Notes:

- (1) Changes in credit quality metrics of customers and counterparties such as probability of default and loss given default.
- (2) Technical adjustments and calibration of models.
- (3) Modelled refers to advanced internal ratings based (AIRB) for non-counterparty credit risk, internal model method (IMM) for counterparty credit risk, value-at-risk (VaR) and related models for market risk.

**Key points**

Business movements include exposure reductions in RCR and CIB.

Methodology changes include the transfer of £11.9 billion of RWAs from non-counterparty credit risk to market risk relating to trading book securitisations.

Operational risk is calculated on a three year average of income and the business and other movement reflects the annual recalculation.

Non-modelled or standardised (STD) credit risk RWAs principally comprised CFG (£56 billion); Private Banking (£10 billion); derivative and repo transactions undertaken by RBSSI, the broker-dealer; and certain securitisation exposures.

Increase in RWA density of bank exposures reflected the impact of CVA and AVC and those on structured entities related to RWA treatment, both relating to the implementation of CRD IV.

## Appendix 1 Capital and risk management

### Risk-weighted assets (continued)

#### Credit risk: RWA density

Refer to the 2013 Pillar 3 Report for details on terminology. For the majority of credit risk, RBS used the internal ratings based (IRB) approach for calculating RWAs. The standardised approach (STD) is used for certain portfolios. RWAs at 30 June 2014 are under current rules and 31 December 2013 are on a Basel 2.5 basis.

|                                    | EAD post CRM (1) |        |         | RWAs   |        |        | RWA density |     |       |
|------------------------------------|------------------|--------|---------|--------|--------|--------|-------------|-----|-------|
|                                    | AIRB             | STD    | Total   | AIRB   | STD    | Total  | AIRB        | STD | Total |
| 30 June 2014                       | £m               | £m     | £m      | £m     | £m     | £m     | %           | %   | %     |
| <b>Sector cluster</b>              |                  |        |         |        |        |        |             |     |       |
| <b>Sovereign</b>                   |                  |        |         |        |        |        |             |     |       |
| Central banks                      | 41,702           | 46,390 | 88,092  | 2,180  | 127    | 2,307  | 5           | -   | 3     |
| Central government                 | 16,860           | 8,522  | 25,382  | 2,435  | 7      | 2,442  | 14          | -   | 10    |
| Other sovereign                    | 5,012            | 5,749  | 10,761  | 1,267  | 197    | 1,464  | 25          | 3   | 14    |
| Total sovereign                    | 63,574           | 60,661 | 124,235 | 5,882  | 331    | 6,213  | 9           | 1   | 5     |
| <b>Financial institutions (FI)</b> |                  |        |         |        |        |        |             |     |       |
| Banks                              | 41,416           | 2,571  | 43,987  | 20,995 | 621    | 21,616 | 51          | 24  | 49    |
| Other FI (2)                       | 48,063           | 23,977 | 72,040  | 19,043 | 10,085 | 29,128 | 40          | 42  | 40    |
| SEs (3)                            | 19,320           | 3,271  | 22,591  | 11,245 | 5,561  | 16,806 | 58          | 170 | 74    |
| Total FI                           | 108,799          | 29,819 | 138,618 | 51,283 | 16,267 | 67,550 | 47          | 55  | 49    |
| <b>Corporates</b>                  |                  |        |         |        |        |        |             |     |       |
| <b>Property</b>                    |                  |        |         |        |        |        |             |     |       |
| - Western Europe                   |                  |        |         |        |        |        |             |     |       |
| - UK                               | 49,501           | 3,388  | 52,889  | 24,963 | 3,154  | 28,117 | 50          | 93  | 53    |
| - Ireland                          | 8,907            | 46     | 8,953   | 1,705  | 43     | 1,748  | 19          | 93  | 20    |

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|  |         |         |         |  |         |        |         |    |     |    |
|--|---------|---------|---------|--|---------|--------|---------|----|-----|----|
| - Other  | 6,385   | 123     | 6,508   |  | 3,461   | 105    | 3,566   | 54 | 85  | 55 |
| - US   | 1,687   | 6,643   | 8,330   |  | 890     | 6,653  | 7,543   | 53 | 100 | 91 |
| - RoW  | 3,525   | 271     | 3,796   |  | 2,272   | 223    | 2,495   | 64 | 82  | 66 |
|  |         |         |         |  |         |        |         |    |     |    |
| Total property   | 70,005  | 10,471  | 80,476  |  | 33,291  | 10,178 | 43,469  | 48 | 97  | 54 |
| Natural resources  | 36,955  | 2,891   | 39,846  |  | 15,840  | 2,564  | 18,404  | 43 | 89  | 46 |
| Transport  | 32,053  | 3,335   | 35,388  |  | 18,466  | 3,168  | 21,634  | 58 | 95  | 61 |
| Manufacturing  | 29,979  | 7,787   | 37,766  |  | 12,909  | 7,626  | 20,535  | 43 | 98  | 54 |
| Retail and leisure                                       | 26,637  | 7,906   | 34,543  |  | 16,008  | 7,894  | 23,902  | 60 | 100 | 69 |
| Services   | 23,991  | 8,232   | 32,223  |  | 14,319  | 8,232  | 22,551  | 60 | 100 | 70 |
| TMT (4)  | 14,868  | 2,249   | 17,117  |  | 7,849   | 2,230  | 10,079  | 53 | 99  | 59 |
|  |         |         |         |  |         |        |         |    |     |    |
| Total corporates   | 234,488 | 42,871  | 277,359 |  | 118,682 | 41,892 | 160,574 | 51 | 98  | 58 |
|  |         |         |         |  |         |        |         |    |     |    |
| Personal   |         |         |         |  |         |        |         |    |     |    |
| Mortgages  |         |         |         |  |         |        |         |    |     |    |
| - Western Europe   |         |         |         |  |         |        |         |    |     |    |
| - UK   | 113,427 | 7,716   | 121,143 |  | 13,554  | 3,031  | 16,585  | 12 | 39  | 14 |
| - Ireland  | 16,279  | 37      | 16,316  |  | 15,609  | 16     | 15,625  | 96 | 43  | 96 |
| - Other  | 227     | 335     | 562     |  | 22      | 128    | 150     | 10 | 38  | 27 |
| - US   | 132     | 18,999  | 19,131  |  | 13      | 9,430  | 9,443   | 10 | 50  | 49 |
| - RoW  | 439     | 540     | 979     |  | 51      | 206    | 257     | 12 | 38  | 26 |
|  |         |         |         |  |         |        |         |    |     |    |
| Total mortgages  | 130,504 | 27,627  | 158,131 |  | 29,249  | 12,811 | 42,060  | 22 | 46  | 27 |
| Other personal   | 32,338  | 14,537  | 46,875  |  | 14,226  | 10,715 | 24,941  | 44 | 74  | 53 |
|  |         |         |         |  |         |        |         |    |     |    |
| Total personal   | 162,842 | 42,164  | 205,006 |  | 43,475  | 23,526 | 67,001  | 27 | 56  | 33 |
| Other items  | 5,484   | 16,468  | 21,952  |  | 4,095   | 16,486 | 20,581  | 75 | 100 | 94 |
|  |         |         |         |  |         |        |         |    |     |    |
| Total  | 575,187 | 191,983 | 767,170 |  | 223,417 | 98,502 | 321,919 | 39 | 51  | 42 |
|  |         |         |         |  |         |        |         |    |     |    |
| For the notes to this table refer to the following page. |         |         |         |  |         |        |         |    |     |    |

## Appendix 1 Capital and risk management

## Risk-weighted assets: Credit risk: RWA density (continued)

|                                    | EAD post CRM (1) |        |         | RWAs   |        |        | RWA density |     |       |
|------------------------------------|------------------|--------|---------|--------|--------|--------|-------------|-----|-------|
|                                    | AIRB             | STD    | Total   | AIRB   | STD    | Total  | AIRB        | STD | Total |
| 31 December 2013                   | £m               | £m     | £m      | £m     | £m     | £m     | %           | %   | %     |
| <b>Sector cluster</b>              |                  |        |         |        |        |        |             |     |       |
| <b>Sovereign</b>                   |                  |        |         |        |        |        |             |     |       |
| Central banks                      | 34,809           | 59,351 | 94,160  | 1,289  | 180    | 1,469  | 4           | -   | 2     |
| Central government                 | 17,940           | 8,401  | 26,341  | 2,418  | 30     | 2,448  | 13          | -   | 9     |
| Other sovereign                    | 5,323            | 5,525  | 10,848  | 1,451  | 149    | 1,600  | 27          | 3   | 15    |
|                                    |                  |        |         |        |        |        |             |     |       |
| Total sovereign                    | 58,072           | 73,277 | 131,349 | 5,158  | 359    | 5,517  | 9           | -   | 4     |
|                                    |                  |        |         |        |        |        |             |     |       |
| <b>Financial institutions (FI)</b> |                  |        |         |        |        |        |             |     |       |
| Banks                              | 37,718           | 2,769  | 40,487  | 11,922 | 689    | 12,611 | 32          | 25  | 31    |
| Other FI (2)                       | 43,460           | 14,033 | 57,493  | 16,391 | 7,940  | 24,331 | 38          | 57  | 42    |
| SEs (3)                            | 21,564           | 2,523  | 24,087  | 5,827  | 2,189  | 8,016  | 27          | 87  | 33    |
|                                    |                  |        |         |        |        |        |             |     |       |
| Total FI                           | 102,742          | 19,325 | 122,067 | 34,140 | 10,818 | 44,958 | 33          | 56  | 37    |
|                                    |                  |        |         |        |        |        |             |     |       |
| <b>Corporates</b>                  |                  |        |         |        |        |        |             |     |       |
| <b>Property</b>                    |                  |        |         |        |        |        |             |     |       |
| - Western Europe                   |                  |        |         |        |        |        |             |     |       |
| - UK                               | 50,250           | 2,771  | 53,021  | 27,904 | 2,461  | 30,365 | 56          | 89  | 57    |
| - Ireland                          | 10,338           | 107    | 10,445  | 3,087  | 136    | 3,223  | 30          | 127 | 31    |
| - Other                            | 8,764            | 143    | 8,907   | 4,937  | 130    | 5,067  | 56          | 91  | 57    |
| - US                               | 1,126            | 6,527  | 7,653   | 600    | 6,272  | 6,872  | 53          | 96  | 90    |
| - RoW                              | 3,579            | 317    | 3,896   | 2,817  | 253    | 3,070  | 79          | 80  | 79    |
|                                    |                  |        |         |        |        |        |             |     |       |
| Total property                     | 74,057           | 9,865  | 83,922  | 39,345 | 9,252  | 48,597 | 53          | 94  | 58    |
| Natural resources                  | 29,403           | 2,826  | 32,229  | 15,586 | 2,435  | 18,021 | 53          | 86  | 56    |
| Transport                          | 31,677           | 3,024  | 34,701  | 21,678 | 2,709  | 24,387 | 68          | 90  | 70    |
| Manufacturing                      | 24,649           | 7,775  | 32,424  | 13,607 | 7,599  | 21,206 | 55          | 98  | 65    |
| Retail and leisure                 | 23,974           | 7,744  | 31,718  | 18,302 | 7,591  | 25,893 | 76          | 98  | 82    |

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|                  |         |         |         |         |        |         |    |    |    |
|------------------|---------|---------|---------|---------|--------|---------|----|----|----|
| Services         | 22,716  | 8,757   | 31,473  | 15,972  | 8,382  | 24,354  | 70 | 96 | 77 |
| TMT (4)          | 13,550  | 2,222   | 15,772  | 8,470   | 2,198  | 10,668  | 63 | 99 | 68 |
|                  |         |         |         |         |        |         |    |    |    |
| Total corporates | 220,026 | 42,213  | 262,239 | 132,960 | 40,166 | 173,126 | 60 | 95 | 66 |
|                  |         |         |         |         |        |         |    |    |    |
| <b>Personal</b>  |         |         |         |         |        |         |    |    |    |
| Mortgages        |         |         |         |         |        |         |    |    |    |
| - Western Europe |         |         |         |         |        |         |    |    |    |
| - UK             | 110,470 | 7,841   | 118,311 | 14,412  | 3,267  | 17,679  | 13 | 42 | 15 |
| - Ireland        | 17,148  | 33      | 17,181  | 16,108  | 12     | 16,120  | 94 | 36 | 94 |
| - Other          | 202     | 507     | 709     | 25      | 202    | 227     | 12 | 40 | 32 |
| - US             | 121     | 19,717  | 19,838  | 15      | 9,756  | 9,771   | 12 | 49 | 49 |
| - RoW            | 396     | 242     | 638     | 50      | 107    | 157     | 13 | 44 | 25 |
|                  |         |         |         |         |        |         |    |    |    |
| Total mortgages  | 128,337 | 28,340  | 156,677 | 30,610  | 13,344 | 43,954  | 24 | 47 | 28 |
| Other personal   | 33,358  | 14,521  | 47,879  | 15,286  | 10,703 | 25,989  | 46 | 74 | 54 |
|                  |         |         |         |         |        |         |    |    |    |
| Total personal   | 161,695 | 42,861  | 204,556 | 45,896  | 24,047 | 69,943  | 28 | 56 | 34 |
| Other items      | 4,756   | 19,189  | 23,945  | 4,061   | 15,798 | 19,859  | 85 | 82 | 83 |
|                  |         |         |         |         |        |         |    |    |    |
| Total            | 547,291 | 196,865 | 744,156 | 222,215 | 91,188 | 313,403 | 41 | 46 | 42 |

## Notes:

- (1) Exposure at default post credit risk mitigation.
- (2) Non-bank financial institutions, such as US agencies, insurance companies, pension funds, hedge and leverage funds, broker-dealers and non-bank subsidiaries of banks.
- (3) Structured entities primarily relate to securitisation related vehicles.
- (4) Telecommunications, media and technology.

## Appendix 1 Capital and risk management

### Liquidity and funding risk

Liquidity and funding risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as they fall due. The risk arises through the maturity transformation role that banks play and is dependent on company specific factors such as: maturity profile, composition of sources and uses of funding, the quality and size of the liquidity portfolio as well as broader factors, such as wholesale market conditions and depositor and investor behaviour. For a description of the liquidity and funding risk framework, governance and basis of preparation refer to the Risk and balance sheet management section of the Group's 2013 Annual Report on Form 20-F.

### Overview

The liquidity position remains strong: the liquidity portfolio of £138 billion at 30 June 2014 covered short-term wholesale funding (STWF) four times.

Liquid assets decreased by £8 billion mainly driven by a targeted decrease in financial institution deposits in Q1, partly offset by additional low-cost secondary liquidity. Average liquid asset balances were down in Q2 compared with Q1 reflecting proactive management of excess liquidity whilst retaining a prudent coverage of potential outflows.

The loan:deposit ratio increased by 200 basis points to 96% from 94% at 31 December 2013 reflecting continued focus on reducing excess funding.

STWF increased marginally to £33.6 billion mainly reflecting the upcoming redemption of trust preferred securities and large term debt deals falling into the less than 1 year to maturity bucket.

## Appendix 1 Capital and risk management

### Liquidity risk

#### Liquidity and related metrics

The table below sets out the key liquidity and related metrics monitored by the Group.

|                                     | <b>30 June</b> | 31 March | 31<br>December |
|-------------------------------------|----------------|----------|----------------|
|                                     | <b>2014</b>    | 2014     | 2013           |
|                                     | %              | %        | %              |
| Stressed outflow coverage (1)       | <b>178</b>     | 165      | 145            |
| Liquidity coverage ratio (LCR) (2)  | <b>104</b>     | 103      | 102            |
| Net stable funding ratio (NSFR) (3) | <b>111</b>     | 110      | 118            |

#### Notes:

- (1) RBS's liquidity risk appetite is based on the Individual Liquidity Adequacy Assessment (ILAA) which is measured by reference to the liquidity portfolio as a percentage of stressed liquidity outflows under the worst of three severe stress scenarios; a market-wide stress, an idiosyncratic stress and a combination of both. Liquidity risk adequacy is determined by the surplus of liquid assets over three month stressed outflows under the worst case stress. This assessment is performed in accordance with PRA guidance.
- (2) In January 2013, the BCBS published its final guidance for calculating LCR which is currently expected to come into effect from January 2015 on a phased basis. Pending the finalisation of the LCR rules within the EU, RBS monitors the LCR based on its own interpretations of current guidance available for EU LCR reporting. Therefore, the reported LCR will change over time with regulatory developments. Due to differences in interpretation of the rules RBS's ratio may not be comparable with those of other financial institutions.
- (3) The NSFR for all periods has been calculated using RBS's current interpretations of the existing rules relating to various BCBS guidance to date. Ratios for 31 March 2014 and 31 December 2013 have been revised accordingly. BCBS is expected to issue revised guidance on the NSFR towards the end of 2014 or early 2015.

#### Liquidity portfolio

The table below shows RBS's liquidity portfolio by product, liquidity value and carrying value. Liquidity value is lower than carrying value as it is stated after discounts applied by the Bank of England and other central banks to instruments, within the secondary liquidity portfolio, eligible for discounting.

|  | Liquidity value |        |       |         |         |         |  |
|--|-----------------|--------|-------|---------|---------|---------|--|
|  | Period end      |        |       |         | Average |         |  |
|  | UK<br>DLG (1)   | CFG    | Other | Total   | Quarter | H1 2014 |  |
| 30 June 2014                                 | £m              | £m     | £m    | £m      | £m      | £m      |  |
| Cash and balances at central banks           | 58,823          | 2,533  | 1,825 | 63,181  | 59,974  | 62,723  |  |
| Central and local government bonds           |                 |        |       |         |         |         |  |
| AAA rated governments                        | 5,583           | 2      | -     | 5,585   | 4,241   | 3,527   |  |
| AA- to AA+ rated governments and US agencies | 5,622           | 6,224  | -     | 11,846  | 10,701  | 11,155  |  |
|  | 11,205          | 6,226  | -     | 17,431  | 14,942  | 14,682  |  |
| Primary liquidity                            | 70,028          | 8,759  | 1,825 | 80,612  | 74,916  | 77,405  |  |
| Secondary liquidity (2)                      | 54,928          | 934    | 1,597 | 57,459  | 53,420  | 53,986  |  |
| Total liquidity value                        | 124,956         | 9,693  | 3,422 | 138,071 | 128,336 | 131,391 |  |
| Total carrying value                         | 160,357         | 10,236 | 2,741 | 173,334 |         |         |  |

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



## Appendix 1 Capital and risk management

### Liquidity risk (continued)

#### Liquidity portfolio (continued)

|                                       | Liquidity value |        |       |         |         |         |
|---------------------------------------|-----------------|--------|-------|---------|---------|---------|
|                                       | Period end      |        |       |         | Average |         |
|                                       | UK              |        |       |         |         |         |
|                                       | DLG (1)         | CFG    | Other | Total   | Quarter | Year    |
| 31 December 2013                      | £m              | £m     | £m    | £m      | £m      | £m      |
| Cash and balances at central banks    | 71,121          | 824    | 2,417 | 74,362  | 76,242  | 80,933  |
| Central and local government bonds    |                 |        |       |         |         |         |
| AAA rated governments and US agencies | 3,320           | -      | -     | 3,320   | 3,059   | 5,149   |
| AA- to AA+ rated governments          | 5,822           | 6,369  | 96    | 12,287  | 13,429  | 12,423  |
| Below AA rated governments            | -               | -      | -     | -       | -       | 151     |
| Local government                      | -               | -      | -     | -       | 7       | 148     |
|                                       | 9,142           | 6,369  | 96    | 15,607  | 16,495  | 17,871  |
| Treasury bills                        | -               | -      | -     | -       | 6       | 395     |
|                                       |                 |        |       |         |         |         |
| Primary liquidity                     | 80,263          | 7,193  | 2,513 | 89,969  | 92,743  | 99,199  |
| Secondary liquidity (2)               | 48,718          | 4,968  | 2,411 | 56,097  | 56,869  | 56,589  |
|                                       |                 |        |       |         |         |         |
| Total liquidity value                 | 128,981         | 12,161 | 4,924 | 146,066 | 149,612 | 155,788 |
|                                       |                 |        |       |         |         |         |
| Total carrying value                  | 159,743         | 17,520 | 6,970 | 184,233 |         |         |

| The table below shows the currency split of the liquidity portfolio. |            |            |            |              |              |
|--|------------|------------|------------|--------------|--------------|
|  |            |            |            |              |              |
|  | <b>GBP</b> | <b>USD</b> | <b>EUR</b> | <b>Other</b> | <b>Total</b> |
| Total liquidity portfolio  | £m         | £m         | £m         | £m           | £m           |

|                     |               |               |               |              |                |
|---------------------|---------------|---------------|---------------|--------------|----------------|
|                     |               |               |               |              |                |
| <b>30 June 2014</b> | <b>91,073</b> | <b>33,028</b> | <b>12,579</b> | <b>1,391</b> | <b>138,071</b> |
| 31 December 2013    | 100,849       | 33,365        | 10,364        | 1,488        | 146,066        |

## Notes:

- (1) The PRA regulated UK Defined Liquidity Group (UK DLG) comprises the RBS's five licensed deposit taking UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company. In addition, certain of the Group's significant operating subsidiaries - RBS N.V., Citizens Financial Group Inc. and Ulster Bank Ireland Limited - hold liquidity portfolios of liquid assets that comply with local regulations that may differ from PRA rules.
- (2) Includes assets eligible for discounting at the Bank of England and other central banks.

## Appendix 1 Capital and risk management

### Funding risk

The composition of RBS's balance sheet is a function of the broad array of product offerings and diverse markets served by its core divisions. The structural composition of the balance sheet is augmented as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise the liquidity profile, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

|                     | Short-term wholesale funding (1) |                                 | Total wholesale funding         |                                 | Net inter-bank funding (2) |               |                        |
|---------------------|----------------------------------|---------------------------------|---------------------------------|---------------------------------|----------------------------|---------------|------------------------|
|                     | Excluding derivative collateral  | Including derivative collateral | Excluding derivative collateral | Including derivative collateral | Deposits                   | Loans (3)     | Net inter-bank funding |
|                     | £bn                              | £bn                             | £bn                             | £bn                             | £bn                        | £bn           | £bn                    |
| <b>30 June 2014</b> | <b>33.6</b>                      | <b>55.1</b>                     | <b>101.6</b>                    | <b>123.1</b>                    | <b>17.7</b>                | <b>(19.3)</b> | <b>(1.6)</b>           |
| 31 March 2014       | 31.0                             | 50.8                            | 101.5                           | 121.3                           | 15.6                       | (18.1)        | (2.5)                  |
| 31 December 2013    | 32.4                             | 51.5                            | 108.1                           | 127.2                           | 16.2                       | (17.3)        | (1.1)                  |
| 30 September 2013   | 34.6                             | 55.1                            | 113.6                           | 134.1                           | 18.1                       | (16.6)        | 1.5                    |
| 30 June 2013        | 36.7                             | 58.9                            | 129.4                           | 151.5                           | 23.1                       | (17.1)        | 6.0                    |

Notes:

- (1) Short-term wholesale funding is funding with a residual maturity of less than one year.
- (2) Excludes derivative cash collateral.
- (3) Principally short-term balances.

| <b>Funding sources</b>   |              |           |       |                  |           |       |       |
|--|--------------|-----------|-------|------------------|-----------|-------|-------|
| The table below shows RBS's principal funding sources excluding repurchase agreements (repos). |              |           |       |                  |           |       |       |
|  | 30 June 2014 |           |       | 31 December 2013 |           |       |       |
|  | Short-term   | Long-term |       | Short-term       | Long-term |       |       |
|  | less than    | more than | Total | less than        | more than | Total | Total |
|  | 1 year       | 1 year    |       | 1 year           | 1 year    |       |       |

|                                | £m      | £m     | £m      |  | £m      | £m     | £m      |
|--------------------------------|---------|--------|---------|--|---------|--------|---------|
| Deposits by banks              |         |        |         |  |         |        |         |
| derivative cash collateral     | 21,430  | -      | 21,430  |  | 19,086  | -      | 19,086  |
| other deposits                 | 16,544  | 1,205  | 17,749  |  | 14,553  | 1,690  | 16,243  |
|                                | 37,974  | 1,205  | 39,179  |  | 33,639  | 1,690  | 35,329  |
| Debt securities in issue       |         |        |         |  |         |        |         |
| commercial paper               | 1,091   | -      | 1,091   |  | 1,583   | -      | 1,583   |
| certificates of deposit        | 1,751   | 97     | 1,848   |  | 2,212   | 65     | 2,277   |
| medium-term notes              | 8,083   | 32,552 | 40,635  |  | 10,385  | 36,779 | 47,164  |
| covered bonds                  | 1,780   | 7,039  | 8,819   |  | 1,853   | 7,188  | 9,041   |
| securitisations                | 511     | 6,183  | 6,694   |  | 514     | 7,240  | 7,754   |
|                                | 13,216  | 45,871 | 59,087  |  | 16,547  | 51,272 | 67,819  |
| Subordinated liabilities       | 3,885   | 20,924 | 24,809  |  | 1,350   | 22,662 | 24,012  |
| Notes issued                   | 17,101  | 66,795 | 83,896  |  | 17,897  | 73,934 | 91,831  |
| Wholesale funding              | 55,075  | 68,000 | 123,075 |  | 51,536  | 75,624 | 127,160 |
| Customer deposits              |         |        |         |  |         |        |         |
| derivative cash collateral (1) | 6,469   | -      | 6,469   |  | 7,082   | -      | 7,082   |
| financial institution deposits | 47,029  | 2,038  | 49,067  |  | 44,621  | 2,265  | 46,886  |
| personal deposits              | 180,024 | 6,089  | 186,113 |  | 183,799 | 8,115  | 191,914 |
| corporate deposits             | 156,451 | 3,157  | 159,608 |  | 167,100 | 4,687  | 171,787 |
| Total customer deposits        | 389,973 | 11,284 | 401,257 |  | 402,602 | 15,067 | 417,669 |
| Total funding excluding repos  | 445,048 | 79,284 | 524,332 |  | 454,138 | 90,691 | 544,829 |

Note:

- (1) Cash collateral includes £5,720 million (31 December 2013 - £6,720 million) from financial institutions.

**Appendix 1 Capital and risk management****Funding risk (continued)**

## Total funding by currency

|                               | GBP     | USD     | EUR    | Other  | Total   |
|-------------------------------|---------|---------|--------|--------|---------|
|                               | £m      | £m      | £m     | £m     | £m      |
| <b>30 June 2014</b>           |         |         |        |        |         |
| Deposits by banks             | 6,830   | 10,808  | 19,300 | 2,241  | 39,179  |
| Debt securities in issue      |         |         |        |        |         |
| - commercial paper            | 3       | 573     | 486    | 29     | 1,091   |
| - certificates of deposit     | 494     | 1,116   | 237    | 1      | 1,848   |
| - medium-term notes           | 5,287   | 10,319  | 20,285 | 4,744  | 40,635  |
| - covered bonds               | 983     | -       | 7,836  | -      | 8,819   |
| - securitisations             | 1,830   | 2,090   | 2,774  | -      | 6,694   |
| Subordinated liabilities      | 1,792   | 13,604  | 7,202  | 2,211  | 24,809  |
| Wholesale funding             | 17,219  | 38,510  | 58,120 | 9,226  | 123,075 |
| % of wholesale funding        | 14%     | 31%     | 47%    | 8%     | 100%    |
| Customer deposits             | 271,438 | 79,877  | 40,137 | 9,805  | 401,257 |
| Total funding excluding repos | 288,657 | 118,387 | 98,257 | 19,031 | 524,332 |
| % of total funding            | 55%     | 22%     | 19%    | 4%     | 100%    |

|                           |       |        |        |       |        |
|---------------------------|-------|--------|--------|-------|--------|
| <b>31 December 2013</b>   |       |        |        |       |        |
| Deposits by banks         | 7,418 | 8,337  | 17,004 | 2,570 | 35,329 |
| Debt securities in issue  |       |        |        |       |        |
| - commercial paper        | 4     | 897    | 682    | -     | 1,583  |
| - certificates of deposit | 336   | 1,411  | 476    | 54    | 2,277  |
| - medium-term notes       | 6,353 | 11,068 | 23,218 | 6,525 | 47,164 |
| - covered bonds           | 984   | -      | 8,057  | -     | 9,041  |
| - securitisations         | 1,897 | 2,748  | 3,109  | -     | 7,754  |
| Subordinated liabilities  | 1,857 | 10,502 | 8,984  | 2,669 | 24,012 |

|                               |         |         |         |        |         |
|-------------------------------|---------|---------|---------|--------|---------|
|                               |         |         |         |        |         |
| Wholesale funding             | 18,849  | 34,963  | 61,530  | 11,818 | 127,160 |
| % of wholesale funding        | 15%     | 28%     | 48%     | 9%     | 100%    |
| Customer deposits             | 272,304 | 86,727  | 49,116  | 9,522  | 417,669 |
|                               |         |         |         |        |         |
| Total funding excluding repos | 291,153 | 121,690 | 110,646 | 21,340 | 544,829 |
|                               |         |         |         |        |         |
| % of total funding            | 54%     | 22%     | 20%     | 4%     | 100%    |

|  |                |                    |
|--|----------------|--------------------|
| <b>Repos</b>   |                |                    |
| The table below analyses RBS's repos by counterparty type. |                |                    |
|  | <b>30 June</b> | <b>31 December</b> |
|  | <b>2014</b>    | <b>2013</b>        |
|  | <b>£m</b>      | <b>£m</b>          |
|  |                |                    |
| Financial institutions                                     |                |                    |
| - central and other banks                                  | <b>31,722</b>  | 28,650             |
| - other financial institutions                             | <b>44,325</b>  | 52,945             |
| Corporate  | <b>7,215</b>   | 3,539              |
|  |                |                    |
|  | <b>83,262</b>  | 85,134             |

**Appendix 1 Capital and risk management****Funding risk** (continued)

## Segment loan:deposit ratios and funding surplus

The table below shows loans, deposits, loan:deposit ratios (LDR) and customer funding surplus/(gap) by reporting segment.

|                    | 30 June 2014 |              |     |               | 31 December 2013 |              |     |               |
|--------------------|--------------|--------------|-----|---------------|------------------|--------------|-----|---------------|
|                    |              |              |     | Funding       |                  |              |     | Funding       |
|                    | Loans (1)    | Deposits (2) | LDR | surplus/(gap) | Loans (1)        | Deposits (2) | LDR | surplus/(gap) |
|                    | £m           | £m           | %   | £m            | £m               | £m           | %   | £m            |
| UK PBB             | 126,422      | 145,971      | 87  | 19,549        | 124,828          | 144,841      | 86  | 20,013        |
| Ulster Bank        | 22,423       | 20,688       | 108 | (1,735)       | 26,068           | 21,651       | 120 | (4,417)       |
| PBB                | 148,845      | 166,659      | 89  | 17,814        | 150,896          | 166,492      | 91  | 15,596        |
| Commercial Banking | 83,980       | 87,987       | 95  | 4,007         | 83,454           | 90,883       | 92  | 7,429         |
| Private Banking    | 16,525       | 35,890       | 46  | 19,365        | 16,644           | 37,173       | 45  | 20,529        |
| CPB                | 100,505      | 123,877      | 81  | 23,372        | 100,098          | 128,056      | 78  | 27,958        |
| CIB                | 68,978       | 55,492       | 124 | (13,486)      | 68,148           | 64,734       | 105 | (3,414)       |
| Central items      | 844          | 1,002        | 84  | 158           | 289              | 1,081        | 27  | 792           |
| CFG                | 51,722       | 52,923       | 98  | 1,201         | 50,279           | 55,118       | 91  | 4,839         |
| RCR                | 15,658       | 1,304        | nm  | (14,354)      | n/a              | n/a          | n/a | n/a           |
| Non-Core           | n/a          | n/a          | n/a | n/a           | 22,880           | 2,188        | nm  | (20,692)      |
|                    | 386,552      | 401,257      | 96  | 14,705        | 392,590          | 417,669      | 94  | 25,079        |

nm = not meaningful

Notes:

- (1) Excludes reverse repo agreements and net of impairment provisions.
- (2) Excludes repo agreements.

£154 billion (or 38%) of the customer deposits included above are insured through the UK Financial Services Compensation Scheme, US Federal Deposit Insurance Corporation scheme and other similar schemes. Of the personal and corporate deposits above, 54% relate to personal customers.

## Encumbrance

RBS's encumbrance ratios are set out below.

In general encumbrance ratios decreased marginally reflecting the balance sheet structure.

|   |  | <b>30 June</b> | 31<br>December |
|---|--|----------------|----------------|
|   |  | <b>2014</b>    | 2013           |
| <b>Encumbrance ratios</b>   |  | %              | %              |
| Total   |  | <b>16</b>      | 17             |
| Excluding balances relating to derivatives transactions                         |  | <b>17</b>      | 19             |
| Excluding balances relating to derivative and securities financing transactions |  | <b>11</b>      | 11             |



## Appendix 1 Capital and risk management

## Balance sheet encumbrance

| Encumbered assets relating to:     |         |      |                           |       |          |            |              |           |          |
|------------------------------------|---------|------|---------------------------|-------|----------|------------|--------------|-----------|----------|
| Debt securities in issue           |         |      | Other secured liabilities |       |          | Total      | Encumbered   | Re        | Realisab |
| Securitisations                    | Covered |      |                           |       | Secured  | encumbered | assets as a  | Liquidity | Re       |
| and conduits                       | bonds   |      | Derivatives               | Repos | balances | assets (2) | % of related | portfolio | Realisab |
|                                    |         |      |                           |       | (1)      |            | assets       |           |          |
| 30 June                            | £bn     | £bn  | £bn                       | £bn   | £bn      | £bn        | assets       | £bn       |          |
| 2014                               |         |      |                           |       |          |            |              |           |          |
| Cash and balances at central banks | -       | -    | -                         | -     | 2.1      | 2.1        | 3            | 61.1      |          |
| Loans and advances to banks        | 4.8     | 0.3  | 9.7                       | -     | 0.3      | 15.1       | 52           | 2.1       |          |
| Loans and advances to customers    |         |      |                           |       |          |            |              |           |          |
| - UK residential mortgages         | 13.2    | 14.9 | -                         | -     | -        | 28.1       | 25           | 67.9      |          |
| - Irish residential mortgages      | 8.9     | -    | -                         | -     | 1.0      | 9.9        | 69           | -         |          |
| - US residential mortgages         | -       | -    | -                         | -     | 10.4     | 10.4       | 55           | 1.4       |          |
| - UK credit cards                  | 3.0     | -    | -                         | -     | -        | 3.0        | 55           | -         |          |
| - UK personal loans                | 3.4     | -    | -                         | -     | -        | 3.4        | 37           | -         |          |
| - other                            | 7.6     | -    | 17.1                      | -     | 1.0      | 25.7       | 11           | 7.5       |          |
| Reverse repurchase agreements      |         |      |                           |       |          |            |              |           |          |

|  |               |              |               |               |               |                |           |              |   |
|--|---------------|--------------|---------------|---------------|---------------|----------------|-----------|--------------|---|
| and stock borrowing                          | -             | -            | -             | -             | -             | -              | -         | -            | - |
| Debt securities                              | <b>0.3</b>    | -            | <b>7.4</b>    | <b>44.9</b>   | <b>2.6</b>    | <b>55.2</b>    | <b>49</b> | <b>15.8</b>  |   |
| Equity shares                                | -             | -            | <b>0.2</b>    | <b>5.1</b>    | -             | <b>5.3</b>     | <b>68</b> | -            |   |
| Settlement balances                          | -             | -            | -             | -             | -             | -              | -         | -            |   |
| Derivatives                                  | -             | -            | -             | -             | -             | -              | -         | -            |   |
| Intangible assets                            | -             | -            | -             | -             | -             | -              | -         | -            |   |
| Property, plant and equipment                | -             | -            | -             | -             | <b>0.3</b>    | <b>0.3</b>     | <b>4</b>  | -            |   |
| Deferred tax                                 | -             | -            | -             | -             | -             | -              | -         | -            |   |
| Prepayments, accrued income and other assets | -             | -            | -             | -             | -             | -              | -         | -            |   |
| Assets of disposal groups                    | -             | -            | -             | -             | -             | -              | -         | -            |   |
|  | <b>41.2</b>   | <b>15.2</b>  | <b>34.4</b>   | <b>50.0</b>   | <b>17.7</b>   | <b>158.5</b>   |           | <b>155.8</b> |   |
| Securities retained                          |               |              |               |               |               |                |           | <b>17.5</b>  |   |
| Total liquidity portfolio                    |               |              |               |               |               |                |           | <b>173.3</b> |   |
| Liabilities secured                          |               |              |               |               |               |                |           |              |   |
| Intra-Group - secondary liquidity            | <b>(16.4)</b> | -            | -             | -             | -             | <b>(16.4)</b>  |           |              |   |
| Intra-Group - other                          | <b>(14.5)</b> | -            | -             | -             | -             | <b>(14.5)</b>  |           |              |   |
| Third-party (6)                              | <b>(6.7)</b>  | <b>(8.8)</b> | <b>(34.4)</b> | <b>(83.3)</b> | <b>(10.4)</b> | <b>(143.6)</b> |           |              |   |
|  | <b>(37.6)</b> | <b>(8.8)</b> | <b>(34.4)</b> | <b>(83.3)</b> | <b>(10.4)</b> | <b>(174.5)</b> |           |              |   |

For the notes to this table refer to page 22.

## Appendix 1 Capital and risk management

## Balance sheet encumbrance (continued)

|                                    | Encumbered assets relating to: |         |                           |       |          | Total      | Encumbered   | Unencumbered |           |
|------------------------------------|--------------------------------|---------|---------------------------|-------|----------|------------|--------------|--------------|-----------|
|                                    | Debt securities in issue       |         | Other secured liabilities |       |          |            |              | assets as a  | Liquidity |
|                                    | Securitisations                | Covered | Derivatives               | Repos | Secured  | encumbered | % of related | portfolio    | Other     |
|                                    | and conduits                   | bonds   |                           |       | balances | assets (2) | assets       | £bn          | £bn       |
| 31 December 2013                   | £bn                            | £bn     | £bn                       | £bn   | £bn      | £bn        |              |              |           |
| Cash and balances at central banks | -                              | -       | -                         | -     | -        | -          | -            | 74.3         | 8.4       |
| Loans and advances to banks        | 5.8                            | 0.5     | 10.3                      | -     | -        | 16.6       | 60           | 0.1          | 10.9      |
| Loans and advances to customers    |                                |         |                           |       |          |            |              |              |           |
| - UK residential mortgages         | 14.6                           | 16.2    | -                         | -     | -        | 30.8       | 28           | 60.8         | 18.6      |
| - Irish residential mortgages      | 9.3                            | -       | -                         | -     | 1.2      | 10.5       | 70           | 0.7          | 3.8       |
| - US residential mortgages         | -                              | -       | -                         | -     | 3.5      | 3.5        | 18           | 9.5          | 6.7       |
| - UK credit cards                  | 3.4                            | -       | -                         | -     | -        | 3.4        | 52           | -            | 3.1       |
| - UK personal loans                | 3.4                            | -       | -                         | -     | -        | 3.4        | 38           | -            | 5.5       |
| - other                            | 13.5                           | -       | 18.1                      | -     | 0.8      | 32.4       | 14           | 4.4          | 9.6       |
| Reverse repurchase agreements      |                                |         |                           |       |          |            |              |              |           |

|  |        |       |        |        |       |         |    |       |       |
|--|--------|-------|--------|--------|-------|---------|----|-------|-------|
| and stock borrowing                          | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Debt securities                              | 0.9    | -     | 5.5    | 55.6   | 2.7   | 64.7    | 57 | 17.0  | 31.9  |
| Equity shares                                | -      | -     | 0.5    | 5.3    | -     | 5.8     | 66 | -     | 3.0   |
| Settlement balances                          | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Derivatives                                  | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Intangible assets                            | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Property, plant and equipment                | -      | -     | -      | -      | 0.4   | 0.4     | 5  | -     | -     |
| Deferred tax                                 | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Prepayments, accrued income and other assets | -      | -     | -      | -      | -     | -       | -  | -     | -     |
| Assets of disposal groups                    | -      | -     | -      | -      | -     | -       | -  | -     | -     |
|  | 50.9   | 16.7  | 34.4   | 60.9   | 8.6   | 171.5   |    | 166.8 | 101.5 |
| Securities retained                          |        |       |        |        |       |         |    | 17.4  |       |
| Total liquidity portfolio                    |        |       |        |        |       |         |    | 184.2 |       |
| Liabilities secured                          |        |       |        |        |       |         |    |       |       |
| Intra-Group - secondary liquidity            | (19.1) | -     | -      | -      | -     | (19.1)  |    |       |       |
| Intra-Group - other                          | (18.4) | -     | -      | -      | -     | (18.4)  |    |       |       |
| Third-party (6)                              | (7.8)  | (9.0) | (34.4) | (85.1) | (6.0) | (142.3) |    |       |       |
|  | (45.3) | (9.0) | (34.4) | (85.1) | (6.0) | (179.8) |    |       |       |

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

## Appendix 1 Capital and risk management

### Balance sheet encumbrance (continued)

#### Notes:

- (1) Includes cash, coin and nostro balance held with the Bank of England as collateral against notes in circulation.
- (2) Encumbered assets are those that have been pledged to provide security for the liability shown above and are therefore not available to secure funding or to meet other collateral needs.
- (3) Unencumbered readily realisable assets are those assets on the balance sheet that can be readily used to meet funding or collateral requirements and comprise:
  - (a) Liquidity portfolio: cash balances at central banks, high quality debt securities and loans that have been pre-positioned with central banks. In addition, the liquidity portfolio includes securitisations of own assets which has reduced over the years and has been replaced by loans.
  - (b) Other readily realisable assets: including assets that have been enabled for use with central banks; and unencumbered debt securities.
- (4) Unencumbered other realisable assets are those assets on the balance sheet that are available for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.
- (5) Assets that cannot be encumbered include:
  - (a) derivatives, reverse repurchase agreements and trading related settlement balances.
  - (b) non-financial assets such as intangibles, prepayments and deferred tax.
  - (c) assets in disposal groups.
  - (d) loans that cannot be pre-positioned with central banks based on criteria set by the central banks, primary US, including those relating to date of origination and level of documentation.
  - (e) non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral.
- (6) In accordance with market practice RBS employs securities recognised on the balance sheet, and securities received under reverse repo transactions as collateral for repos. Secured derivative liabilities now reflect net positions that are collateralised by balance sheet assets.

## Appendix 1 Capital and risk management

### Credit risk

Credit risk is the risk of financial loss due to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts. For a description of the bank's credit risk framework, governance, policies and methodologies refer to the Risk and balance sheet management - Credit risk section - of the Group's 2013 Annual Report on Form 20-F.

### Financial assets

#### Exposure summary

The table below analyses financial asset exposures, both gross and net of offset arrangements as well as credit mitigation and enhancement.

|                                    | Collateral |         |           |            |        |            |             |            |             |  |
|------------------------------------|------------|---------|-----------|------------|--------|------------|-------------|------------|-------------|--|
|                                    | Gross      | IFRS    | Carrying  | Non-IFRS   |        |            | Real estate |            | Credit      |  |
|                                    | exposure   | offset  | value (2) | offset (3) | Cash   | Securities | Residential | Commercial | enhancement |  |
| 30 June 2014                       | (1)        | (2)     | (3)       | (4)        | (5)    | (6)        | (6)         | (7)        | en          |  |
|                                    | £bn        | £bn     | £bn       | £bn        | £bn    | £bn        | £bn         | £bn        | £bn         |  |
| Cash and balances at central banks | 68.7       | -       | 68.7      | -          | -      | -          | -           | -          | -           |  |
| Lending                            | 419.3      | (3.8)   | 415.5     | (35.5)     | (1.8)  | (3.2)      | (146.0)     | (61.2)     | (4.8)       |  |
| Reverse repos                      | 133.9      | (52.2)  | 81.7      | (7.2)      | -      | (74.4)     | -           | -          | -           |  |
| Debt securities                    | 112.8      | -       | 112.8     | -          | -      | -          | -           | -          | (0.7)       |  |
| Equity shares                      | 7.8        | -       | 7.8       | -          | -      | -          | -           | -          | -           |  |
| Settlement balances                | 24.2       | (4.5)   | 19.7      | -          | -      | -          | -           | -          | -           |  |
| Derivatives                        | 461.5      | (186.6) | 274.9     | (227.6)    | (26.4) | (4.9)      | -           | -          | (15.1)      |  |

|                        |                |                |               |                |               |               |                |               |               |
|------------------------|----------------|----------------|---------------|----------------|---------------|---------------|----------------|---------------|---------------|
|                        |                |                |               |                |               |               |                |               |               |
| Total                  | <b>1,228.2</b> | <b>(247.1)</b> | <b>981.1</b>  | <b>(270.3)</b> | <b>(28.2)</b> | <b>(82.5)</b> | <b>(146.0)</b> | <b>(61.2)</b> | <b>(20.6)</b> |
| Short positions        | <b>(39.0)</b>  | -              | <b>(39.0)</b> | -              | -             | -             | -              | -             | -             |
| Net of short positions | <b>1,189.2</b> | <b>(247.1)</b> | <b>942.1</b>  | <b>(270.3)</b> | <b>(28.2)</b> | <b>(82.5)</b> | <b>(146.0)</b> | <b>(61.2)</b> | <b>(20.6)</b> |

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

## Appendix 1 Capital and risk management

## Financial assets (continued)

|                                    | Collateral     |                 |                    |                     |          |                |                 |                |                        | Exposure |
|------------------------------------|----------------|-----------------|--------------------|---------------------|----------|----------------|-----------------|----------------|------------------------|----------|
|                                    | Gross exposure | IFRS offset (1) | Carrying value (2) | Non-IFRS offset (3) | Cash (4) | Securities (5) | Real estate     |                | Credit enhancement (7) |          |
|                                    |                |                 |                    |                     |          |                | Residential (6) | Commercial (6) |                        |          |
| 31 December 2013                   | £bn            | £bn             | £bn                | £bn                 | £bn      | £bn            | £bn             | £bn            | £bn                    | £bn      |
| Cash and balances at central banks | 82.7           | -               | 82.7               | -                   | -        | -              | -               | -              | -                      | -        |
| Lending                            | 423.6          | (3.4)           | 420.2              | (37.2)              | (1.6)    | (2.7)          | (145.4)         | (60.0)         | (3.9)                  |          |
| Reverse repos                      | 117.2          | (40.7)          | 76.5               | (11.4)              | -        | (65.0)         | -               | -              | -                      |          |
| Debt securities                    | 113.6          | -               | 113.6              | -                   | -        | -              | -               | -              | (1.3)                  |          |
| Equity shares                      | 8.8            | -               | 8.8                | -                   | -        | -              | -               | -              | -                      |          |
| Settlement balances                | 8.2            | (2.7)           | 5.5                | (0.3)               | -        | -              | -               | -              | -                      |          |
| Derivatives                        | 553.7          | (265.7)         | 288.0              | (241.3)             | (24.4)   | (6.0)          | -               | -              | (7.3)                  |          |
| Total                              | 1,307.8        | (312.5)         | 995.3              | (290.2)             | (26.0)   | (73.7)         | (145.4)         | (60.0)         | (12.5)                 |          |
| Short positions                    | (28.0)         | -               | (28.0)             | -                   | -        | -              | -               | -              | -                      |          |
| Net of short positions             | 1,279.8        | (312.5)         | 967.3              | (290.2)             | (26.0)   | (73.7)         | (145.4)         | (60.0)         | (12.5)                 |          |

## Notes:

- (1) Relates to offset arrangements that comply with IFRS criteria and transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation.



- (2) The carrying value on the balance sheet represents the exposure to credit risk by class of financial instrument.
- (3) Balance sheet offset reflects the amounts by which the bank's credit risk is reduced through master netting and cash management pooling arrangements. Derivative master netting agreements include cash pledged with counterparties in respect of net derivative liability positions and are included in lending in the table above.
- (4) Includes cash collateral pledged by counterparties based on daily mark-to-market movements of net derivative positions with the counterparty.
- (5) Securities collateral represent the fair value of securities received from counterparties, mainly relating to reverse repo transactions as part of netting arrangements.
- (6) Property valuations are capped at the loan value and reflect the application of haircuts in line with regulatory rules to indexed valuations. Commercial collateral includes ships and plant and equipment collateral.
- (7) Credit enhancement comprises credit derivatives (bought protection) and guarantees and reflects notional amounts less fair value and notional amounts respectively.

### Key points

The major components of net exposures are cash and balances at central banks, unsecured commercial, corporate and bank loans, debt securities and short-term settlement balances. Of the £112 billion of debt securities, £34 billion are asset-backed but underlying collateral is not reflected above as the bank only has access to cashflows from the collateral.

## Appendix 1 Capital and risk management

### Financial assets (continued)

#### Asset quality

The table below analyses the bank's financial assets excluding debt securities by internal asset quality (AQ) ratings. Debt securities are analysed by external ratings and are therefore excluded from the table below and are set out on page 33.

|                      | Loans and advances                 |               |                            |            |        |               |                            |                |          |  |
|----------------------|------------------------------------|---------------|----------------------------|------------|--------|---------------|----------------------------|----------------|----------|--|
|                      | Cash and balances at central banks | Banks (1)     |                            |            |        | Customers     |                            |                |          | Settlement balances and other financial assets |
|                      |                                    | Reverse repos | Derivative cash collateral | Bank loans | Total  | Reverse repos | Derivative cash collateral | Customer loans | Total    |  |
| 30 June 2014         | £m                                 | £m            | £m                         | £m         | £m     | £m            | £m                         | £m             | £m       | £m   |
| <b>Total</b>         |                                    |               |                            |            |        |               |                            |                |          |  |
| AQ1                  | 66,802                             | 7,614         | 1,976                      | 4,063      | 13,653 | 34,525        | 9,982                      | 39,075         | 83,582   | 7,028  |
| AQ2                  | -                                  | 5,097         | 3,949                      | 1,126      | 10,172 | 69            | 1,630                      | 18,475         | 20,174   | 748  |
| AQ3                  | 1,542                              | 2,952         | 1,728                      | 4,492      | 9,172  | 5,182         | 3,314                      | 28,596         | 37,092   | 3,476  |
| AQ4                  | 321                                | 9,636         | 1,571                      | 7,567      | 18,774 | 8,483         | 1,677                      | 114,339        | 124,499  | 5,358  |
| AQ5                  | 3                                  | 1,484         | 361                        | 1,298      | 3,143  | 4,441         | 442                        | 67,179         | 72,062   | 1,314  |
| AQ6                  | -                                  | 815           | 42                         | 150        | 1,007  | 189           | 27                         | 38,141         | 38,357   | 244  |
| AQ7                  | -                                  | 565           | 21                         | 189        | 775    | 653           | 36                         | 29,124         | 29,813   | 112  |
| AQ8                  | 2                                  | -             | 1                          | 54         | 55     | -             | 6                          | 7,059          | 7,065    | -  |
| AQ9                  | -                                  | -             | 5                          | 316        | 321    | -             | 1                          | 9,544          | 9,545    | 31   |
| AQ10                 | -                                  | -             | -                          | -          | -      | -             | -                          | 919            | 919      | 9  |
| Past due             | -                                  | -             | -                          | -          | -      | -             | -                          | 7,141          | 7,141    | 1,362  |
| Impaired             | -                                  | -             | -                          | 60         | 60     | -             | -                          | 32,241         | 32,241   | -  |
| Impairment provision | -                                  | -             | -                          | (50)       | (50)   | -             | -                          | (22,396)       | (22,396) | -  |
|                      | 68,670                             | 28,163        | 9,654                      | 19,265     | 57,082 | 53,542        | 17,115                     | 369,437        | 440,094  | 19,682   |

For the note to this table refer to the following page.

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## Appendix 1 Capital and risk management

## Financial assets: Asset quality (continued)

|                      | Loans and advances                 |               |                       |            |        |               |                       |                |          |       |  |             |
|----------------------|------------------------------------|---------------|-----------------------|------------|--------|---------------|-----------------------|----------------|----------|-------|--|-------------|
|                      | Cash and balances at central banks | Banks (1)     |                       |            |        |               | Customers             |                |          |       | Settlement balances and other financial assets | Derivatives |
|                      |                                    | Reverse repos | Derivative collateral | Bank loans | Total  | Reverse repos | Derivative collateral | Customer loans | Total    |       |  |             |
|                      |                                    | £m            | £m                    | £m         | £m     | £m            | £m                    | £m             | £m       | £m    | £m   |             |
| <b>Total</b>         |                                    |               |                       |            |        |               |                       |                |          |       |  |             |
| 31 December 2013     | 80,305                             | 5,885         | 2,043                 | 6,039      | 13,967 | 30,233        | 10,042                | 34,395         | 74,670   | 2,707 | 71   |             |
| AQ1                  | 1                                  | 4,744         | 4,930                 | 672        | 10,346 | 996           | 1,899                 | 17,695         | 20,590   | 192   | 69   |             |
| AQ2                  | 1,873                              | 2,164         | 1,502                 | 2,347      | 6,013  | 1,857         | 3,796                 | 29,364         | 35,017   | 746   | 94   |             |
| AQ3                  | 479                                | 9,864         | 1,451                 | 7,031      | 18,346 | 10,642        | 1,894                 | 99,258         | 111,794  | 470   | 39   |             |
| AQ4                  | -                                  | 1,776         | 416                   | 662        | 2,854  | 5,403         | 297                   | 77,045         | 82,745   | 717   | 8  |             |
| AQ5                  | -                                  | 1,823         | 1                     | 157        | 1,981  | 82            | 38                    | 39,324         | 39,444   | 59    | 1  |             |
| AQ6                  | -                                  | 301           | -                     | 237        | 538    | 684           | 50                    | 30,279         | 31,013   | 22    | -  |             |
| AQ7                  | 3                                  | -             | -                     | 48         | 48     | -             | 10                    | 8,482          | 8,492    | 58    | -  |             |
| AQ8                  | -                                  | -             | -                     | 34         | 34     | -             | 41                    | 16,944         | 16,985   | -     | -  |             |
| AQ9                  | -                                  | -             | -                     | -          | -      | -             | -                     | 730            | 730      | -     | -  |             |
| AQ10                 | -                                  | -             | -                     | -          | -      | -             | -                     | 9,068          | 9,068    | 620   | -  |             |
| Past due             | -                                  | -             | -                     | 70         | 70     | -             | -                     | 37,101         | 37,101   | -     | -  |             |
| Impaired             | -                                  | -             | -                     | (63)       | (63)   | -             | -                     | (25,162)       | (25,162) | -     | -  |             |
| Impairment provision |                                    |               |                       |            |        |               |                       |                |          |       |  |             |
|                      | 82,661                             | 26,557        | 10,343                | 17,234     | 54,134 | 49,897        | 18,067                | 374,523        | 442,487  | 5,591 | 288  |             |

Note:

- (1) Excludes items in the course of collection from other banks of £1,523 million (31 December 2013 - £1,454 million).



## Appendix 1 Capital and risk management

### Financial assets: Asset quality (continued)

#### Key points

Overall asset quality improved slightly with AQ1-AQ4 (investment grade of BBB- or above) increasing from 75% at 31 December 2013 to 77% at 30 June 2014 reflecting improving credit conditions and disposals and run-down in RCR.

Cash and balances at central banks decreased £14.0 billion reflecting the management of surplus liquidity.

Asset quality trends improved with loans to banks and customers rated AQ1 (equivalent to AA or above) up by £3 billion. Recalibration of retail and business banking models using updated data trends from the last three years resulted in a significant upward shift between AQ5 and below to AQ4.

Gross derivatives decreased 5% to £274.9 billion with the proportion AQ1-AQ4 stable at 96%.

Past due loans decreased £1.1 billion or 11% driven mainly by CFG (£1.0 billion) and a decrease in Ulster Bank (£0.3 billion) reflecting increased work with customers in arrears.

Loan impairment provisions decreased £2.8 billion mainly in relation to RCR disposals and run-off (£2.0 billion).

## Appendix 1 Capital and risk management

### Loans and related credit metrics

The tables below analyse gross loans and advances (excluding reverse repos) and the related credit metrics by business unit.

|                    | Gross loans to |         | REIL   | Provisions | Credit metrics |           |           |            |              |             |
|--------------------|----------------|---------|--------|------------|----------------|-----------|-----------|------------|--------------|-------------|
|                    |                |         |        |            | Banks          | Customers | REIL as a | Provisions | Year-to-date |             |
|                    |                |         |        |            |                |           | %         |            | as a %       | Impairment  |
|                    |                |         |        |            |                |           | loans to  | of REIL    | charge       | written-off |
| customers          | of REIL        | £m      | £m     |            |                |           |           |            |              |             |
| 30 June 2014       | £m             | £m      | £m     | £m         | %              | %         | £m        | £m         |              |             |
| UK PBB             | 900            | 129,243 | 4,278  | 2,821      | 3.3            | 66        | 148       | 407        |              |             |
| Ulster Bank        | 3,036          | 25,708  | 4,861  | 3,285      | 18.9           | 68        | 57        | 33         |              |             |
| PBB                | 3,936          | 154,951 | 9,139  | 6,106      | 5.9            | 67        | 205       | 440        |              |             |
| Commercial Banking | 861            | 85,142  | 2,860  | 1,162      | 3.4            | 41        | 31        | 201        |              |             |
| Private Banking    | 1,426          | 16,618  | 239    | 93         | 1.4            | 39        | -         | 24         |              |             |
| CPB                | 2,287          | 101,760 | 3,099  | 1,255      | 3.0            | 40        | 31        | 225        |              |             |
| CIB                | 19,405         | 69,154  | 105    | 177        | 0.2            | nm        | (36)      | -          |              |             |
| Centre             | 2,513          | 848     | 3      | 3          | 0.4            | nm        | (12)      | 56         |              |             |
| CFG                | 277            | 52,221  | 1,307  | 500        | 2.5            | 38        | 102       | 147        |              |             |
| RCR                | 551            | 30,014  | 20,428 | 14,405     | 68.1           | 71        | (19)      | 1,619      |              |             |
| RBS                | 28,969         | 408,948 | 34,081 | 22,446     | 8.3            | 66        | 271       | 2,487      |              |             |

| 31 December 2013 |     |         |       |       |      |    |       |     |
|------------------|-----|---------|-------|-------|------|----|-------|-----|
| UK PBB           | 760 | 127,781 | 4,663 | 2,957 | 3.6  | 63 | 497   | 967 |
| Ulster Bank      | 591 | 31,446  | 8,466 | 5,378 | 26.9 | 64 | 1,774 | 277 |

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|                    |        |         |        |        |      |    |       |       |
|--------------------|--------|---------|--------|--------|------|----|-------|-------|
| PBB                | 1,351  | 159,227 | 13,129 | 8,335  | 8.2  | 63 | 2,271 | 1,244 |
|                    |        |         |        |        |      |    |       |       |
| Commercial Banking | 701    | 85,071  | 4,276  | 1,617  | 5.0  | 38 | 652   | 587   |
| Private Banking    | 1,531  | 16,764  | 277    | 120    | 1.7  | 43 | 29    | 15    |
|                    |        |         |        |        |      |    |       |       |
| CPB                | 2,232  | 101,835 | 4,553  | 1,737  | 4.5  | 38 | 681   | 602   |
|                    |        |         |        |        |      |    |       |       |
| CIB                | 20,550 | 69,080  | 1,661  | 976    | 2.4  | 59 | 598   | 360   |
|                    |        |         |        |        |      |    |       |       |
| Centre             | 2,670  | 341     | 1      | 66     | 0.3  | nm | 65    | -     |
| CFG                | 406    | 50,551  | 1,034  | 272    | 2.0  | 26 | 151   | 284   |
| Non-Core           | 431    | 36,718  | 19,014 | 13,839 | 51.8 | 73 | 4,646 | 1,856 |
|                    |        |         |        |        |      |    |       |       |
| RBS                | 27,640 | 417,752 | 39,392 | 25,225 | 9.4  | 64 | 8,412 | 4,346 |

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## Appendix 1 Capital and risk management

### Loans and related credit metrics (continued)

#### Key points

Gross loans and advances to customers decreased by £8.8 billion or 2% to £408.9 billion; excluding the impact of foreign exchange the movement was £6.3 billion mainly driven by disposals and run off in RCR. REIL fell by 13% to £34.1 billion. Provision coverage strengthened to 66% compared with 64% at the end of 2013 and REIL were 8.3% of gross customer loans compared with 9.4% as at 31 December 2013. Asset quality continued to improve across the board.

Impairment charge for the first half of 2014 was significantly lower at £271 million compared with the prior year including £180 million of latent provision releases primarily reflecting more favourable credit conditions.

30% of the £56.9 billion property loans were REIL, with a provision coverage of 66%. 20% of property loans carry a provision. Refer to page 41 for an analysis of commercial real estate in RCR.

Strong mortgage lending in UK PBB of £2.5 billion was offset by a fall in unsecured lending of £1.1 billion. Impairment charges and credit metrics continued to show improving trends with REIL as a percentage of gross loans falling to 3.3% from 3.6% at 31 December 2013 reflecting improved asset quality and lower default trends. Write-offs of £0.4 billion reflected the continued write-off of legacy balances.

Ulster Bank loans, excluding the impact of foreign exchange and transfers to RCR, were £0.5 billion lower than at the year end mainly as customers deleveraged. Impairment charges were significantly lower at £57 million in the first half of 2014 reflecting the transfer of underperforming assets to RCR and the ongoing reduction in mortgage arrears.

Lending in CPB remained broadly stable with REIL, excluding the impact of the transfers to RCR, decreasing by £0.7 billion with write-offs and repayments outpacing new provisions.

CFG loans showed growth of £1.2 billion excluding the impact of foreign exchange with impairment charges of £102 million, higher than the prior year due to the transfer in Q1 of serviced-by-others, home equity and other portfolios in Non-Core. Credit metrics remained broadly stable.



## Appendix 1 Capital and risk management

### Loans and related credit metrics: Loans, REIL, provisions and impairments

The tables below analyse gross loans and advances to banks and customers (excluding reverse repos) and related credit metrics by sector and geography (by location of lending office).

| 30 June 2014                  | Credit metrics |        |            |                       |                |                       |                   |                     |
|-------------------------------|----------------|--------|------------|-----------------------|----------------|-----------------------|-------------------|---------------------|
|                               | Gross loans    | REIL   | Provisions | REIL                  | Provisions     | Provisions            | Year-to-date      |                     |
|                               |                |        |            | as a % of gross loans | as a % of REIL | as a % of gross loans | Impairment charge | Amounts written-off |
|                               | £m             | £m     | £m         | %                     | %              | %                     | £m                | £m                  |
| Central and local government  | 8,191          | 5      | 4          | 0.1                   | 80             | -                     | 3                 | -                   |
| Finance                       | 34,166         | 466    | 318        | 1.4                   | 68             | 0.9                   | 43                | 13                  |
| Personal mortgages            | 148,237        | 5,871  | 1,731      | 4.0                   | 29             | 1.2                   | 110               | 109                 |
| Personal unsecured            | 27,482         | 2,102  | 1,754      | 7.6                   | 83             | 6.4                   | 261               | 420                 |
| Property                      | 56,908         | 17,315 | 11,490     | 30.4                  | 66             | 20.2                  | (113)             | 1,189               |
| Construction                  | 6,261          | 1,190  | 737        | 19.0                  | 62             | 11.8                  | 68                | 65                  |
| Manufacturing                 | 22,491         | 651    | 472        | 2.9                   | 73             | 2.1                   | (38)              | 38                  |
| Finance leases (1)            | 13,252         | 195    | 150        | 1.5                   | 77             | 1.1                   | (1)               | 38                  |
| Retail, wholesale and repairs | 18,031         | 1,072  | 773        | 5.9                   | 72             | 4.3                   | 111               | 97                  |
| Transport and storage         | 14,415         | 1,303  | 631        | 9.0                   | 48             | 4.4                   | 32                | 31                  |
| Health, education and leisure | 15,374         | 855    | 478        | 5.6                   | 56             | 3.1                   | (13)              |                     |