RBS Group


Annual Review and Summary Financial Statement 2012

rbs.com

The RBS Group (RBS) is a UK-based banking and financial services company. Headquartered in Edinburgh, the Group operates in the United Kingdom, Europe, the Middle East, the Americas and Asia, serving over 30 million customers worldwide.

The Group provides a wide range of products and services to personal, commercial and large corporate and institutional customers through its two main subsidiaries, The Royal Bank of Scotland and NatWest, as well as through a number of other well-known brands including Citizens, Charter One, Ulster Bank, Coutts, Direct Line and Churchill.

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"The Bank's purpose is to serve customers well. The better we do this the better the results will be for all our stakeholders"

Stephen Hester
Group Chief Executive

2012 Financial Results

£6,341m
Core operating profit (1)

£3,462m
Group operating profit (1)

(£5,165m)
Loss before tax

9.8%
Core return on equity (2)

59%
Core cost:income ratio (3)

10.3%
Core Tier 1 ratio

100%
Loan:deposit ratio (4)

£42bn
Short-term wholesale funding (5)

£147bn
Liquidity portfolio (6)

1.93%
Group net interest margin

(1) Operating profit before tax, own credit adjustments, Asset Protection Scheme, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory fines, amortisation of purchased intangible assets, integration and restructuring costs, gain on redemption of own debt, strategic disposals, bank levy, write-down of goodwill and other intangible assets and RFS Holdings minority interest, and includes the results of Direct Line Group, which are included in discontinued operations in the statutory results.

(2) Based on indicative Core attributable profit taxed at standard rates and Core average tangible equity per the average balance sheet (83% of Group tangible equity based on risk-weighted assets at 31 December 2012).

(3) Cost:income ratio is based on total income excluding own credit adjustments, Asset Protection Scheme, gain on redemption of own debt, strategic disposals and RFS Holdings minority interest, and operating expenses excluding Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory fines, amortisation of purchased intangible assets, integration and restructuring costs, bank levy, write-down of goodwill and other intangible assets and RFS Holdings minority interest; and after netting insurance claims against income.

(4) Net of provisions and including disposal groups.

(5) Excludes derivatives collateral.

(6) Eligible assets held for contingent liquidity purposes including cash, Government issued securities and other eligible securities with central banks.

Our Sustainable Business Principles recognise that balancing the needs of all of our stakeholders is the best way to deliver sustainable commercial success.

Sustainable Business Principles

90%
business customer Relationship Managers accredited to help customers further

95%+
employees received Anti-Money Laundering training

£200m
Carbon Reduction Fund launched

340,000+
young people received a MoneySense lesson for the first time

184k+
hours given to employees to volunteer in the community

104k+
start-up businesses in the UK supported

14
advocacy groups had face to face meetings with Group Sustainability Committee

£3m
made available to organisations who help young people and women looking to start their own business

Sustainability is central to how we are working to build a good company. Our Sustainable Business Principles are Group commitments that set out how we can operate responsibly. We will do this by being:

Secure
- Maintaining our financial health whilst meeting our responsibilities to customers, employees and suppliers
- Keeping our customers' and employees' data and assets safe
- Protecting against fraud and corruption

Supportive
- Meeting our customers needs
- Supporting sustainable and inclusive economic growth
- Helping customers in financial difficulty

Open
- Consulting with and listening to our stakeholders
- Showing transparency in the way we run our business
- Publicly communicating our efforts to be responsible and sustainable

A Responsible Citizen
- Working within both the letter and spirit of legislation and abiding by relevant codes of practice and voluntary standards
- Supporting the communities we work in
- Respecting human rights throughout our sphere of influence
- Upholding environmental responsibility within the bank, and through our customers and suppliers

A Good Employer
- Providing our people with the tools and support to do their jobs effectively and develop their skills
- Valuing and promoting diversity in all areas of recruitment and employment
- Rewarding our people fairly for their work

Our Core businesses

RBS is rooted in the UK serving personal, business and institutional customers in the UK and around the world. Our businesses are strong players in the markets in which we choose to compete. As a Group, the businesses are stronger together than apart, to the benefit of customers and shareholders.

Since we began the job of rebuilding RBS in 2009, our priorities have been:
- to serve customers well;
- to restore RBS to a sustainable and conservative risk profile; and
- to rebuild sustainable value for all shareholders.

We are building the new RBS on our Core businesses. They have competitive strengths in their markets. We are managing them so that their performance will improve and they can meet external challenges that arise. Separately, we manage the businesses that we are winding-down or plan to sell in our Non-Core Division.

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

UK Retail

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

Performance highlights	2012	2011
Return on equity (%)	**24.4**	24.5
Cost:income ratio (%)	**51**	49
Loan:deposit ratio (%)	**103**	106

see page 22 for further information

UK Corporate

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

Performance highlights	2012	2011
Return on equity (%)	**14.5**	15.2
Cost:income ratio (%)	**44**	44
Loan:deposit ratio (%)	**82**	86

see page 23 for further information

Wealth

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

Performance highlights	2012	2011
Return on equity (%)	**13.7**	13.1
Cost:income ratio (%)	**74**	75
Loan:deposit ratio (%)	**44**	44

see page 24 for further information

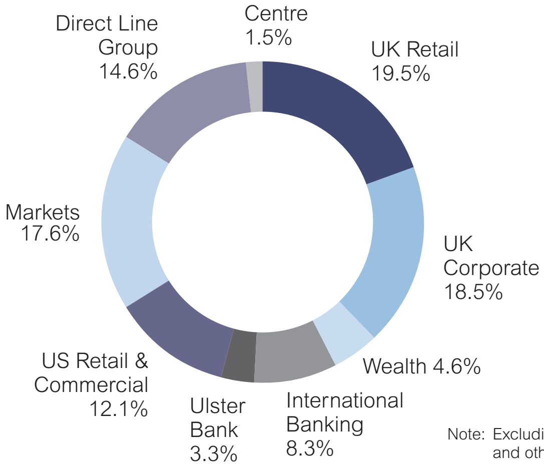
International Banking

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

Performance highlights	2012	2011
Return on equity (%)	**9.2**	11.5
Cost:income ratio (%)	**66**	62
Loan:deposit ratio (%)	**85**	103

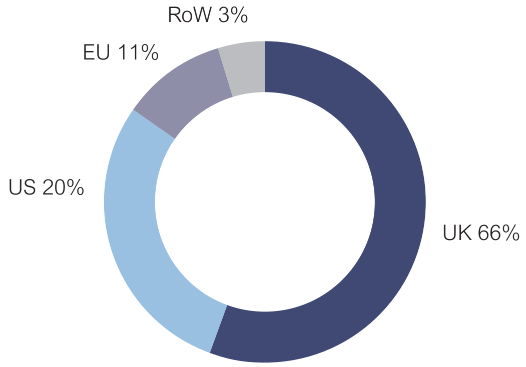
see page 25 for further information

Core income by division – 2012



Note: Excluding one-off and other items.

Total income by region – 2012



Note: Excluding one-off and other items.

Ulster Bank

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

Performance highlights	2012	2011
Return on equity (%)	(21.8)	(22.8)
Cost:income ratio (%)	62	58
Loan:deposit ratio (%)	130	143

see page 26 for further information

US Retail & Commercial

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

Performance highlights	2012	2011
Return on equity (%)	8.3	6.3
Cost:income ratio (%)	73	72
Loan:deposit ratio (%)	86	85

see page 27 for further information

Markets

We provide financing, risk management and advisory services to the Group's corporate and institutional clients.

Performance highlights	2012	2011
Return on equity (%)	10.0	6.1
Cost:income ratio (%)	64	77

see page 28 for further information

Direct Line Group

Direct Line Group is a retail general insurer with leading market positions in the UK and businesses in Italy and Germany.
Our brands include Direct Line, Green Flag, Churchill and Privilege.

Performance highlights	2012	2011
Return on tangible equity (%)	11.7	10.3
Combined operating ratio (%)	100	101

see page 29 for further information

Our approach to business

The job of creating the new RBS, a good company and a good bank, has three parts.

- We need to put customers first and serve them well.
- We have to make RBS safe and sound by restoring a sustainable and conservative risk profile.
- We have to rebuild sustainable value for all shareholders.

These goals are linked and each one supports the others. After four years of our Strategic Plan, we have made progress in all three areas but there is more to do. In particular, we are intensifying our efforts to become a bank that is known for the quality of service we give our customers.

Serving customers well

Serving customers well is what a really good bank does. In the past the banking industry, including RBS, has simply not been good enough at it. Putting that right needs hard work, determination and focus. It will not happen overnight. But at RBS, we are resolutely committed to making sure we put customers first.

Examples of the steps we took in 2012 to put customers first included:

- strengthening our customer culture through customer charters and commitments across our businesses;
- introducing a training and accreditation programme for all of our front-line SME bankers to ensure they are better equipped to serve our customers; and
- making sure we regularly and actively monitor customer satisfaction levels, customer complaints and customer feedback across our divisions.

While we are encouraged by our progress, we are not complacent. We understand the need to keep improving, particularly in light of the challenging and competitive environment in which we operate. And we will not waver in our commitment to embed serving customers well into our DNA.

Restoring RBS to a sustainable and conservative risk profile

We must operate safely and soundly if we are to serve all those who rely on us. This aim has underpinned our recovery plan. Our progress can be measured by our capital, how we fund ourselves and the reserves we hold in case of emergencies.

In 2012:

- we increased our Core Tier 1 capital ratio to 10.3% and were able to exit the Asset Protection Scheme (APS);
- we have reached our target of sustainable funding, with a loan to deposit ratio of 100%; and
- we now have an excess of liquidity which we are keen to lend to our customers, if loan demand picks up.

The focus is now on absorbing the upcoming regulatory changes to emerge from our five-year turnaround at the end of next year with a Core Tier 1 capital ratio of at least 10%.

Rebuilding sustainable value for all shareholders

Rebuilding a sustainably valuable business is important not just from the conventional perspective of delivering shareholder value but in our case to enable the UK Government to recover the taxpayers' investment.

We took a first step by repaying the liquidity and credit support that we needed from the government at the start of the financial crisis. Our exit from the APS in 2012, after paying the Government £2.5 billion, was another major milestone. The next step is to make RBS attractive enough to allow the UK Government to consider selling some of its shares in the bank.

Building sustainable value requires us first and foremost to demonstrate that we can operate safely and soundly and that we are serving our customers well. These are the cornerstones of our strategy. Each of our businesses must add value in its own right. They also provide a stronger, more stable and valuable whole because of the linkages between them. Among the strategic actions we have already taken to get to this position are:

- reshaping our business portfolio to concentrate on a select group of market-leading customer franchises;
- dramatically restructuring our investment banking business to adapt our business mix to the changing regulatory landscape;
- focusing relentlessly on cost control across all our businesses; and
- investing in our Core UK Retail and Commercial businesses to bring their capabilities towards the levels our customers expect.

We outline how each of our divisions are performing together to deliver our Strategic Plan on pages 16 to 17.

How we do business

We need to complete these three jobs if RBS is to be a really good bank. Alongside this, we have to be clear about how we want do business. That is why we aspire to standards of behaviour in six areas around our customers, finances, people, reputation, risk and security. These are summarised opposite.

Customers

- We understand our customers
- We know who we are dealing with
- We treat our customers fairly
- We treat all customer information as confidential

Finances

- We manage our finances carefully
- We use the Group's capital and resources efficiently
- We account for and report our transactions properly

People

- We value our people
- We recruit, develop and reward people based on their ability to do the job
- We manage our people responsibly and fairly

Risk

- We understand and manage the risks we are taking
- We identify and manage the level of risk we are prepared to take

Reputation

- We conduct ourselves in a way that protects our reputation
- We work within all relevant laws and regulations
- We are a responsible and engaged member of the community
- We conduct our business in a sustainable manner
- We deliver essential customer services and critical business processes at all times

Security

- We operate in a secure environment
- We protect access to our premises, systems and data
- We operate our processes, systems and controls to minimise loss from fraud or error

Our customers

Successful companies put their customers first. If they do not serve customers well they have no purpose. Without satisfied customers there is no return for shareholders, no jobs for employees, no sales for suppliers and no taxes to support public services.

Most of us at RBS get up every day with the aim of serving our customers well.

But we know that for all of the good work we have done there are just too many cases in the past when we could have done better, when some of our people acted in their own interests or with a misplaced sense of what was best for customers.

Failing to act in the right way is not just dishonourable or unethical. It is unprofitable. We have had to set aside £1.1 billion in 2012 to recompense people to whom we sold Payment Protection Insurance when sometimes we should not have done that. We have been fined £381 million in connection with inappropriate conduct relating to the setting of the LIBOR benchmark interest rate.

In rebuilding RBS, we want to make it safe and to serve customers well. Part of making RBS safe involves putting in place the systems and controls that would have helped to stop many of the errors of the past. That job is well underway, although we are not complacent.

But better systems and controls are only part of the solution. All of our people need to know that, as most of them want to, our focus must be on serving customers well. How are we doing that?

It starts by setting the right example from the top. Words are important – our Board and Executive Committee have made it clear that customers come first – but actions are more powerful.

In Business & Commercial, *'Working with You'* is our commitment that all of our relationship managers will spend time working in customers' businesses. Chris Sullivan, Chief Executive of Corporate Banking, helped lead the way.

UK Retail aspires to be the UK's most helpful bank. Feedback from customers, including their complaints, gives our leaders real insights into what works for customers and what doesn't. But there is no substitute for direct experience. *'Back to the Frontline'* takes senior people from across RBS, not just UK Retail, and puts them in branches and call centres, meeting customers and working shoulder to shoulder with colleagues.

Les Matheson, one of our Managing Directors, was a pioneer for the programme, working as a Banking Hall Coordinator in our branch on Edinburgh's Princes Street.

Next, we need to be sure our people understand what putting customers first means.

During 2012, Coutts developed its *'Crown Standard'*. It reflects Coutts' values of striving for excellence and operating to the highest possible standards so that it earns clients' trust and loyalty. Coutts also expects its Private Bankers to have a passion for client service.

Our new UK Retail Chief Executive, Ross McEwan, has said that his business is going to obsess about the customer experience, delivering a consistently high level of service.

On their first day in the job, new starts in Corporate Banking Division hear from Chris Sullivan. He tells them unequivocally that, *'our entire focus has to be on adding value to customers.'*

We need to reinforce these messages by training and developing our people so that they can do their best for customers.

In UK Retail, we are training Customer Service Officers and Customer Contact people using courses accredited by the Chartered Banker Institute. That will give our people the knowledge, skills and confidence to help customers.

Across Business & Commercial Banking over 90% of Relationship Managers (RMs) have successfully completed the Chartered Banker Institute's comprehensive Accreditation programme. This is part of our commitment to put properly trained bankers back on the High Street. It means our RMs are:

- better equipped to respond to customers' business needs and opportunities – delivering their business and sector expertise; and
- confidently providing the right solutions at the right time – sharing in SME customers' ambitions.

We try to choose carefully who joins us, tell them what we expect and train them to do the job. We also need to give them the correct incentives. RBS has led the industry in reforming how we reward people, better aligning that with the interests of our stakeholders. Now we have gone further. In UK Retail, we have changed how we reward people, putting more emphasis on customer service and feedback.

Becoming a really good bank starts and ends with the customer. Every one of us at RBS has an impact one way or another on how we serve customers. We need to become a company that has a simple, overriding determination to serve customers well. This must be our obsession. If we do this, it will become our visible point of differentiation. It will define the way we think, how we work together and how we make the most of our efforts. Doing the right thing for customers also means ensuring we are a positive part of the fabric of our communities – because we know that when they succeed, so do we.

Chairman's statement

Watch or listen to Philip Hampton
www.rbs.com/AnnualReview

The plan to rebuild RBS from 2009 has been based on two primary elements. The first was to stabilise the company, making it safe so that it could stand on its own feet. The second was to focus our energies on serving customers well. We were clear that the plan would take time and that it would take five years and more for key aspects to be delivered.

Four years on, I am pleased to report that we made more progress in 2012, passing a number of important milestones. Perhaps the most significant was when, with our regulator's agreement, we exited the Asset Protection Scheme in October, the earliest date at which that was possible. We were able to do so because we have made RBS safer. Our Core Tier 1 capital ratio was 10.3% at the end of 2012, above our target, despite some large unplanned charges. The balance sheet is smaller, falling by a further £195 billion to £1,312 billion, as the run-down of Non-Core assets continued faster than we first planned. Our funding is more stable too, with the Group loan to deposit ratio at 100% or 90% in our Core business and our liquidity portfolio is 3.5x times short-term wholesale funding.

We have achieved all of this in the most testing economic environment for many decades. The UK economy is still smaller than before the crisis struck and the US economy is only slightly bigger. This weakness in the main economies where we operate was a headwind to our plans, and regulatory changes have further reduced our return on equity in some areas. In particular, lower returns from investment banking activities necessitated further restructuring.

Much of what RBS has accomplished since 2009 has been down to the hard work, professionalism and commitment of our people. I would like to thank every one who did their best for our customers in 2012.

However, it became painfully clear during the year that some of our employees had behaved in ways that do not represent the values of RBS. Their misconduct casts a shadow across our progress and the good work of many thousands in the Group. I have already spoken about the behaviour of some people in RBS in making LIBOR submissions. It was wrong. The RBS Board has acknowledged that there were serious shortcomings in our risk and control systems, and also in the integrity of a small group of our employees, and has taken action to ensure full and proper accountability.

At times like these, your Board and the senior management of the company have a duty to lead. Our response has been diligent and determined in tackling any hint of misconduct and other failings, past or present. Our job has been three-fold: to understand what had happened and why, to put it right and then to minimise the chance that such problems happen again.

The failure of one of our IT systems in June had unacceptable consequences for many of our customers in the UK and the Republic of Ireland. The Board Risk Committee has led a rigorous review of what went wrong. The Committee has sought to ensure that customers who were affected are appropriately compensated. It will continue to oversee the management of technology risks and lead our communication with customers, regulators and others when the investigations conclude. The response of our staff in branches, call centres and elsewhere in dealing with the problems we had caused to our customers was outstanding.

While these failings show our continuing need to improve our risk and control systems, they at times had a deeper cause. Some employees put their own interests well ahead of customers' and shareholders', ignoring the difference between right and wrong. Your Board expects our people to demonstrate the highest standards of personal and professional conduct. We know that our shareholders, our customers and others will hold us to high standards. It is a matter of great regret that the conduct and values of a very small number of our people fell so far short of what we expect.

That is why your Board is determined to ensure that RBS exemplifies the culture you would expect in a bank that serves customers well and makes an important contribution to the communities where we operate. It is why we have taken steps to manage more effectively what the industry now calls conduct risk. In short, this is the risk that the company is damaged because our people do not behave properly. The Board Risk Committee has supervised the development of our approach to conduct risk management. Together, the Board Risk Committee and Remuneration and Performance Committee have developed proposals that mean our reward policies will support good conduct.

As a Board, we are determined that RBS should be known in future for how we behave as well as for commercial success.

On LIBOR, IT and many other issues, my fellow directors have shouldered a considerable and growing burden of work. I wish to thank them for that and for their support throughout the year.

We know our future performance will be heavily influenced by economic conditions. Consensus forecasts for 2013 give some hope that this year will see a return to modest growth in the UK and continued, if moderate, expansion in the US. Compared with a year ago, the problems of the euro area appear less pressing though key challenges remain. Governments and central banks are now managing that crisis more effectively and they have started to put in place the financial infrastructure needed to sustain the euro. We are entitled to some confidence that the economic environment in 2013 will be better than at any time since the financial crisis struck in 2007.

We are delivering what we said we would do in our strategic plan. We have made RBS safer. It is much closer now to being in the good financial health that would allow shareholders to receive a dividend and the Government to start to sell its stake. The challenge that remains is to serve customers better and to do business in a way that makes you and us proud to be part of RBS.

Philip Hampton
Chairman

Group Chief Executive's review

Watch or listen to Stephen Hester
www.rbs.com/AnnualReview

RBS is four years into its recovery plan and good progress has been made. We are a much smaller, more focused and stronger bank. Our target is for 2013 to be the last big year of restructuring. There will be important work still to do, but an increasingly sound base from which to work. As the spotlight shifts to the 'new RBS' post restructuring, we are determined that it will show a leading UK bank striving to be a really good bank. By serving customers well RBS can become one of the most respected, valued and stable of banks. That is our goal.

2012 saw landmark achievements for RBS. It was also a chastening year. Along with the rest of the banking industry we faced significant reputational challenges as we worked with regulators to put right past mistakes. We are determined to overcome the cultural and reputational baggage of pre-crisis times with the same focus we have applied to the financial clean-up from that era.

Priorities

The Bank's purpose is to serve customers well. The better we do this the better the results will be for all our stakeholders over time.

We need to complete and sustain our return to a safe and conservative risk profile.

And these priorities need in turn to produce a sustainable result for shareholders, and to create the opportunity for taxpayer share sales.

If we make continued progress across these priorities, and do it in the right way, we can become a really good bank and serve our stakeholders and society well.

2009-2012 Report Card

RBS has:

- Sustained its 33 million customer franchise in the face of substantial restructuring and other pressures. Lending balances to Core UK businesses and homeowners (excluding commercial real estate) were grown by over 3%, ahead of growth in the wider economy.
- Rebuilt financial resilience. RBS's huge restructuring process is moving successfully to its later stages. From their worst point, total assets are down £906 billion, short-term wholesale borrowing is £255 billion down. Risk concentrations are well down. Balance sheet leverage is reduced from 21x to 15x. In each case we are well ahead of original targets. And a Core Tier 1 capital ratio of 10.3% provides us some 3.5 times more capital per unit of equivalent risk than pre-crisis levels.
- Reached a loan to deposit ratio - perhaps the clearest indicator of a bank's funding prudence – of 1:1 from a worst point of 154%. Achieving this 'golden rule' of banking is a powerful symbol of our recovery.
- Produced £43 billion in pre-impairment profits from Core businesses. These have been used to self fund the majority of £52 billion of legacy losses, loan impairments, restructuring charges, regulatory costs and other clean-up items.

2012 Results

2012 saw landmark achievements in our restructuring plan. It saw sustained customer lending support. A 61% share price rise during the year (and 215% versus the January 2009 low point) underlined an improvement of investor belief in our future and that of the banking sector generally.

The critical task of financial stabilisation passed milestones as RBS recommenced preference share dividends, completed the repayment of all crisis liquidity facilities from public authorities and exited the UK Government £282 billion Asset Protection Scheme without making any claim under it. The notable flotation of Direct Line Group represented the third of four EU state aid conditions and offset the disappointment of Santander withdrawing from its agreed purchase of 315 branches from RBS.

Underlining this progress, RBS 5 year bonds traded at c.1% credit spreads compared to their wide levels earlier in the year of c.4.5%. The resultant own-credit accounting charge of £4.6 billion reflects this huge improvement in the perceived credit quality of RBS.

Core Bank operating profits were £6.3 billion of which Retail and Commercial businesses were £5.3 billion (excluding Ulster Bank) and Markets £1.5 billion. Non-Core losses declined again (32% to £2.9 billion) and Non-Core assets also fell ahead of target to £57 billion. We expect to slow the pace and cost of the remaining run-down once we hit the £40 billion asset target for the end of 2013. Exceptional charges in relation to Payment Protection Insurance claims, LIBOR settlements and interest rate hedging product redress, together with the own credit adjustment, resulted in a loss before tax of £5,165 million.

In a tough economic environment, most of the banking industry's ongoing businesses are running hard to stand still, and so it was at RBS. But the existing level of operating performance is essential to fund our historic clean-up with the moment coming ever closer when these costs are behind us and rewards flow directly once more to shareholders.

Reputation

Our industry faces a tough challenge rebuilding its reputation. 2012 was a wrenching year on that front as the cultural clean-up came to the fore which was always a companion to physical changes required from pre-crisis times.

Expectations are changing fast and even past ones have not been lived up to often enough. And the mistakes of some, grievous in cases, are tainting the efforts of the majority of bank staff. Most banks have past failings on a range of fronts. For RBS the two worst in the past year were LIBOR and our IT incident - quite different though they are.

There is no single solution or dramatic action able to address this problem. The best companies in the world in any industry develop, almost as part of their DNA, the consistent commitment to serve customers well and act accordingly. Our sights are set here. The facts and the culture that drives them will be established one piece at a time across many many issues. But we have no higher priority.

Strategy

The new RBS is a leading UK bank anchored in retail and commercial business lines. Our businesses are shaped around customer needs with substantial competitive strengths in their respective fields. Each unit is being retooled to provide improved and enduring performance and to meet new external challenges. We sustain strong capabilities internationally and in financial markets to support the needs of our customers and shareholders. Our businesses are managed to add value in their own right but to provide a stronger, more balanced and valuable whole through vital cross-business linkages.

The physical weaknesses uncovered by the financial crisis - of leverage, risk concentration and business stretch - are close to being fixed. RBS's total assets have already been reduced by £906 billion from their peak in 2008 - more than any other entity worldwide has achieved.

The principles behind this strategy are sound and working. But it will continue to evolve. A much slower economic recovery and tougher set of regulatory and policy pressures need to be absorbed. We have done this with more emphasis on customer service, balance sheet conservatism and while asking staff to do more with less during a period of significant change. Our business ambitions have been trimmed as a necessary reaction.

But whatever the outside conditions and evolution of strategy we are clear about the interrelated nature of our priorities. To serve customers well, run only prudent risk and reward shareholders over the longer term.

In this context we have set a new medium-term target for our Markets business, which is an important part of our service to corporate and institutional customers. We aim to further reduce its scale and scope, targeting capital consumption of £80 billion RWAs whilst sustaining the service provided to our customer base.

Additionally, the Board has decided it is now the right time to begin work on a partial flotation of Citizens, our US banking business, targeted probably at around 2 years from now. Citizens is a good business, serving around 5 million customers in the north east of the United States where it is has a strong market position. It has been substantially improved since 2009 and a local public listing will help to highlight its growing value. This provides a positive opportunity for Citizens and its 14,700 employees, as well as being a sensible move for RBS as a whole.

People

The banking industry has come down to earth hard. While a more balanced global economy has clear merits, the changes, pressures and adjustments asked of our people remain high. And successful results are vital for the many who rely on us. The engagement, dedication and professionalism of RBS employees remains outstanding and has much to be commended.

Concluding remarks

RBS is coming through an immense and wrenching restructuring. Much has been achieved and that should underpin our energy for what remains. Much is already good about our Core business, how it serves customers, how it performs. Our ambition is to be a really good bank – for all our stakeholders. Simple to say. A lot still to do. Many will benefit from our achieving that goal.

I thank our staff and all our stakeholders for their continued support in this effort.

Stephen Hester
Group Chief Executive

Q&As

When we speak to our investors, some questions are asked more often than others. Below we provide a selection of those frequently asked questions and answers

Q What is the trend in your margins?

Group net interest margin was broadly stable over the year meaning the profitability of taking in savings and lending to our customers stayed broadly constant. This is a struggle with interest rates so low but an important sign of financial resilience.

Q When will I receive a dividend?

Over the last two years RBS has been subject to dividend restrictions imposed by the European Commission. This prevented us from paying dividends on ordinary shares, B shares and hybrid securities, unless we had a legal obligation to do so.

With the exception of certain securities issued by the RBS N.V. legal entity, this restriction has expired and the Group has resumed payment to date on hybrid securities.

With the resumption of payments on hybrid securities, the Board is in the legal position to consider the payment of dividends on ordinary shares.

Considerations around timing of any such decision will primarily be driven by,

- the Group’s operating environment and profitability;
- uncertainty around regulatory capital adequacy requirements, most notably the impact of Basel III; and
- the Dividend Access Share held by the UK Government

The Dividend Access Share entitles the Government to a dividend on issued B Shares at the higher of 7%, or 2.5x the ordinary dividend. This could be a barrier to resuming ordinary dividends in the near term. Resolution of this issue could be achieved via engagement with the Government at some time in the future, when the Group feels it is closer to announcing the resumption of ordinary dividends.

Q When will the UK Government sell its shares?

The UK Government created UK Financial Investments (UKFI) to manage its shareholdings in financial institutions.

UKFIs overarching objective is to manage these shareholdings commercially and to devise and execute a strategy for realising value in an orderly and active way over time. For further details please see: *http://www.ukfi.co.uk/about-us/what-we-do*

As a consequence, the decision of when to sell, and to whom, is at the full discretion of UKFI and the Government.

To best facilitate this process, the Group remain focussed on delivering a sustainable, attractive and profitable business with a strong investment proposition.

Q When will you return to profitability?

RBS has been profitable on an operating basis for the past three years. However the Group has continued to incur significant costs in resolving the ‘sins of the past’, such as: restructuring costs, conduct related fines, and impairments on legacy portfolios.

With the culmination of the restructuring phase of our strategic plan in 2013, these associated ‘exceptional costs’ should start to significantly reduce from next year.

We retain the conviction that the underlying businesses of RBS can deliver sustainable profitability using a more conservative business model.

Q How are you controlling expenses?

Disciplined cost management has been a foundation of our strategic plan. The Group's cost reduction programme realised over £3.6 billion of sustainable savings to date, versus its original £2.5 billion target. This has seen Group operating costs reduce by 18%, or £3.2 billion, since 2008. We have embedded cost discipline across our Core businesses, where operating expenses are down 9% since 2009. Non-Core's costs have significantly reduced, and should continue to fall as we approach the end of the active run-down process.

Our key targets

Key performance indicator	Why?	How are we doing?	Medium-term target
Return on equity (1)	We need to earn solid returns that consistently cover our cost of capital in the long run in order to justify our shareholders' support	2011: 10.4% / **2012: 9.8%**	Core >12%
Cost:income ratio (2)	What it costs us to generate each unit of income is a key measure of efficiency affecting how we price our services and meet shareholders' need for profits	2011: 60% / **2012: 59%**	Core <55%
Core Tier 1 ratio	This is the most important measure of capital strength. We need to meet society's expectation of a safe and sound banking system by maintaining a strong capital ratio	2011: 9.7% (6) / **2012: 10.3%**	>10%
Loan:deposit ratio	We want to fund our customer lending with stable deposits from customers in order to maintain a sustainable balance sheet	2011: 108% / **2012: 100%**	c.100%
Short-term wholesale funding (3)	We want to have proportionately low reliance on more volatile short-term money market funding	2011: £102bn / **2012: £42bn**	<10% TPAs (7)
Liquidity portfolio (4)	We want to hold a strong liquidity buffer to guard against unexpected funding emergencies	2011: £155bn / **2012: £147bn**	>1.5x STWF (8)
Leverage ratio (5)	A useful cross check to ensure that we are protected against risks that might turn out to be greater than we calculate	2011: 16.9x / **2012: 15.0x**	<18x

(1) Based on indicative Core attributable profit taxed at standard rates and Core average tangible equity per the average balance sheet (83% of Group tangible equity based on risk-weighted assets at 31 December 2012).

(2) Cost:income ratio net of insurance claims.

(3) Excluding derivatives collateral.

(4) Eligible assets for contingent liquidity purposes including cash, Government issued securities and other eligible securities with central banks.

(5) Funded tangible assets divided by total Tier 1 capital.

(6) Core Tier 1 ratio excluding benefit from the Asset Protection Scheme of 90 basis points in 2011.

(7) Third Party Assets.

(8) Short-term wholesale funding.

Progress on our Strategic Plan

Strategy and business objectives

RBS to be based on enduring customer franchises with each business capable of generating a sustainable return in excess of its cost of capital

How are we going to do this?

Franchises with substantial competitive strength

- Track market positions and customer satisfaction in all Core businesses

Income growth

- Focus on businesses capable of delivering sustainable growth and achieve market-level growth in each

Cost control

- Deliver on the Group's cost programmes, whilst making essential investments in our businesses. Achieve a cost:income ratio that places RBS among the most efficient of its global peers.

Rigorous capital and cost allocation

- Accurately deploy the Group's capital and allocate appropriate costs to focus the divisions on sustainable returns, as well as on profit growth.

Our progress so far

- Our goal is for the new RBS to be built upon customer-driven businesses with substantial competitive strengths in their respective markets. We have top tier competitive positions across all of our enduring customer franchises. We continue to monitor closely and drive improvements in our customer satisfaction scores.
- Achieving growth continues to be a major challenge in our operating environment. Put simply, if our customers are not growing, we will not grow. We have restructured and invested in our ongoing businesses to serve our customers better and deliver improved and enduring performance. We believe there is additional upside to these franchises when economic recovery takes hold.
- So far, through our cost reduction programme, we have taken £3.6 billion annualised out of our cost base. This, along with lower than originally projected programme spend, has allowed us to invest in our Core franchises in order to enhance our customer service and product offerings through improvements to our technology and infrastructure.
- In 2012 our Core cost:income ratio of 59% showed a further improvement towards our target.
- We use direct service usage, requirement for market funding and other appropriate drivers to allocate costs accurately to the divisions. Capital is allocated with a focus on sustainable risk-adjusted returns rather than short-term performance prospects. This gives our divisions a realistic view of how their income translates into profits and returns. In 2012, the only Core business that was materially short of earning its cost of capital was Ulster Bank, although a number of our other businesses have some work to do to improve their returns. Core return on equity in 2012 was 9.8%, reflecting protracted economic challenges in the areas in which we operate.

Medium-term target

- All our principal Core businesses sustain positions amongst the leaders in their chosen fields.
- Core cost:income ratio <55%
- Core return on equity >12%
- Group leverage ratio <18x

Strategy and business objectives

RBS to deliver its strategy from a stable risk profile and balance sheet, with each banking business self-funding (1:1 loan:deposit ratio)

How are we going to do this?

Reduced balance sheet scale

- Continue to de-risk and shrink our Non-Core balance sheet. Careful control of future asset growth to support Core customers'.

Funding programme

- Limit over-reliance on wholesale markets to meet the Group's funding requirements, while building up an appropriate liquidity reserve. Generate a stable deposit base to fund each business.

Stable and robust capital support

- Focus on implementing state of the art risk controls, run-off of excess risk concentrations and maintenance of strong equity capital.

Our progress so far

- The Group's funded balance sheet was further managed down to £870 billion by the end of 2012. Non-Core and M&IB have driven the deleveraging to date, with Non-Core's funded balance sheet standing at £57 billion, 22% of its starting point in 2008 and ahead of target for the year.
- Throughout the restructuring process we have been able to shrink our assets while sustaining a strong capital base. Our Tier 1 leverage ratio of 15.0x times in 2012 comfortably met our target.
- Our Core bank continued to take in more than £1 of deposits for every £1 of loans made in 2012 with a loan to deposit ratio of 90%. The Group met its target of 100% loan to deposit ratio at the end of 2012.
- Our reliance on short-term wholesale funding has been further reduced to £42 billion or 5% of funded assets.
- We had an excess of liquidity in 2012 with liquidity reserves of £147 billion, or 3.5x our short-term wholesale funding, surpassing our target.
- In 2012, we passed a major milestone in our capital story when we exited the Asset Protection Scheme ("APS"), the Government scheme we entered in 2009 to provide capital relief and insurance against the possibility of a further significant deterioration in credit losses. Now, even without the benefit of APS, we have maintained a Core Tier 1 capital ratio of 10.3%, above our target.
- Our capital ratio meets regulatory requirements well ahead of the internationally agreed implementation timeline and shows that the Group has sufficient capital to deal with future requirements.

Medium-term target

- Group leverage ratio <18x
- Group loan:deposit ratio of 100%
- Short-term wholesale funding <10% of third party assets
- Liquidity portfolio >1.5x short-term wholesale funding
- Core Tier 1 capital ratio >10%

Strategy and business objectives

The chosen business mix to produce an attractive blend of profitability, stability and sustainable growth

How are we going to do this?

Focused on retail and commercial banking

- Our leading UK retail and corporate customer franchises form the anchor of our strategy, strengthened by selected international businesses that provide deep local franchises with material synergies with the rest of the Group.

Concentrate on the core strengths of our wholesale businesses

- Re-balance and shrink our markets activities, focusing on the businesses that form key aspects of our customer proposition and where we have strength.

Exit Non-Core business lines

- Expeditious run-off or sale of businesses and asset portfolios while maximising the value obtained for the Group.

Our progress so far

- Our business mix has made strong progress towards being dominated by high quality, stable customer franchises. We have moved from 64% retail and commercial operating profit in 2007 to 83% (operating profit before impairment losses) operating profit this year, in line with our target.
- In this time we have also ramped up our investment in these businesses, spending on enhancing customer experience, developing IT infrastructure and transforming our front and back office functions.
- We believe that having a focused international presence adds value, allowing us to access additional growth opportunities and benefit from long-term globalisations trends, although we want to be anchored in the UK. In 2012 we have met our target geographical business mix with the UK contributing 66% to income.
- We undertook a major restructuring of our wholesale businesses this year, focusing on our strongest businesses and exiting loss-makers. We shed £29 billion of funded assets from Markets balance sheet. This will help improve the efficiency of our capital usage and strengthen our overall balance sheet and funding profile whilst ensuring we continue to provide our larger corporate customers with the access to global markets that they require.
- We have decreased Non-Core's funded balance sheet by £201 billion since the creation of the division in 2008 through run-off and disposals.

Medium-term target

- Approximately 80% of operating profit to come from our retail and commercial banking activities and approximately 60% of income to come from UK businesses
- Approximately 20% of operating profit to come from our Markets activities

Strategy and business objectives

RBS management hallmarks to include an open, investor-friendly approach, discipline and proven execution effectiveness, strong risk management and central focus on serving our customers well, and better

How are we going to do this?

Publish targets for risk/return balance

- Demonstrate execution effectiveness by setting clear performance targets for risk and returns, and give regular updates on progress against them.

Improve levels of disclosure

- Rebuild confidence and trust with investors by combining clear performance targets with improved disclosure.

Set customer franchise targets for every business

- Put serving our customers well, and better, at the heart of our agenda. Measure our progress on this with reference to a series of targets.

Management change

- At the centre of its effort to rebuild the Group, RBS is dedicated to maintaining the strength of its Board and senior management teams.

Strong risk management

- Embed the new set of management disciplines to ensure that the RBS of the future is adequately protected, notably by its risk management processes and frameworks.

Our progress so far

- In 2011, we revisited our targets in light of the economic and regulatory landscape being significantly different to what was forecast back in 2009 when the original targets were communicated. We strengthened many of our balance sheet and risk targets, and the revised income targets indicate that we remain committed to earning sustainable returns from all our ongoing businesses.
- We are transparent in explaining our progress towards targets, reporting this in our quarterly results. Further details can be found on page 13.
- We provide detailed financial information, including disclosures on risk and balance sheet management, to the market each quarter.
- Improving support for our customers was the top goal of our 2009 strategic plan. We track, and target improvements in, customer satisfaction and market position for all of our core franchises. In addition, we have implemented customer charters and have piloted training programmes for our front line staff. We plan to widen further the scope of these going forward.
- We believe that the majority of our people want to, and do, serve our customers well already. However, we need to do more to ensure that customers receive the best possible service consistently.
- A number of legacy conduct issues have had to be addressed, particularly in the last year. These highlight the importance of the cultural change we are undergoing in order for us to do better for our customers in the future.
- Since the start of the financial crisis we have overhauled RBS's management. We believe that we now have a strong and qualified team in place to finish restoring RBS to a normal bank, then to build on our core franchises from there.
- We are committed to restoring the Group to a sustainable and conservative risk profile. The RBS risk management framework, and our risk management teams, are clearly aligned with the Group priority. For an overview of how this is working in practice, see pages 19 and 20.

Medium-term target

- Implemented in 2009, some reviewed in 2012

The economic environment

We have noted before that when economies are emerging from recessions rooted in high levels of debt and stresses in the financial system, growth is slower than in the typical recovery. That was the experience of our major markets again in 2012.

In the UK, growth weakened. Total economic activity, as measured by gross domestic product (GDP), was flat compared with growth of 0.9% in 2011. At the start of the year, expectations had been more positive, the consensus forecast for growth having been 0.5%. Yet the year ended with the economy contracting.

More positively, unemployment fell, from around 8.3% at the turn of the year to 7.7% towards its end. That helped to offset the continuing squeeze on the spending power of earnings as wages grew by less than inflation.

Housing market activity remained subdued. Prices were broadly stable, some indices showing a rise and others a fall. Any price increases seem to have been concentrated in and around London.

The Bank of England continued its ultra-loose monetary policy stance. Although inflation remained above target, the Bank kept interest rates at 0.5%. In fact, its greater concern was that the weak economy would cause inflation to be too low and in both February and July it increased its asset purchase programme by £50 billion taking the total value of assets purchased to £375 billion. The Government's decision to transfer the coupon payments from the Asset Purchase Facility to HM Treasury, which will use these proceeds to reduce the stock of Government debt, has a similar effect to further quantitative easing.

In July, the Bank of England and HM Treasury launched the Funding for Lending Scheme (FLS). It is designed to boost lending to households and non-financial firms. Early indications from the Bank's Credit Conditions Survey suggested that the supply of credit had expanded towards the end of the year.

In the United States, GDP growth was slightly stronger at 2.2% compared with 1.8% in 2011. Uncertainty about how leaders might resolve immediate and longer-term fiscal challenges weighed on growth during much of the year.

There was encouraging news on the job market, where unemployment had fallen to 7.8% in December, and the housing market, where prices and construction activity started to rise.

However, concerned that the recovery remained too slow to return unemployment to rates consistent with its mandate to foster maximum employment, the Federal Open Market Committee changed policy in two ways. In September it agreed to increase monetary accommodation by purchasing mortgage-backed securities at a pace of $40 billion per month. Second, it announced in December it anticipates the Fed Funds rate remaining exceptionally low as long as the unemployment rate is above 6.5%, inflation one to two years ahead is expected to be no more than 2.5% and inflation expectations are well anchored.

Ireland's GDP grew by 1.3% in the four quarters to Q3 2012 as the economy continued its slow recovery from deep recession. The export sector continued to benefit from the boost to competitiveness delivered by falling real wages.

For Ireland, gross national product (GNP) is a better measure of people's material well-being. It reflects the income residents receive rather than the value of the incomes generated in the country, an important distinction where there is a large foreign-owned sector that remits profits overseas. GNP increased by 1.1%.

Unemployment in Ireland averaged more than 14%. At the end of the year house prices were 4.5% lower than 12 months earlier and around 50% below their peak. The rate of decline was slower than at any time since 2008 and there were tentative signs that prices were stabilising.

Entering 2012, the greatest economic concern was how problems related to sovereign debt in the euro zone would be managed. By agreeing the outline of a banking union, undertaking to purchase sovereign debt to push down yields and making progress on fiscal rules, European leaders and the European Central Bank took some steps that are necessary if an economic and monetary union is to be sustained. At the end of the year the probability that some of the worse outcomes would be realised had fallen although they had not disappeared. Despite this progress, euro zone GDP contracted and unemployment had risen to almost 12% by December.

Unemployment rates, %, December

Sources: Datastream and Office for National Statistics

Real GDP growth rates, %

Sources: Datastream
Note: Ireland growth rates are four quarters to Q3 2012 over four quarters to Q3 2011 and four quarters to Q3 2011 over four quarters to Q3 2010

Our approach to risk management

An integral role for Risk Management
Risk Management is essential to making RBS safe and sustainable. A strong culture of risk management and control provides the foundation for this.

Financial strength and resilience are at the heart of our Strategic Plan. The plan targets a credit rating in line with those of our strongest peers, without government support.

In 2009, the Group Board set four strategic risk objectives aligned to the Strategic Plan.

These are to:
- maintain capital adequacy;
- deliver stable earnings growth;
- ensure stable and efficient access to funding and liquidity; and
- maintain stakeholder confidence.

These strategic risk objectives link the Group's business strategy to the way we set risk appetite and manage risk in our business. We set risk appetite at Group level.

This establishes the level and type of risks that we are able and willing to take to meet our strategic objectives and our wider obligations to stakeholders.

We cascade and embed this risk appetite across the Group, allowing:
- each business to understand its acceptable levels of risk; and
- commercial strategies to be aligned with the use of available financial resources.

By setting a clear risk appetite and embedding a strong risk culture throughout our businesses, we can identify, measure and control risk exposures and respond effectively to shocks.

Key developments in 2012
In 2012, we continued to strengthen our approach to risk management amidst a challenging and ever-changing external environment. Areas of progress included:
- refining our understanding of the risks we face and their scale;
- reducing our exposures in line with our objective of being safe and sustainable;
- improving the quality of our data, including forward-looking measures;
- developing a framework for the effective management of our conduct risk;
- strengthening our credit risk and country risk appetite and management frameworks and ensuring consistent application across the Group; and
- further realigning our Group Policy Framework to our business model and continuing assurance.

In the table on the following page, we summarise the risks we face. We provide a more detailed discussion of developments in 2012 in the 'Risk and balance sheet management' section of the Annual Report and Accounts.

This is how we bring the Strategic Plan to life in our management of risk.

The main risk types facing the Group, which are covered by the risk appetite framework, are shown below:

Risk type	Definition	Features
Capital adequacy risk	The risk that the Group has insufficient capital.	Potential to disrupt the business model and stop normal functions of the Group. Potential to cause the Group to fail to meet the supervisory requirements of regulators. Significantly driven by credit risk losses.
Liquidity and funding risk	The risk that the Group is unable to meet its financial liabilities as they fall due.	
Credit risk	The risk that the Group will incur losses due to the failure of a customer to meet its obligation to settle outstanding amounts.	Loss characteristics vary materially across portfolios. Significant link between losses and the macroeconomic environment. Can include concentration risk – the risk of loss due to the concentration of credit risk to a specific product/asset class, sector or counterparty.
Country risk	The risk of material losses arising from significant country-specific events.	Can arise from sovereign events, economic events, political events, natural disasters or conflicts. Potential to affect parts of the Group's credit portfolio that are directly or indirectly linked to the country in question.
Insurance risk	The risk of financial loss through fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations at the time of underwriting.	Frequent small losses which are material in aggregate. Infrequent large material losses.
Market risk	The risk arising from fluctuations in interest rates, exchange rates, credit spreads, equity prices, commodity prices, and risk-related factors such as market volatilities.	Frequent small losses which are material in aggregate. Infrequent large material losses due to stress events.
Operational risk	The risk of loss resulting from inadequate or failed processes or systems, from inappropriate human actions, or from external events.	Frequent small losses. Infrequent material losses.
Regulatory risk	The risk arising from non-compliance with regulatory requirements, regulatory change or regulators' expectations.	Adverse impacts on strategy, capital structure, business models and operational effectiveness. Financial cost of adapting to changes in laws, rules and regulations or of penalties for non-compliance. Financial cost and reputational damage in respect of penalties for non-compliance/breach of regulations.
Conduct risk	The risk that the conduct of the Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss.	Arises from breaches of regulatory rules or laws by individual employees or as a result of the Group's retail or wholesale market conduct. It may also arise from the failure to meet customers' or regulators' expectations of the Group. Non-compliance may result in regulator enforcement, adverse publicity and financial penalties.
Reputational risk	The risk of brand damage and/or financial loss due to failure to meet stakeholders' expectations of the Group.	Can arise from actions taken or not taken by the Group or from its wider conduct, policies and practices. Can be detrimental to the business in a number of ways, including an inability to build or sustain customer relationships, low staff morale, regulatory censure or reduced access to funding sources.
Business risk	The risk of losses as a result of adverse variance in the Group's revenues and/or costs relative to its business plan and strategy.	May be caused by internal factors such as volatility in pricing, sales volumes and input costs, and/or by external factors such as exposure to macroeconomic, regulatory and industry risks.
Pension risk	The risk arising from the Group's contractual liabilities to or with respect to its defined benefit pension schemes, as well as the risk that it will have to make additional contributions to such schemes.	Funding position can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities.

Divisional review

Contents

UK Retail

Ross McEwan
CEO
UK Retail

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www.rbs.com/AnnualReview

Operating profit of £1,891 million was six per cent lower than in 2011. A ten per cent decline in income was only partly offset by lower costs, down six per cent, and a 33 per cent fall in impairment losses. Return on equity was broadly stable at 24.4 per cent. Deposit growth of six per cent contributed to a further reduction in the loan to deposit ratio, which improved to 103 per cent.

Making RBS safer

Our starting point in making UK Retail safer was understanding and agreeing how much risk we are prepared to take. We have done that and abide by the disciplines that imposes. We know we will be safer if we do business properly. That is why we improved how we manage conduct risk by putting the customer at the heart of all we do, focusing on customer outcomes through the advice we give, the products we sell and the services we provide. We built on the significant progress we have made on credit risk over the last few years. We live within the risk limits we have set and we are confident that we would remain profitable in a stressed environment.

We have improved our liquidity risk by reducing our funding gap. We now hold £100 of deposits for every £103 we lend. Large portions of our mortgage portfolio are now available for use in the event of a stress situation.

Despite our progress, in June, we let our customers down when our IT systems failed. We are sorry for that. We've investigated and understand where we need to improve.

In the latter part of 2012, we welcomed Ross McEwan, our new Chief Executive. Coming from Commonwealth Bank with an abundance of energy and experience, Ross has listened to our customers and people and has set a clear direction for 2013 with a focus on making it simple and easy for our customers to do business with us.

Building a better bank that serves customers well

We want to put customers first and we made changes that help us do that.

- Our knowledgeable staff will put our customers' needs first. The Chartered Banker Institute accredits our training to help ensure our staff have the knowledge to help customers.
- Help when they need it most. Emergency Cash allows customers to get cash if their cards are lost or stolen. More than 80,000 people used the service in 2012.
- Quick and convenient service. We cut average branch queuing time from almost five minutes to less than three and a half minutes. We open 1,263 branches on Saturdays and 254 open until 6pm on weekdays. We upgraded and improved our market-leading mobile app, growing our regular user base from 1.4 million to 2 million. It used to take three weeks to open an account with us, now it takes 24 hours. Our mobile branches average 7,000 miles each week to serve our customers in 347 remote communities.

In response to the Retail Distribution Review we're building a simpler, nimbler, more customer focused advice business.

We made changes to our branches to make life easier for customers and help us reduce costs. We refurbished nine branches and refreshed 59 more. By introducing Banking Hall Coordinators and more Cash and Deposit Machines, we moved transactions away from branch counters, giving our people more time to talk to customers.

Changing our culture

Our people are vital in ensuring we become the Helpful and Sustainable Bank we want to be. We're changing our culture to get the whole organisation focused on the needs of our customers. That starts when we recruit new people who have a great approach to helping customers. From day one, our Big Welcome induction makes clear our commitment to customers and how best to meet their needs.

A new incentive approach has been introduced for our frontline people which is all about meeting customer needs and encouraging sustainable and profitable growth.

Every day, our people put our customers first, and often go to heroic efforts to do so. And we recognise them. Across our business our people nominate their colleagues for Helpful Banking Hero awards and winners are selected by a panel of frontline employees. They are our role models.

Our Helpful Leadership Academy gives leaders the skills, understanding and confidence to lead all of us towards becoming the UK's most Helpful Bank. We reward leaders for their contributions to service and risk management but also by how they provide leadership for their teams and how well they manage customers' complaints.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	**2,420**	2,809
Impairment losses (£m)	**(529)**	(788)
Operating profit (£m)	**1,891**	2,021
Return on equity (%)	**24.4**	24.5

UK Corporate

Chris Sullivan
Chief Executive,
UK Corporate

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Operating profit of £1,796 million was seven per cent lower than in 2011. That reflected a decline in income of three per cent and increased impairments, up six per cent, which were partly offset by a three per cent fall in costs. Return on equity was slightly lower than in 2011 at 14.5 per cent. The loan to deposit ratio was 82 per cent.

Making RBS safer

In Corporate Banking, we understand the importance of managing risk well. We have enhanced our approach to risk, introducing improved frameworks and processes; reducing risk concentrations and bringing key risks closer to within appetite.

We have increased our focus in the areas of Anti-Money Laundering, Sanctions, Conflicts Management, Information Security, Records Management and Data Quality, and have implemented new credit processes to improve the quality and speed of our credit decisions.

Building a better bank that serves customers well

Our customers are at the core of everything we do. Our sole purpose is to help them realise their ambitions, achieve growth, and become more efficient. We have the capital, the funding and the professional expertise within our people to deliver.

In August, we were the first bank to launch the Funding for Lending Scheme (FLS) to UK businesses. We used FLS to make in excess of £1.7 billion in allocated funds available to over 11,000 SME customers strengthening our position as the UK's leading bank for SMEs, through discounted interest rates and no arrangement fees.

We are also helping larger businesses by investing in sector and asset class expertise, Our Manufacturing Fund has made £1 billion available for investment in technology, innovation, working capital and business acquisitions. Our Carbon Reduction Fund provides a further £200 million of ring-fenced funding for businesses undertaking energy-efficiency projects.

We are a leading provider of FLS and all other major lending initiatives including the Regional Growth Fund, Enterprise Finance Guarantee and the Business Growth Fund.

Lending is a vital part of our business, but we do much more than that.

- We introduced a new enhanced telephony and online offering, *Business Connect*. We currently support over 170,000 small business customers, who have access to experienced Relationship Managers from 8am to 8pm.
- *Bizcrowd* is our new online business-to-business community. It helps businesses find new customers, and offers interactive business education. We are the first bank to support customers in this way and have over 5,000 customers involved in its pilot.
- We recognise time is of the essence to our customers. Our new mobile banking apps allow them to manage multiple accounts, make payments and transfers, and see detailed statements going back seven years. We have over 70,000 customers using the apps on average twice a day and they have transferred more than £750 million since launch.
- Our turnaround plan relies on supporting the communities and local economies we serve. Our regional *'Great place to do business'* events bring investors, local authorities and prominent members of the community together to stimulate growth in their area.

Changing our culture

Our *Working with You* (WwY) initiative shows our dedication to understanding our customers and helping them realise their ambitions. All our SME relationship managers and leaders are committed to spending at least two days working for their customers at their premises. Our relationship managers have undertaken over 10,000 WwY visits since the initiative launched in June 2011.

As part of our commitment to put qualified bankers back on the high street, our RMs go through an accreditation programme. It has been independently accredited by the Chartered Banking Institute. No other bank does this and it is a key differentiator for us. So far, 93% of our SME relationship managers have completed a minimum of foundation level training.

We understand the importance of knowing the sectors and people we work with. Our Women in Business (WiB) proposition, first of its kind, is industry-leading. We have over 120 accredited WiB specialists helping our female customers succeed by providing a bespoke and tailored service.

We have reintroduced banking apprenticeships. In November, we recruited an initial 16 young unemployed people under the Evening Standard's Ladder for London and the City Gateway Initiative. This is part of RBS's wider strategy to support young people as they move from school to work.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	**2,634**	2,717
Impairment losses (£m)	**(838)**	(793)
Operating profit (£m)	**1,796**	1,924
Return on equity (%)	**14.5**	15.2

Wealth

Rory Tapner
Chief Executive,
Wealth

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www.rbs.com/AnnualReview

Operating profit increased by £5 million, or two per cent, to £253 million, driven by higher income partially offset by increased expenses and impairment losses. Total income increased by £66 million and expenses by £40 million. Impairments were £21 million higher. Return on equity increased to 13.7 per cent. The loan to deposit ratio was stable at 44 per cent.

Making RBS safer

Our strategic priorities mean that we will continue to contribute to making RBS safer. One of these is our sharpened focus on scalable markets following the introduction of a refreshed strategy in 2011. During the year we sold our Latin American, Caribbean and African businesses to Royal Bank of Canada, an important step in concentrating on core geographies.

Together with RBS Group Risk, we introduced the Coutts Conduct programme in order to deliver new standards and frameworks by the end of 2013. The intent of the programme is to safeguard clients and the business from breaches of regulatory rules or law.

Building a better bank that serves customers well

We launched Coutts Mobile in October. It means we can offer clients greater choice and flexibility in the way they manage their banking needs, providing them with the same access and convenience of Coutts Online on their smartphone or tablet.

The UK rollout of the Coutts global technology platform was completed in early 2012, enabling us to operate as an international organisation on unified and common information technology, transforming our ability to serve clients globally.

We introduced a new Sales Management Framework for the International business focusing on recruitment and induction, coaching, training and development, target setting, performance management and monitoring.

Throughout 2012, our UK business prepared to implement the Retail Distribution Review (RDR) regulations. This resulted in the introduction of the new advice model on 26 November, ahead of the required implementation date.

We significantly enhanced our Lombard lending programme in 2012, which will be central to our success and a source of important focus in 2013 and beyond. We set higher lending values for Chinese H-shares and Red Chips, and further increased lending values on Russian bonds. China, India and Russia were approved as 'special emerging markets', with a corresponding removal of the 50% emerging market cap for each country. The ruble and renminbi were added as approved currencies and lending values were also agreed for renminbi cash and bonds.

In the UK, we launched the Coutts multi-asset funds comprising a range of seven UK and global RDR-compliant funds. These aim to deliver attractive long-term returns by investing in a broad range of asset classes including cash, bonds, equities, commodities and property that allow each client's individual investment objectives to be matched to an appropriate investment strategy based on four separate asset allocation models.

We introduced a new client feedback programme in the UK in 2012 in order to improve the volume and quality of client feedback and enable us to react swiftly to any issues identified. We expect to roll out similar programmes with Adam & Company and the International business in 2013.

Changing our culture

During the year we began the journey towards creating Coutts' 'Crown Standard'. It reflects our values as we strive for excellence in everything we do. Whether our people serve clients at the front line, or work in a functional or support role, we must take pride in how we go about our tasks and work to the highest possible standards.

If we get this right for ourselves, we will get it right for our clients and we will earn their trust and loyalty for years to come. Each of us has a hand to play in building our Crown Standard and, as we continue with our transformation, there is every opportunity for us to define what this should look and feel like.

We held our first Diversity & Inclusion Week in November. Led by our Diversity & Inclusion Council, it recognises that at the heart of our business are our people who represent a variety of different cultures and beliefs. We celebrate these differences and want to embed Diversity and Inclusion in the DNA of our people and our business.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	299	273
Impairment losses (£m)	(46)	(25)
Operating profit (£m)	253	248
Return on equity (%)	13.7	13.1
Assets under management, excluding deposits (£bn)	28.9	30.9

International Banking

John Owen
Chief Executive,
International Banking

Watch or listen to John Owen
www.rbs.com/AnnualReview

Operating profit of £594 million was £161 million (21 per cent) lower than in 2011 as a 17 per cent decline in income was only partially offset by lower expenses, down 13 per cent, and impairment losses, down 34 per cent. Return on equity was lower than in 2011 at 9.2 per cent. The loan to deposit ratio improved to 85 per cent.

Making RBS safer

International Banking is making RBS safer by:

- reducing third party assets from £69.9 billion in 2011 to £53.0 billion;
- boosting customer deposits by £1.1 billion as a result of an improved customer offering, including our Global Liquidity Solutions Portal.

As a result of this reduction in third-party assets and increase in our deposits, our loan to deposit ratio has moved from 103% to 85%.

Our core message to our people is that customers must be at the heart of what we do and how we do it. We have put in place a conduct risk framework with integrity of our staff at its centre. It emphasises the behaviour we expect from everyone in International Banking and its messages are reinforced regularly by our senior leaders.

Building a better bank that serves customers well

Others recognised our success in serving customers.

- In the Euromoney Cash Management Survey clients voted us number one cash management manager in the UK and number two in Europe. In addition RBS was number two in Europe and North America for handling sterling transactions.
- RBS was the Greenwich Quality Leader in Large Corporate Trade Finance in the UK. It also ranked us number one for Large Corporate Trade Finance Penetration in the UK.
- Trade & Forfaiting Review named us Best Trade Bank, Western Europe.
- Global Finance rated us Best Supply Chain Finance Provider, Western Europe, and we won its Best Customer Implementation of Supply Chain Financing award for work carried out for brewer Carlsberg.

These successes came in our first year as we built the new division. Customer service was our priority but we still managed to complete a complex restructuring and to reduce our costs by £215 million while maintaining our global reach. We have restructured our business which puts us in a strong position to serve customers well in the future.

Changing our culture

International Banking is committed to treating our customers fairly, continually enhancing the risk and control framework and conducting business in an ethical manner. This is how we will continue to improve our culture and how we interact with customers.

In addition, we aim to run International Banking openly and transparently.

- The M&IB transformational leadership programme is designed to develop more agile, commercially-aware and people-focused leaders.
- We have made our graduate recruitment process more robust and graduates now receive more training, with greater emphasis on what our regulators expect.
- We believe that we will serve customers better if our people look more like our clients. That is why we increased the proportion of women in our graduate programme.

We have embedded the principles of correct behaviour within staff job descriptions. They will be recognised for demonstrating compliance and integrity behind their achievements, as well as for the achievements themselves in their half-yearly and year-end performance reviews. These measures are supported by a suite of intranet-based learning tools.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	705	923
Impairment losses (£m)	(111)	(168)
Operating profit (£m)	594	755
Return on equity (%)	9.2	11.5

Ulster Bank

Jim Brown
Chief Executive,
Ulster Bank

Watch or listen to Jim Brown
www.rbs.com/AnnualReview

Operating loss of £1,040 million was £56 million higher than in 2011. This primarily reflected a reduction in income driven by lower interest earning asset volumes. Total expenses fell by £26 million as a result of cost saving initiatives. Impairment losses remained high. Falling asset prices and high levels of unemployment coupled with weak domestic demand continued to depress the property market. The loan to deposit ratio improved and net interest margin increased slightly. Retail and SME deposits increased by eight per cent, although this was partly offset by outflows of wholesale balances.

It was another testing year. There were some signs of improvement but the economy was weak. Unemployment remained high, house prices fell further and wages were flat.
We continued to deal with the legacy of the past. Our review of how we operate confirmed that Ulster Bank has a sustainable future if we make the right changes.

Our systems failed in June. We are very sorry for the effects that had on our customers.
We worked hard to support them and put things right.

- We extended normal opening hours at 83 branches and Saturday hours at 60. We opened 22 branches on a Sunday.
- Our call centre extended its hours to 10pm.
- We were able to transfer funds via Western Union for customers who were abroad.
- Corporate customers were able to withdraw up to £5,000 or €5,000 with the agreement of their relationship manager.
- We processed transactions manually if corporate customers could not use online banking.

In September, we announced how we were going to make amends to customers who were affected. We wrote to every Ulster Bank customer to apologise.

Making RBS safer
Our appointment of a board-level Chief Risk Officer and a new Risk Leadership Team show how we are contributing to making RBS safer. The Chief Risk Officer has led a Group-wide review of risk as well as playing a central role in our strategic review.

We moved most of our mortgage accounts to a new system, which reduces operational risk.

Building a better bank that serves customers well
We know that Ulster Bank has a sustainable future. But that depends on us changing how we work and dealing with the past so that we focus on serving customers well. Our review told us our business was too complicated and our costs too high. We are making changes that will reduce costs by £80 million by the end of 2013.

The most significant action we took was dealing with loans we sold before the crisis. We gave more effort to managing unsecured loans, mortgages, SME facilities and larger corporate exposures. In particular, we are supporting customers who are finding it hard to pay their mortgage.

We improved our digital services. That makes it easier for customers to do business with us. With our apps for iPhone, BlackBerry and Android handsets you can:

- get an up-to-the-minute balance;
- view a mini-statement with your last six transactions;
- make transfers between your Ulster Bank accounts;
- pay your friends, family, credit card, or utility bills; and
- locate your nearest Ulster Bank branch or cash machine.

Customers used the service almost 18 million times making 1.2 million payments worth £282 million.

Changing our culture
After the IT failure we ran Listening Groups with our people. We wanted to make sure that their views on what went well and what didn't could be incorporated into our future strategy.

Through our Culture and Engagement Team we listen to our people, take their feedback and use it to drive improvement.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	324	400
Impairment losses (£m)	(1,364)	(1,384)
Operating loss (£m)	(1,040)	(984)
Return on equity (%)	(21.8)	(22.8)

US Retail & Commercial

Ellen Alemany
Chief Executive,
Citizens and Head of Americas

Watch or listen to Ellen Alemany
www.rbs.com/AnnualReview

Operating profit of £754 million was £217 million (40 per cent) higher than in 2011. Total income increased by 2 per cent. Higher net interest income was driven by targeted commercial loan growth, deposit pricing and lower funding costs. Non-interest income was slightly higher despite a decline in debit card fees as a result of the Durbin Amendment legislation, lower securities fees and lower deposit fees. Expenses were 3 per cent higher, largely as a result of one-off items. Impairments fell sharply, by £235 million to £91 million. Return on equity was higher at 8.3 per cent. The loan to deposit ratio was broadly stable at 86%.

Making RBS safer

US Retail and Commercial continues to help make RBS a safer bank. We have delivered 12 straight quarters of operating profit and improving annual returns on equity. Our capital position is among the strongest in our peer group. For the first time since 2008, we were able to return capital to RBS Group.

We strengthened our balance sheet. Our loan to deposit ratio was 86% at year end and we have improved our deposit mix, adding core checking accounts while reducing more costly term and time deposits. Wholesale funding sources are greatly diminished.

Strong risk management remains a top strategic priority. We have a clearly defined credit risk appetite, driven by disciplined underwriting, which has led to consistently improving credit risk ratios. Asset quality has improved in all portfolios as evidenced by loss rates that are near or below pre-crisis levels.

Building a better bank that serves customers well

In Consumer Banking, our commitment to customers is clear in the investments we have made.

- We continued to upgrade our ATM network. The new “Intelligent Deposit Machines” provide customers with more convenience, including enhanced deposit capabilities.
- We enhanced our online and mobile services. Our iPhone and Android applications earned a combined 4.25 out of 5 rating from consumers. We tied for first in a ratings analysis of 25 large banks conducted by financial services consulting firm Javelin Strategy & Research.

Our deposit and credit products help customers achieve their goals. Through our branches we opened 455,000 new checking accounts in 2012.

We believe we can win and deepen customer relationships by delivering high levels of service. There is a dedicated team which continues to improve the customer experience. This team examines data from customer surveys, feedback and complaints. This allows us to identify trends and sources of issues. We are able to understand what has not worked for customers and fix it. In one example, customer feedback led us to cut the wait time between when we mail a customer’s debit card and the associated PIN.

We jumped eight spots in 2012 to number 10 in a survey of bank reputations conducted by American Banker, an industry publication.

In Commercial Banking, our goal is to help business customers grow and prosper.
We continue to improve client service and build strong relationships. The strategy is paying off. We were lead arranger in 109 deals, up from 83 in 2011. We are now within the top 10 arrangers of middle market syndicated debt transactions. These deals earned us more than $52 million in fees compared with $40 million in 2011. We are building our treasury management capabilities as well. Now, four out of five of our middle market credit clients also use our cash management products.

Changing our culture

People lost confidence in banks during the financial crisis. We have taken steps over the past few years to strengthen our culture, which we believe is the foundation of a good bank. In 2009, we launched our ‘back to basics’ strategy. It keeps us focused on our customers and what they want and need. Alongside it, we created a vision, purpose and credo, emphasizing customers, colleagues and community.

In 2012, we built on these foundations, adding five strategic priorities that make it clearer where we should focus our efforts. These priorities put ‘back to basics’ in words that connect with our colleagues.

Performance highlights	2012	2011
Operating profit before impairment losses (£m)	**845**	863
Impairment losses (£m)	**(91)**	(326)
Operating profit (£m)	**754**	537
Return on equity (%)	**8.3**	6.3

Markets

Peter Nielsen
Co-CEO, Markets

Suneel Kamlani
Co-CEO, Markets

Operating profit of £1,509 million was 68 per cent higher than in 2011. Income increased by 2 per cent and expenses were sharply lower, falling 16 per cent, with staff expenses down by 26 per cent. Return on equity was up on 2011 at 10.0 per cent.

Watch or listen to Peter Nielsen and Suneel Kamlani *www.rbs.com/AnnualReview*

Making RBS safer

We took significant steps to reduce risk.

- We reduced our third party assets from £312.6 billion to £284.4 billion and we cut risk-weighted assets from £120.3 billion to £101.3 billion.

Changes we made to the structure of our business to reduce risk.

- We moved out of the cash equities and equity risk trading businesses that had made losses.
- We transferred a substantial part of RBS N.V. to RBS plc. That made our structure simpler and reduced the capital we need to hold.

Improvements we made to internal controls make clear to our leaders that it is important to manage their teams effectively. We have improved oversight of our traders through better supervision and tighter checks and controls.

Building a better bank that serves customers well

Our job is to help clients find the money they need so that they can invest. Across Europe in 2012, we were the leading bank in supporting clients issuing investment grade corporate bonds, running c.£20 billion of issues of these bonds.

We:

- worked with the International Banking division to organise a £1 billion refinancing for the holiday company Center Parcs;
- helped to raise US$2.2 billion for Formula 1;
- we were a structuring adviser on a three-part hybrid bond, helping BG Group strengthen its capital structure, maintain its credit rating and diversify its funding;
- underwrote and arranged €700 million loan and £466 million fund raising to allow DS Smith to buy SCA Packaging to create Europe's second-biggest packaging company.

We are innovative. We helped UBS to raise US$2 billion. It was the first time the Swiss bank had issued contingent capital to institutional investors. We were the book runner on an offshore renminbi transaction for Veolia Environnement. This was the first renminbi transaction on Euronext Paris.

We received a number of awards for our client successes.

- The Euromoney Awards for Excellence named us Best Debt House in the UK.
- We were Best for Sterling Issues and Best for Liability Management in the Euromoney Primary Debt Survey.
- International Financing Review named us EMEA Structured Finance House of the Year for an unprecedented second year in succession.
- Euromoney FX Survey 2012 rated us number one for overall client service in the EMEA time zone.
- The Derivatives Intelligence Awards named us Interest Rate Derivatives House of the Year.

We recorded these achievements while creating Markets as a new division and reducing costs by £541 million. Our focus is now on serving clients in businesses where we have market-leading products.

Changing our culture

We are changing our culture in a number of ways.

- Proper conduct is a core principle for all our people. A continual emphasis on the need to 'do the right thing in the right way' is part of our drive to embed the right behaviours in our culture, and 'treating customers fairly' is a central principle in that culture
- We have changed how we manage people. The Accountability Review process ensures appropriate management of misconduct, including consequences for remuneration
- Diversity and Inclusion has been a key area for the Markets business.
- We launched the M&IB transformational leadership programme to develop leaders who are more agile, people-focused and commercially aware.

Performance highlights

	2012	2011
Operating profit before impairment losses (£m)	**1,546**	937
Impairment losses (£m)	**(37)**	(38)
Operating profit (£m)	**1,509**	899
Return on equity (%)	**10.0**	6.1

Direct Line Group

Paul Geddes
Chief Executive,
Direct Line Group

Operating profit of £441 million was £13 million, three per cent, lower than in 2011 as improved underwriting results were more than offset by a £22 million reduction in investment income. Total income of £3,474 million was £333 million, nine per cent, lower. Net claims of £2,427 million were £345 million, 12 per cent, lower. Expenses of £849 million were broadly flat. Return on tangible equity was higher than in 2011 at 11.7 per cent. The combined operating ratio improved by 100 basis points to 100 per cent.

Making RBS safer

We took several actions to make RBS safer and to make Direct Line Group more robust for its future.

- We successfully completed the sale of 35% of ordinary shares in Direct Line Group on the London Stock Exchange. Demand for our shares was strong.
- Direct Line Group's IPO raised £911 million for RBS Group.
- Our risk-based capital coverage ratio was 151.4% at the end of the year, compared with our target of 125-150%.
- Our Insurance Groups Directive (IGD) surplus was £1.8 billion and our IGD coverage ratio was 279.4%.

Direct Line Group manages its capital levels with the objective of maintaining a credit rating in the "A" range.

Building a better bank that serves customers well

Direct Line Group made dividend payments of £1 billion to RBS Group in 2012. We enhanced efficiency and improved pricing and underwriting.

We made progress on our aim of cutting costs by £100 million per year by 2014. We will achieve that through a range of actions and we have already announced half of those initiatives. These savings come on top of cutting the number of UK sites from 32 to 16. We achieved that by mid-2012.

We continued to roll out our claims transformation programme. It is a more efficient way of managing claims. Our new system for managing claims is handling 400,000 motor and own brand home claims.

One of our assets is the large amount of data we hold. We are using it to price products more accurately by understanding better still the risks we are taking.

We made significant progress in developing our distribution capabilities. The partnership agreements that we renewed or expanded represent a substantial portion of our portfolio, especially in the home segment.

- We expanded our agreement with Sainsbury's Bank. Now we provide its customers with home insurance as well as motor insurance.
- We agreed a distribution agreement with the UK Retail division that will last five years. That means we will continue to provide general insurance products when we are divested.
- We launched Churchill and Privilege on comparethemarket.com. That means their motor and home insurance products are available on the UK's four major price comparison websites. This reinforces our strategy of delivering products through a range of channels.

Changing our culture

We started The Best Programme in 2011, continuing it last year. It is our cultural transformation programme. The Best Programme focuses our people on how to achieve our ambition – to be Best for Customer, Best for Shareholder and Best for our People.

All of our employees were invited to take part in facilitated workshops as part of The Best Programme. These workshops engage our people and gather their ideas about how we can become 'Best'. Our state of the art internal social media site – Best Quest – allows open discussion and lets people post their ideas for the changes we need to make if we are to achieve our goals.

One of the most important outputs of the programme was the creation of a set of values, conceived and written by a team representing all our people – from the bottom up.

Performance highlights	2012	2011
Net premium income (£m)	3,718	3,969
Net claims (£m)	(2,427)	(2,772)
Operating profit (£m)	441	454
Combined operating ratio (%)	100	101
Return on tangible equity (%)	11.7	10.3

Business Services

Ron Teerlink
Group Chief Administrative Officer

Business Services are the people who keep RBS running. We put money in the ATMs, keep the Bank's technology systems operating, help keep our customers safe from fraud, process billions of pounds worth of payments across the world, and provide call centre and on-line services to customers.

The Bank faced one of its biggest technical challenges ever when we had some IT problems in June. We are sorry for the disruption it caused our customers. To support our customers through this difficult period we opened our branches for longer, doubled the number of staff in our UK-based call centres and gave them greater authority to provide on-the-spot help to support our affected customers.

Building a better bank that serves customers well

Business Services is behind many of the innovations that make life easier for our customers.

- During the year, we made further improvements to our mobile banking app which more than three million customers have used, making over £11 billion worth of payments and transfers.
- Our Pay Your Contacts feature allows customers to send instant payments of up to £300 to any of their phone contacts who have the NatWest or RBS app.

We helped our customers keep in touch with us and get access to their funds:

- Our helpdesks held over 1.2 million online web chats.
- We processed over 4.2 billion payments worldwide. That's 16.8 million transactions every day.

Changing our culture

Our flexible working programme, Choice is helping us optimise our work spaces. We are now in the Top 10 Employers for Working Families in the UK.

1.2m
online web chats

16.8m
transactions every day

4.2bn
payments processed worldwide

£11bn
worth of payments and transfers using the mobile app

Top 10
Employer for Working Families in the UK

Bruce Van Saun
Group Finance Director

Watch or listen to Bruce Van Saun
www.rbs.com/AnnualReview

Nathan Bostock
Head of Restructuring and Risk

Watch or listen to Nathan Bostock
www.rbs.com/AnnualReview

Elaine Arden
Group Human Resources Director

Central Functions

Group Finance
Group Finance is responsible for the external reporting of the Group's performance and financial position, including regulatory and central bank reporting. We manage the Group's capital, ensure compliance with tax regulations and support executive decision making through financial analysis. Our external reporting is highly rated by stakeholders.

The Treasury function drives efficient and prudent management of our balance sheet resources, playing a central role in the Group's participation in the UK Government's Funding for Lending Scheme in 2012.

Our Strategy and Corporate Finance function helps ensure RBS has the right portfolio of businesses, developing the Group's strategy and executing acquisitions and disposals. The team was instrumental in the successful Initial Public Offering of Direct Line Group.

Risk Management
Risk Management underpins the Group's reputation, performance and future success. We delivered risk appetite frameworks and the tool-kits to help staff implement them. These have helped embed the risk appetite statements agreed with the board in 2011. They help further to reduce the balance sheet and ensure that all divisions work within their agreed risk appetite.

Effectively embedding the risk appetite frameworks was central to convincing the Financial Services Authority and HM Treasury that we were strong enough to exit the Asset Protection Scheme.

Risk continued to influence the pay and reward process at senior levels through input to objective setting and performance feedback. There is risk assessment of incentive schemes and bonus pools, 360 degree feedback and performance management. This helps drive behavioural change. Our conduct risk policy will focus on behaviours and the "how" part of the way we do things.

Human Resources
During 2012, we recognised that if RBS is to become a really good bank, one that serves customers well, we would need to be much clearer to our people about our purpose, vision and values. Human Resources has led this work. While we have some way to travel, the pace of activity has been intense. By the end of 2012, 200 of our top leaders had participated in sessions to help establish what they will do to embed a culture that meets our aspiration of putting customers first. Human Resources supported the implementation of the Group's strategic plan, including the disposal of Non-Core businesses that are part of the wind down to make our balance sheet risk safe.

We simplified human resources policies in 2012. They are clearer and more accessible to our managers, who now know better what we expect of them.

Legal, Secretariat and Group Regulatory Affairs
Our Legal, Secretariat and Group Regulatory Affairs functions help to set the framework within which the Group can deliver sustainable returns. They operate commercially but retain their independence and professional judgement so they can drive a culture of legal and regulatory compliance and good governance to protect the Group's franchise.

Group Communications
Communications manages our relationships with external stakeholders and makes sure we keep our employees informed about developments in the business. RBS wants to be open to stakeholders and, during the year, Communications helped elected officials, commentators and others gain a better understanding of our business and our plans.

Non-Core Division

Rory Cullinan
Head of Non-Core Division

Watch or listen to Rory Cullinan
www.rbs.com/AnnualReview

Non-Core has reduced funded assets by over £200 billion to date. In 2012, funded assets reduced by £36 billion (39 per cent) to £57 billion and risk-weighted assets reduced by £33 billion (35 per cent) to £60 billion. An operating loss of £2.9 billion was £1.3 billion lower than 2011, partly due to a £1.7 billion reduction in impairments to £2.2 billion and a £351 million (27 per cent) reduction in costs. As a net result, the Division released capital back to the Group through the net impact of lowering risk-weighted assets, partially offset by a smaller pre-tax loss.

Making RBS safer

Non-Core aims to run down its portfolio in a capital efficient manner at a pace the Group can afford. We make RBS safer through reducing our funded assets, capital requirement, provisions, costs, losses and operational risk.

Non-Core has reduced its third party assets by over £200 billion since it was formed at the start of 2009. In 2012, we reduced third party assets by 39% to £57 billion. We disposed of £18 billion and negotiated run-off of £16 billion of funded assets during 2012. We also reduced our derivatives portfolio by 45% to £6 billion, down from £85 billion at the start of 2009.

Non-Core targets a balanced run-down of all the portfolio asset classes in parallel. For example, in 2012 Real Estate reduced by 30%, Markets by 48% and Corporates by 40%. Using diverse approaches across the portfolio gives us the flexibility to react to market conditions.

We completed a number of notable transactions across asset classes in 2012 including the sale of:

- RBS Aviation Capital to Sumitomo Mitsui Financial Group for approximately £5 billion, which also reduced RWAs by approximately £2 billion. The business is the world's fourth largest aircraft lessor by owned and managed fleet value, including a portfolio of 203 owned aircraft;
- two buildings in Frankfurt and Berlin to AXA Real Estate investment Management and Norges Bank Investment Management for €784 million;
- sale of £275 million securitised real estate loans. This transaction improved the funding of the partnership with Blackstone to manage a fund of £1.4 billion of UK loans that we announced last year;
- over £300 million leveraged assets through auctions; and
- our Reverse Mortgages Services business in Australia to Macquarie.

Non-Core reduced its capital requirement in 2012 through running down the portfolio and pursuing targeted capital management actions. We reduced risk-weighted assets by £33 billion (35%) over 2012 to £60 billion from £93 billion in 2011 and also undertook transactions to avoid or reduce the amount of additional capital that we will require following the implementation of the new Basel III rules, including the fourth Capital Requirements Directive.

We reduced our impairments again in 2012. This reflects the run-down of the portfolio and our recognition of impairments in prior years, as well as how we managed the remaining portfolio. We continue to remain cautious on our Ulster Bank real estate portfolios which accounted for 40% of the 2012 impairments.

We also reduced our cost base by £351 million (27%) and operational risk through reducing the scope and headcount of the Division, particularly through the completion of business exits such as RBS Aviation Capital.

Building a better bank that serves customers well

Non-Core releases capital back to the Group that can be used to support new Core lending and generate better returns on equity.

Changing our culture

We are helping to change the culture of RBS by addressing transparently the legacy of the past. We do that through:

- detailed analysis of the risks in the portfolio so we can mitigate them;
- making capital the prime driver of decision-making to ensure that the Division focuses on shareholder value;
- transparent accountability and responsibility for asset management; and
- maintaining rigorous controls over the management and run-down of the portfolio.

Performance highlights	**2012**	2011
Operating loss before impairment losses (£m)	**(656)**	(302)
Impairment losses (£m)	**(2,223)**	(3,919)
Operating loss (£m)	**(2,879)**	(4,221)
Risk-weighted assets (£bn)	**60.4**	93.3

Sustainability

Contents

Sustainability

We want to build a good company and a good bank. Sustainability is central to achieving this goal and to making sure that the misconduct of the past is not repeated.

Governance

Sustainability at RBS is built on a robust governance framework that provides clarity around the development of our strategic sustainability objectives. The Group Sustainability Committee (GSC) is a Group Board Committee, chaired by our Senior Independent Director, Sandy Crombie. It consists of independent non-executive directors and all key business areas are represented at Committee meetings and the Group Chairman is also invited to attend. The GSC has overseen some progressive developments within the company. In 2012, the GSC focused on reviewing the Group's overall sustainability strategy, values and policies and aligning the Group's approach to ethical, social and environmental issues. In 2013, the scope will widen to include sustainability and reputational issues related to customer and citizenship activities; oversight of the delivery of the Group purpose, vision and values cultural and behavioural change; and oversight of the sustainability aspects of the people agenda. The renewed GSC will also be responsible for overseeing and challenging how management is addressing sustainability and reputational issues relating to all stakeholder groups. For more information on the GSC or sustainability visit *rbs.com/sustainable*.

Stakeholder engagement

Balancing the needs of stakeholders means understanding the views of all those who have an interest in our business. As an international company we have many stakeholders and we engage with them in a variety of ways. These discussions inform decision making across the Group.

The GSC took part in three stakeholder sessions in 2012 on our themes of:

- Citizenship and environment;
- Supporting enterprise; and
- Employee engagement.

WWF, the Tax Justice Network, Transparency International, Big Issue Invest, the Confederation of British Industry and Unite are just a few of the groups that attended. These sessions are an open forum for organisations to present the issues they most care about to the senior people from RBS who sit on the GSC. We do not set the agenda. Others do that and we go out of our way to involve people who are highly and constructively critical of RBS. We will hold more of these sessions as a clear illustration of our commitment to our openness to stakeholders.

Sustainability policy development

Addressing risks arising from Environmental, Social and Ethical (ESE) issues is an integral part of meeting our commitment to becoming a more responsible business. Over the last two years we have updated and improved our policy framework. We increased the transparency and disclosure of our business risk appetite and developed ESE policies for four sensitive sectors: defence, oil and gas, mining and metals, and forestry. These policies have been fully implemented and follow a clear governance structure and decision making process involving divisional Reputational Risk forums throughout the business. New policies for the Power Generation and Gambling sectors are currently being implemented, with further sector-specific policies also being considered. ESE reviews involve an assessment of a company's commitment, capacity and track record in managing ESE risks. We assessed our clients and transactions against the relevant ESE risk criteria and found that our risk management systems are in good health. A web-based training tool on our ESE policies was launched in 2012. This training was compulsory for all staff working in the relevant divisions and can also be accessed by all RBS Group staff to ensure they understand the Group's ESE policies.

Our policy making also incorporates a number of voluntary global standards. We are members of the Equator Principles and follow its environmental and social impact assessment criteria in our Project Finance lending. We are also members of the UN Global Compact (UNGC) which brings companies together with UN agencies, labour organisations and civil society to support human rights, labour rights, the environment and anti-corruption. We adhere to the ten UNGC Principles and report against these each year.

A full sustainability update will be provided in our 2012 Sustainability Report, published in April 2013.

Sustainable Business Principles

Our Sustainable Business Principles set out sixteen separate commitments that underline our commitment to operating responsibly. They are a recognition that balancing the needs of all our stakeholders is the best way to deliver sustainable commercial success. The following table sets out some of the work we are doing to meet those commitments:

Principles	Measure of progress in 2012
Secure o Maintaining our financial health whilst meeting our responsibilities to customers, employees and suppliers o Keeping our customers' and employees' data and assets safe o Protecting against fraud and corruption	o Reportable major injuries decreased by 57% o 22% reduction in fraud losses in 2012 against a corresponding 1% increase in fraud cases, compared with 2011 o Eight million customers have downloaded our free online anti-fraud software o Over 95% of employees have received Anti-Money Laundering training
Supportive o Meeting our customers needs o Supporting sustainable and inclusive economic growth o Helping customers in financial difficulty	o 3,700 UK business customers facing financial difficulty were returned to mainstream banking o £3 million has been made available to organisations that help young people and women looking to start their own business o 90% UK business customer Relationship Managers have been accredited to help provide customers with further business expertise o We lent £2.7 billion to over 20,000 first time buyers in the UK
Open o Consulting with and listening to our stakeholders o Showing transparency in the way we run our business o Publicly communicating our efforts to be responsible and sustainable	o Our Group Sustainability Committee met with 14 different advocacy groups to discuss the issues that matter most to them o We continue to be open and transparent in our reporting. The 'Our financing of the energy sector' reports have provided industry-leading analysis since 2009 o The leadership of RBS has been pro-active in engaging with the media and our stakeholders to explain the role of RBS in society and how we are changing o We have increased the number of visitors to the rbs.com website by 50%
A Responsible Citizen o Working within both the letter and spirit of legislation and abiding by relevant codes of practice and voluntary standards o Supporting the communities we work in o Respecting human rights throughout our sphere of influence o Upholding environmental responsibility within the Bank, and through our customers and suppliers	o We are longstanding members and contributors to the development of the Equator Principles and UN Global Compact o We supported over 41,000 members of staff to take time off to support the communities in which we live and work o We have looked at ESE risk issues across a range of sectors and developed ESE appetite position staements for six of the more sensitive sectors o Our total scope 1 emissions were 66,586 and scope 2 emissions were 497,762 tonnes CO e (from Q4 2011 to Q3 2012), a decrease of 6% and 15% respectively compared with 2011
A Good Employer o Providing our people with the tools and support to do their jobs effectively and develop their skills o Valuing and promoting diversity in all areas of recruitment and employment o Rewarding our people fairly for their work	o In 2012, RBS was included in the Working Families top 10 Employers for quality of work-life balance o We continue to promote diversity through internal employee networks and the number of female executives and senior managers have both increased by 1% o We have reformed our remuneration policies to reflect a more appropriate approach to pay. Since 2009, the investment banking bonus pool has reduced by 70%

Directors' report and summary financial statement

Contents

Our Board

Chairman

Philip Hampton (age 59)
Date of appointment: appointed to the Board on 19 January 2009 and to the position of Chairman on 3 February 2009

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

External appointments
- Non-executive director of Anglo American plc

Board Committee membership
- Group Nominations Committee (Chair)

Executive directors

Group Chief Executive

Stephen Hester (age 52)
Date of appointment: appointed to the Board on 1 October 2008 and to the position of Group Chief Executive on 21 November 2008

Previously chief executive of The British Land Company PLC, chief operating officer of Abbey National plc and prior to that held positions with Credit Suisse First Boston including chief financial officer, head of fixed income and co-head of European investment banking. After nationalisation in 2008, he served as non-executive Deputy Chairman of Northern Rock plc.

External appointments
- Trustee of The Foundation and Friends of the Royal Botanical Gardens, Kew

Board Committee membership
- Executive Committee

Group Finance Director

Bruce Van Saun (age 55)
Date of appointment: 1 October 2009

Extensive leadership experience with 30 years in the financial services industry. From 1997 to 2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as vice-chairman and chief financial officer and before that was responsible for Asset Management and Market Related businesses. Prior to that he held senior positions with Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co. He has served on several corporate boards as a non-executive director and has been active in numerous community organisations.

External appointments
- Non-executive director of Direct Line Insurance Group plc
- Non-executive director of Lloyd's of London Franchise Board
- Non-executive director of Worldpay (Ship Midco Limited)

Board Committee membership
- Executive Committee

Independent non-executive directors

Sandy Crombie (age 64)
Senior Independent Director
Date of appointment: 1 June 2009

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

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

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

Alison Davis (age 51)
Date of appointment: 1 August 2011

Former director of City National Bank, First Data Corporation and chair of the board of LECG Corporation. She previously worked at McKinsey & Company, AT Kearney, as chief financial officer at Barclays Global Investors (now BlackRock) and managing partner of Belvedere Capital, a private equity firm focused on buy-outs in the financial services sector.

External appointments
- Non-executive director of Unisys Corporation
- Non-executive director, chair of compensation committee and member of audit committee of Diamond Foods Inc.
- Non-executive director, chair of audit committee and member of compliance committee of Xoom Corporation
- Chair of the Governing Board of Women's Initiative for Self Employment

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

Tony Di Iorio (age 69)
Date of appointment: 1 September 2011

Has worked for a variety of financial institutions starting with Peat Marwick (now KPMG) and then Goldman Sachs, ultimately as controller of the global firm. He was chief financial officer of the investment bank of NationsBank (now Bank of America) before joining Paine Webber and then Deutsche Bank where he became chief financial officer in 2006. After retiring in 2008 he served as senior adviser to Ernst & Young working with the firm's financial services partners in the UK, Europe, the Middle East and Africa.

External appointments
- None

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

Independent non-executive directors

Penny Hughes, CBE (age 53)

Date of appointment: 1 January 2010

Previously a director and chairman of the Remuneration Committee of Skandinaviska Enskilda Banken AB and a non-executive director of Home Retail Group plc and chairman of its Remuneration Committee. She spent the majority of her executive career at Coca-Cola where she held a number of leadership positions, latterly as President, Coca-Cola Great Britain and Ireland. Former non-executive directorships include Vodafone Group plc, Reuters Group PLC, Cable & Wireless Worldwide plc and The Gap Inc.

External appointments

- Non-executive director, chair of corporate compliance and responsibility committee and member of audit, nomination and remuneration committees of Wm Morrison Supermarkets plc
- Trustee of the British Museum

Board Committee membership

- Group Performance and Remuneration Committee (Chair)
- Group Nominations Committee

Joe MacHale (age 61)

Date of appointment: 1 September 2004

Held a number of senior executive positions with J.P. Morgan between 1979 and 2001 and was latterly chief executive of J P Morgan Europe, Middle East and Africa Region. Previously held non-executive roles at The Morgan Crucible Company plc and Brit Insurance Holdings plc and former Trustee of MacMillan Cancer Support. He is a Fellow of the Institute of Chartered Accountants.

External appointments

- Chairman of Prytania Holdings LLP
- Chairman of the Brendoncare Foundation
- Non-executive director of Huntsworth plc

Board Committee membership

- Board Risk Committee
- Group Nominations Committee

Brendan Nelson (age 63)

Date of appointment: 1 April 2010

Former global chairman, financial services for KPMG. Previously held senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 to 2006 and as vice chairman from 2006. Chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland from 2005 to 2008.

External appointments

- Non-executive director and chairman of the audit committee of BP plc
- Board member of Financial Skills Partnership
- Member of the Financial Reporting Review Panel
- Deputy President of the Institute of Chartered Accountants of Scotland

Board Committee membership

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

Baroness Noakes, DBE (age 63)

Date of appointment: 1 August 2011

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

External appointments

- Non-executive director and chairman of audit committee of Severn Trent plc
- Deputy chairman and senior independent director and chairman of the nominations committee of Carpetright plc
- Trustee of the Thomson Reuters Founders Share Company Ltd

Board Committee membership

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

Independent non-executive directors

Arthur 'Art' Ryan (age 70)
Date of appointment: 1 October 2008

Former chairman, chief executive officer and president of Prudential Financial Inc. Previously he held senior positions with Chase Manhattan Bank N.A. and was a founding member of the Financial Services Forum. He is a non-executive director of RBS Citizens Financial Group, Inc.

External appointments
- Non-executive director of Regeneron Pharmaceuticals Inc.
- Active member of numerous community boards

Board Committee membership
- Group Nominations Committee
- Group Performance and Remuneration Committee

Philip Scott (age 59)
Date of appointment: 1 November 2009

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

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

Board Committee membership
- Board Risk Committee (Chair)
- Group Audit Committee
- Group Nominations Committee

Group Secretary

Aileen Taylor (age 40)
Date of appointment: 1 May 2010

A qualified solicitor, joined RBS in 2000. She was appointed Deputy Group Secretary and Head of Group Secretariat in 2007, and prior to that held various legal, secretariat and risk roles including Head of External Risk, Retail, Head of Regulatory Risk, Retail Direct and Head of Legal and Compliance at Direct Line Financial Services.

She is a fellow of the Chartered Institute of Bankers in Scotland and a member of the European Corporate Governance Council.

Executive Committee

Stephen Hester, Group Chief Executive
Bruce Van Saun, Group Finance Director
For biographies see page 37

Ellen Alemany (age 57)
Chief Executive, RBS Citizens and Head of Americas

Ellen Alemany joined the RBS Group in June 2007 as Head of RBS Americas. She became Chief Executive Officer of RBS Citizens Financial Group, Inc. in March 2008 and Chairman in March 2009. Prior to these appointments, Ellen was the chief executive officer for Global Transaction Services at Citigroup, one of Citi's 12 publicly reported product lines. Ellen joined Citibank in 1987 and held various positions including executive vice-president for Commercial Business Group, chairman and chief executive officer for Citibank International plc and Citibank's European bank. She also served on the Citibank, N.A., Board of Directors. Ellen was elected to serve on the Board of Directors of Automatic Data Processing, Inc., beginning in January 2012.

Nathan Bostock (age 52)
Head of Restructuring & Risk

Nathan Bostock joined the RBS Group in June 2009. He is Head of Restructuring and Risk with responsibility for Risk Management, Legal & Regulatory Affairs and the Global Restructuring Group. Before joining RBS, Nathan spent eight years with Abbey National plc in several roles and was latterly the chief financial officer and main board director responsible for Products & Marketing, HR, Insurance and Cards. Before joining Abbey in 2001, Nathan spent ten years with RBS in a number of roles, including Chief Operating Officer of Treasury and Capital Markets and Group Risk Director. A Chartered Accountant, Nathan worked with Coopers & Lybrand, before starting his career in banking. He spent seven years in Chase Manhattan Bank in a variety of areas and functions. He also holds a BSc (Hons) in Mathematics.

Ross McEwan (age 55)
Chief Executive, UK Retail

Ross McEwan was appointed Chief Executive Officer for UK Retail in August 2012. Ross joined RBS from Commonwealth Bank of Australia where he was Group Executive for Retail Banking Services for 5 years and prior to that position Ross was Executive General Manager in charge of its branch network, contact centres and third party mortgage brokers. Ross has worked in the insurance and investment industries both in Australia and New Zealand for more than 25 years. He has extensive management experience having spent 18 years in senior executive roles including Managing Director of stockbroking business First NZ Capital Securities and Chief Executive of National Mutual Life Association of Australasia Ltd/AXA New Zealand Ltd. Ross holds a Bachelor of Business Studies, majoring in Industrial Relations & Personnel Management.

John Hourican (age 42)
Chief Executive, Markets & International Banking

John Hourican was appointed Chief Executive, Markets & International Banking in January 2012 having served as Chief Executive of its predecessor, Global Banking & Markets, since October 2008. Prior to this John held a variety of positions across the RBS Group. John is a fellow of the Institute of Chartered Accountants in Ireland and received a degree in Economics and Sociology from the National University of Ireland and a Postgraduate Diploma in Accounting from Dublin City University.

On 6 February 2013, the Group announced that John Hourican will leave the Group once he has completed a handover of his responsibilities. With effect from 1 March 2013, Suneel Kamlani and Peter Nielsen will be co-heads of the Markets division and John Owen will continue to lead the International Banking division and all will report directly to the Group Chief Executive.

Chris Sullivan (age 55)
Chief Executive, Corporate Banking

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

Ron Teerlink (age 52)
Chief Administrative Officer

Ron Teerlink joined the RBS Group in April 2008 as Chief Executive of Business Services, becoming the Group Chief Administrative Officer in February 2009. At the same time he was re-appointed to the Managing Board of ABN AMRO to oversee the integration programme. Ron started his career with ABN Bank in 1986 as an IT/Systems analyst and held various functional positions before becoming Chief Operating Officer of the Wholesale Clients Business in 2002. He was appointed Chief Executive Officer of Group Shared Services in 2004 and joined ABN AMRO's Managing Board in January 2006, where he was responsible for Services and Market Infrastructure. Ron holds a Masters degree in Economics from Amsterdam's Vrije Universiteit. Ron will step down from his role at RBS in the first half of 2013.

Management Committee

The Management Committee, comprising our major business and functional leaders, meets as required to review strategy and business performance.

It comprises members of the Executive Committee plus a number of other senior executives. Full details of membership of the Management Committee can be found on the Group's website www.rbs.com

Our approach to governance

"We remain committed to the highest standards of governance, integrity and professionalism throughout the Group."

Philip Hampton

Message from the Chairman

It has been a challenging year for the Group, and the banking sector as a whole, against a backdrop of difficult market conditions and a fast moving regulatory environment. We are fortunate to have engaged and dedicated Board members willing to commit extensive time, individually and collectively, to work towards the recovery of the Group and to build a sustainable business.

The Board has dealt with a very full agenda and key priorities during 2012 have been conduct risk and culture, the changing regulatory architecture and regulatory investigations. It is recognised that a real change is required in the culture of the banking industry and the Board is committed to driving the required change and setting the appropriate "tone from the top". The Board is fully engaged in the work to improve standards of behaviour within the RBS Group. We have also continued to drive the delivery of the Group's Strategic Plan and ensure the Group has sufficient capital and funding to make it safer and stronger for the long term. During 2013, the Board is expected to continue to focus on capital, funding and risk as well as delivery of the Strategic Plan.

Events like the IT incident in the summer of 2012 and investigations into LIBOR and Markets controls have increased significantly the workload of the Board during the year. The Board has demonstrated strong engagement and leadership in dealing with these matters, and Board committees have also taken a very prominent role, assuming responsibility for specific issues. As a result, the time commitment required from our non-executive directors is extremely onerous and I would like to thank both the executive and non-executive directors for their outstanding commitment and their contributions to the Board and committees in 2012.

Philip Hampton
Chairman of the Board of directors
27 February 2013

How does RBS comply with key corporate governance standards?
Throughout the year ended 31 December 2012, the company has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated June 2010 (the "Code") except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors.

The company considers that this is a matter which should rightly be reserved for the Board. This approach allows all non-executive directors, and not just those who are members of the Group Performance and Remuneration Committee, to participate in decisions on the executive directors' and the Chairman's remuneration and also allows the executive directors to input to the decision on the Chairman's remuneration. No director is involved in decisions regarding his or her own remuneration. We do not anticipate any changes to our approach on this aspect of the Code.

The company has also complied early with a number of the new provisions included in the new edition of the UK Corporate Governance Code issued by the Financial Reporting Council dated September 2012 (the "2012 Code"). A copy of both the Code and the 2012 Code can be found at www.frc.org.uk

The company has also implemented the recommendations arising from the Walker Review and has also complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in September 2012.

Under the US Sarbanes-Oxley Act of 2002, specific standards of corporate governance and business and financial disclosures apply to companies with securities registered in the US. The company complies with all applicable sections of the US Sarbanes-Oxley Act of 2002.

How has the structure and composition of the Board changed?
The Board currently comprises the Chairman, two executive directors and nine independent non-executive directors, one of whom is the Senior Independent Director. The Board functions effectively and efficiently and is considered to be of an appropriate size.

John McFarlane stepped down from the Board in March 2012. Whilst no new directors were appointed to the Board in 2012, changes were made during the year to the composition of Board committees. Baroness Noakes joined the Board Risk Committee, Art Ryan joined the Group Performance and Remuneration Committee and Alison Davis became a member of the Group Sustainability Committee. These committees have benefitted from the skills and experience of these directors.

Successful governance starts at the top

The Board is the main decision-making forum at Group level, setting the strategic direction of the Group and ensuring that the Group manages risk effectively.

The Board is collectively responsible for the long-term success of the company and is accountable to shareholders for financial and operational performance. The Board's terms of reference include key aspects of the company's affairs reserved for the Board's decision.

All directors participate in discussing strategy, performance and the financial and risk management of the company. Meetings of the Board are structured to allow sufficient time for consideration of all items and the Chairman encourages constructive challenge and debate.

The roles of Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated by the Board. There are a number of areas where the Board has delegated specific responsibility to management, including responsibility for the operational management of the Group's businesses as well as reviewing strategic issues and risk matters in advance of these being considered by the Board and/or its committees.

The directors provide the Board with the mix of knowledge, skills and experience required. The Board committees comprise directors with a variety of relevant skills and experience so that no undue reliance is placed on any individual.

The non-executive directors combine broad business and commercial experience with independent and objective judgement. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership across the Group's business activities.

Is there a boardroom diversity policy?

The Board remains supportive of Lord Davies' recommendations on diversity and currently meets the target of 25 per cent female board representation. The Board operates a boardroom diversity policy and the search for Board candidates continues to be conducted with due regard to the benefits of diversity on the Board. However, all appointments to the Board are based on merit and the skills and experience the individual can bring to the Board.

How often are directors re-elected?

In accordance with the provisions of the Code, all directors of the company are required to stand for re-election annually by shareholders at the company's Annual General Meeting. Further information in relation to the company's Annual General Meeting can be found in the Chairman's letter to shareholders that accompanies the notice of meeting.

How often does the Board meet?

There were nine scheduled Board meetings during 2012. In advance of each Board meeting, the directors were supplied with comprehensive papers in hard copy and/or electronic form. At each Board meeting the Chairman provided a verbal update on his activities and external engagement and the Group Chief Executive provided a written report on business activities. In addition to the scheduled meetings, 28 additional meetings of the Board and committees of the Board were held.

What is the role of the Board committees?

The Group Audit Committee is comprised of at least three independent non-executive directors and assists the Board in discharging its responsibilities for the disclosure of the financial affairs of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit and reviews the practices of the Divisional Risk and Audit Committees.

The Board Risk Committee is comprised of at least three independent non-executive directors. It provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's performance on risk appetite and oversees the operation of the Group Policy Framework.

The Group Performance and Remuneration Committee is comprised of at least three independent non-executive directors and has oversight of the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on remuneration of executive directors.

The Group Nominations Committee comprises all of the non-executive directors, and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

The Group Sustainability Committee comprises of independent non-executive directors and is chaired by the Senior Independent Director. It is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

The Executive Committee is responsible for managing Group-wide issues and those operational issues that affect the broader Group. It reviews strategic issues and initiatives, monitors financial performance and capital allocations and considers risk strategy, policy and risk management.

How do the Committees interact?

The Chair of each committee reports back to the Board on matters raised at committee meetings to ensure that other Board members are kept appraised of the areas considered by each committee. Additionally, agendas for committee meetings are circulated to all directors for information.

How do the directors get the information they need to fulfil their roles properly?

All directors receive accurate, timely and clear information on all relevant matters and have access to the advice and services of the Group Secretary who is responsible to the Board for ensuring that Board procedures are followed and for advising on all governance matters. In addition, all directors are able, if necessary, to obtain independent professional advice at the company's expense.

Members of the executive management team attend and make regular presentations at Board meetings to give the directors greater insight into business areas. Additionally, the Group Audit Committee and Board Risk Committee undertake an annual programme of visits to the Group's business and control functions. An invitation to attend is extended to all non-executive directors.

Board induction and continuing professional development

In line with the recommendations of the Walker Review and the Code, the Group has a comprehensive induction programme for new directors that is kept under review by the Group Secretary. Each new director receives a formal induction on joining the Board, including visits to the Group's major divisions and meetings with directors and senior management and key stakeholders. Each induction programme includes a mandatory element and the remainder of the induction is tailored to the new director's specific requirements.

As part of their ongoing professional development, directors are advised of appropriate external training and professional development opportunities and undertake the training and professional development they consider necessary to assist them to carry out their duties as directors. Internal training is also provided, tailored to the business of the Group.

How does the Board review its performance?

The Board reviews its performance annually. An external evaluation of the Board takes place every three years and an internal evaluation takes place in the intervening years. The 2011 evaluation was conducted internally by the Group Secretary and the recommendations from the 2011 evaluation have been implemented in full.

In 2012, the Board and Committee evaluation process was independently facilitated by IDDAS Limited, a specialist board evaluation consultancy that has no other connection with the Group. IDDAS Limited undertook the evaluation using a detailed framework of questions to structure individual meetings held with each director. Amongst the areas reviewed were Board structure, membership (including diversity) and processes, Board committees, director competence, independence and behaviour. The 2012 performance evaluation has concluded that the Board and Board committees are operating effectively.

Letter from the Chairman of the Group Audit Committee

Letter from Brendan Nelson,
Chairman of the Group Audit Committee

Dear Shareholder

External market conditions have continued to be difficult and managing the intensity of the regulatory agenda while remediating existing and certain new issues has inevitably determined the focus of the Group Audit Committee during 2012. However, I am pleased to report that against this challenging backdrop, the Committee continued to meet its key objectives in the period in accordance with its terms of reference.

The Group Audit Committee exercised oversight of the Group's financial reporting and policy. It monitored the integrity of the financial statements of the Group and reviewed significant financial and accounting judgements. The Committee sought to understand and to challenge management's accounting judgements and satisfied itself that disclosures in the financial statements about these judgements and estimates were transparent and appropriate. The Group Audit Committee also met the External Auditors in private in advance of key meetings in order to obtain an independent view on the key disclosure issues and risks in relation to the financial statements.

In particular, the Committee has considered:

- the directors' going concern disclosure including the Group's capital, liquidity and funding position;
- the adequacy of the Group's loan impairment provisions, focusing particularly on the Ulster Bank loan portfolio and commercial real estate exposures;
- the impact of the Group's forbearance policies on provisioning;
- the Group's valuation methodologies and assumptions for financial instruments measured at fair value;
- the adequacy of the Group's general insurance reserves;
- valuation of the Group's defined benefits pension schemes;
- carrying value of the Group's goodwill and other intangible assets;
- the recoverability of the Group's deferred tax assets;
- the methodology and assumptions underlying the Group's provisions for payment protection insurance and interest rate hedging products redress;
- the Group's provisions for outstanding litigation and regulatory investigations; and
- the impact of the announcement that Santander would not complete its planned purchase of certain UK branch-based businesses.

The Group Audit Committee continued to encourage enhancements to the disclosures in the Group's external financial reports. Revised versions of the UK Corporate Governance Code and related Guidance for Audit Committees were issued by the Financial Reporting Council in September 2012. The Committee considered the new requirements and has endeavoured to comply early, where appropriate to do so. The Committee also considered the recommendations of the Enhanced Disclosure Task Force of the Financial Stability Board and the Group's plans to meet the recommendations. I am pleased to report that several of the Group's disclosures were highlighted within the report as examples of best practice.

A key responsibility of the Committee is to monitor and review the scope, nature and effectiveness of Internal Audit. As in previous years, I met regularly with the Head of Group Internal Audit. The Committee also held two in depth sessions with Group Internal Audit. These additional meetings enabled the members of the Committee to be briefed on Group Internal Audit's strategy under the leadership of Nicholas Crapp, who joined the Group at the start of the year, and to meet the senior management team. The Committee ensured that the Head of Group Internal Audit has appropriate independence and authority; that the scope of Internal Audit is unrestricted; that planning is appropriately risk based; and that the function has the requisite budget and resource strategy. The Head of Group Internal Audit has a direct reporting line to me and I will continue to work closely with him as we seek to strengthen further the function during 2013.

The Committee also monitored and reviewed aspects of the Group's external audit in the period. It reviewed the scope and planning of the external audit and considered reports and recommendations from the External Auditors. It monitored the External Auditors' independence and objectivity and ensured effective controls were in place to oversee engagements for the External Auditors to provide non-audit services. The Committee undertook an assessment of the External Auditors' performance and recommended to the Board that re-appointment of the External Auditors be submitted to shareholders for approval at the Annual General Meeting in 2013.

During 2012, I met with the FSA and with the External Auditors on a trilateral basis as envisaged by the FSA Code of Practice. The purpose of this meeting was to discuss, in the framework of an open and cooperative relationship between the supervisor and the External Auditors, issues considered to be of interest to the parties in meeting their respective responsibilities. This meeting formed part of the Committee's oversight of the Group's relationship with its regulators.

The Committee reviewed the Group's systems of internal controls and the procedures for monitoring their effectiveness. The Committee placed particular focus in 2012 on ensuring that the Group had articulated an appropriate three lines of defence model that clearly stated individuals' responsibility and accountability for risk and control at all levels. This model is expected to be fully embedded in 2013 and the Group Audit Committee will closely monitor delivery within the divisions and functions.

Litigation and regulatory investigations featured heavily on the agenda of both the Group Audit Committee and Board Risk Committee in the period, highlighting some deficiencies in the control environment. During 2012 the Board asked the Group Audit Committee to monitor progress of the internal and various ongoing regulatory investigations and claims based on allegations that the Group had made inappropriate submissions to influence the setting of interest rates. The Committee met regularly to receive updates on the investigations, including on an ad hoc basis. It worked closely with the Group Performance and Remuneration Committee to make decisions and recommendations in relation to individual accountability.

The implications for the Group's culture and control environment were considered in light of this and other ongoing investigations. The Committee in particular, reviewed proposed enhancements to the culture and control framework in the Markets and International Banking divisions. It has monitored the implementation of remedial action in the Markets business and has overseen liaison with the Group's regulators. Independent assurance has been obtained regarding the comprehensiveness and timeliness of plans. The Committee is confident that the change programme will result in genuine behavioural change across the business as well as robust and sustainable control remediation. It will closely monitor implementation of these plans in 2013.

Inevitably, the challenges that have arisen during the year have meant that members have had to dedicate some considerable time to the work of the Committee. I would like to extend my thanks to my fellow Committee members for their continued dedication and support throughout 2012.

Brendan Nelson
Chairman of the Group Audit Committee
27 February 2013

Letter from the Chairman of the Board Risk Committee

**Letter from Philip Scott,
Chairman of the Board Risk Committee**

Dear Shareholder,

I report to you following another challenging twelve months for the Board Risk Committee. The already demanding schedule of the Committee was intensified in the period by a number of significant issues, most notably the IT incident that occurred in June 2012. The Board Risk Committee has undertaken, on behalf of the Board, to review the cause, consequence and subsequent management of the IT incident which had such unacceptable consequences for many of our customers. As a priority, the Committee has overseen remediation and has sought to ensure appropriate redress for customers. It will continue carefully to oversee management of residual technology risks and will ensure communication with our regulators and stakeholders on conclusion of the internal and external investigations of the incident, as appropriate.

While 2012 has presented significant challenges, there has also been a great deal of progress on the development and implementation of risk and control throughout the organisation. The Board Risk Committee has been pleased to exercise an oversight role in the development and enhancement of the risk management framework and associated tools that support the Group's aim of being a safer and more sustainable bank. The Committee has provided input into the Group's risk strategy and objectives during 2012 and has overseen the refinement and further embedding of the Group's framework into the business divisions. This has enabled the Committee to gain an improved understanding of the major risks which the Group faces, including market risk, conduct risk, country risk, credit risk (including single name concentrations and sector risk) regulatory risk and operational risk and to ensure robust plans are in place to manage excess exposures. The Group's stress testing capabilities have been developed and are now being used within business as usual as an effective strategic planning and capital management tool.

The Board Risk Committee has supported the articulation of a conduct risk appetite statement which is being embedded strategically within the Group's Policy Framework. Conduct Risk standards are being communicated to staff using the four pillars of conduct risk, employee conduct, market conduct, corporate conduct and conduct towards customers. The Committee will monitor implementation of these enhanced standards during 2013.

Enhancements to risk reporting have continued in the period to ensure that reports are insightful and relevant, and provide more metric based information. Data quality is, of course, critical to the accuracy of reporting and the Committee has received in depth updates on the progress of data quality programmes and reporting initiatives ongoing throughout the organisation, most notably the Finance and Risk Transformation Programme.

However, inevitably risk management tools and measures can only take the organisation so far. The future success of RBS depends upon the correct culture and approach that places the customer at the forefront of all decision making. The Board Risk Committee is fully supportive of the measures being developed to engender the correct behaviours at all levels within the RBS Group. The Committee has worked closely with the Group Performance and Remuneration Committee over the past 12 months to consider issues relating to individual accountability and responsibility for legacy and new issues. Where appropriate, recommendations have been made to the Group Performance and Remuneration Committee in relation to risk performance and reward. Culture, including the role of financial incentives and reward, will continue to be a priority of the Committee during 2013.

The members of the Committee have dedicated significant additional time to the consideration of risk issues during 2012 and I would like to thank them for their dedication and commitment. The business of the Committee is set to be no less demanding in 2013. The creation of the Prudential Regulatory Authority and the Financial Conduct Authority as part of the UK's twin peaks regulatory framework will be a major influence and the Group will have to adapt to the new regulatory approach and work closely with regulators to implement changes to standards and reporting where required.

Philip Scott
Chairman of the Board Risk Committee
27 February 2013

Summary remuneration report

Letter from Penny Hughes
Chair of the Group Performance and Remuneration Committee

Dear Shareholder

There is no doubt that 2012 has been another challenging year and events such as attempts to manipulate LIBOR and the IT incident have had a direct impact on the Group, both from a financial and a reputational point of view. The Board has acknowledged the serious shortcomings in systems and controls which were uncovered as part of the investigations into LIBOR and deeply regrets the lack of integrity shown by a small group of employees.

I would like to assure you that the Committee has spent a great deal of time challenging and taking action in response to past events and considering how remuneration can help to drive appropriate behaviours at RBS in future. Individuals found culpable in relation to LIBOR have left the Group with no annual incentive awards for 2012 and full clawback of outstanding awards. The Committee has also taken action across the Group, particularly in the Markets division, to account for the reputational damage of these events.

Against this backdrop, we should not lose sight of the fact that the vast majority of employees at RBS continue to do their jobs well and are not responsible for the events that have made headlines. Around one third of our employees joined after the financial crisis. During the IT incident, there was a very positive illustration of the loyalty and determination of staff to support customers during a difficult and regrettable period. It is vital that we retain and motivate good people as the foundation upon which we will generate a valuable business for shareholders and a bank that society can respect.

Considerable progress has been made over the past four years and the Committee remains focused on delivering remuneration structures that complement our goal of rebuilding a safer and more sustainable business, capable of serving customers and shareholders well in the long term. It is a difficult but important balance that we are trying to achieve, reducing overall spend on pay and increasing accountability whilst nurturing the business from which future profits can flow. We have sought to strike this balance fairly, whilst demonstrating our ongoing commitment to restraint, reflecting the nature of our ownership.

I have set out below a summary of how the Committee approached the year: how performance has been assessed; the decisions that have been reached on pay for 2012 and how past mistakes have been taken into account; and changes that we are making to ensure a fair and transparent remuneration policy.

Review of Group Performance

A number of significant milestones were reached during the year as part of the Group's turnaround plan including:

- Repayment of the liquidity support to UK Government in May 2012;
- The successful flotation of more than one third of our stake in Direct Line Insurance Group plc in difficult market conditions; and
- The exit from the Asset Protection Scheme in October 2012.

Key financial achievements for 2012 were:

- Core Operating Profit of £6.3 billion, which represents a strong performance;
- Further significant progress in removing Non-Core assets, a key part in managing down legacy issues. Non-Core third party assets are down £36 billion in 2012 to £57 billion, representing 92% progress towards the 2013 target of c.£40 billion;
- Capital, funding and liquidity positions remain robust with key performance indicators (KPIs) on short-term wholesale funding, liquidity portfolio, leverage ratio, Core Tier 1 capital ratio and loan:deposit ratio all exceeding or in line with medium-term targets;
- Core Return on Equity (ROE) was 10%, with Retail & Commercial ROE at 10% or 14% excluding Ulster Bank. The ROE for Markets was 10% in challenging market conditions;
- Group expenses were 6% lower than in 2011 with staff costs down 6%; and
- Impairment losses totalled £5.3 billion, down 29% from 2011.

As well as financial achievements, the Committee takes into account performance against a broader range of objectives, including support to customers. For example, in 2012 the Group accounted for 36% of all Small and Medium Enterprises (SME) lending, compared with its overall customer market share of 24%. The Group advanced £16 billion of UK home loans, including £3 billion to first time buyers. Using the Bank of England's Funding for Lending Scheme the Group has offered lower interest rates and waived arrangement fees on certain SME loans, benefiting over 11,000 SMEs in the second half of 2012.

Decisions made on pay

In addition to financial and non-financial measures, the Committee applies a rigorous accountability review process in determining pay outcomes. This framework enables us to claw back awards made in previous years where current or new information would change the decisions made in previous years. The review considers not only financial losses but also behavioural and reputational issues that have arisen.

Whilst the Group made significant progress across a range of measures in 2012, the Committee, in conjunction with the Board, agreed that the reduction to shareholder value and reputational damage caused by incidents such as the LIBOR settlement should result in a reduction of this year's variable pools and the application of clawback. Further details of the impact of these incidents on remuneration is set out on page 341 of the 2012 Report and Accounts. Some of the key outcomes on pay are as follows:

- Total variable compensation has been reduced from 2011 by 14% at a Group level and 20% for Markets (the reductions are 23% and 40% respectively after the application of clawback) as further evidence of the action that has been taken to bring down overall levels of pay;
- Variable compensation (pre clawback) as a percentage of operating profit before variable compensation decreased from 28% to 16% for 2012 for the Group and from 25% to 16% for Markets. Full details can be found in Note 3 to the consolidated accounts on pages 379 and 380 of the 2012 Report and Accounts;
- Since 2010, total variable compensation for the Group has been reduced by over 50%;
- Within the context of reduced variable pools, incentive awards continue to be targeted towards high performers and, as a consequence, 40% of employees eligible for an award will receive zero for 2012;
- Of those employees who do receive an award for 2012, 68% will receive less than £2,000 in total and 81% will receive less than £5,000; and
- Average salary increases across the Group for 2013 will be less than 2%.

The CEO, Stephen Hester, will not receive any salary increase in 2013. In addition, he decided during the year that it would not be appropriate for him to be considered for any annual incentive award. Whilst respecting his decision, I would like to put on record that the Committee believes the CEO continues to demonstrate strong performance and leadership. The Committee receives regular encouragement from institutional shareholders to improve the delivery of market competitive remuneration to the CEO.

Enhancements to remuneration policy

The Committee continues to recognise the importance of driving cultural change both in terms of pay and in a wider sense. As Chair, I am actively involved in a number of initiatives relating to diversity, graduate recruitment and management development and many of these initiatives have received award-winning recognition.

It is clear that challenges remain in rebuilding the reputation of banks but progress has been made in evolving the culture of RBS. Our remuneration policy underpins this work by encouraging appropriate behaviours and adjusting for risk. Examples of enhancements are as follows:

- Simplification of sales incentives with a broad move to a balanced scorecard type approach focused on customer service and risk;
- All executives and Code Staff have culture included as part of their 2013 objectives supported by quantitative and qualitative measures;
- Full review of balanced scorecard metrics, supported by independent control function review in advance of variable pools being agreed;
- This year, all our employees will be paid salaries at or above the Living Wage; and
- Shareholding requirements for the executive directors have been strengthened and new requirements introduced for senior executives to better align their interests with those of shareholders.

We will continue to monitor external developments and, where appropriate, refine our remuneration policy, for example in light of the requirements of CRD IV.

Enhancements to remuneration governance and reporting

In recognition that the Committee considers issues wider than just remuneration, the name of the Committee was changed to the Group Performance and Remuneration Committee. This reflects the Committee's broader oversight role to consider performance in the round in supporting the Group's purpose, vision and values aspirations. During 2012, the Committee has worked closely with the Board Risk Committee and Group Audit Committee, both of which have provided valuable input on key risk and control issues.

Changes have been made to this report in line with a number of anticipated government reforms on remuneration reporting. The Remuneration Governance section covers the activities and decision-making process of the Committee; the Policy Report covers future remuneration policy; and the Implementation Report demonstrates how pay arrangements have been implemented over the past year.

As in previous years, we have consulted with our major shareholders, including UKFI, on remuneration matters. I would like to thank those shareholders who continue to recognise and support our efforts to reform remuneration practices at RBS. In this turnaround period where it has not been possible to pay ordinary dividends to shareholders, this support on pay decisions has been an essential part of our restructuring programme.

Finally, I would also like to thank my fellow Committee members for their expertise and guidance and all those who have supported the Committee in its efforts to make fair and appropriate judgements.

Penny Hughes
Chair of the Group Performance and Remuneration Committee
27 February 2013

Summary of remuneration policy for executive directors for 2013

The remuneration policy for executive directors follows the Group-wide policy applicable to other employees but with greater emphasis on variable performance-related pay. This is to ensure that delivery of total remuneration to executive directors is more dependent on performance and can only be achieved if specific strategic targets and other measures are met. The structure of remuneration for executive directors involves greater delivery in shares in order to align further their reward with the long-term interests of shareholders. A summary is set out below:

Element of pay	Operation	Maximum potential	Performance metrics and period	Changes to policy since last approved
Base salary	Reviewed annually and considered against annual market data and in the context of wider Group increases.	Rate at 1 January 2013: Stephen Hester: £1,200,000 Bruce Van Saun: £750,000	N/A	A 2% increase to the salary of Bruce Van Saun to £765,000 with effect from 1 April 2013.
Annual incentive	Any annual incentive to be awarded entirely in shares. Shares vest in two equal tranches on the first and second anniversary of the date of grant. Provision for clawback prior to vesting. Additional six month holding period post vesting.	Normal maximum: 200% of base salary Exceptional maximum: 250% of base salary	Balanced scorecard of KPIs measured over the financial year. KPIs are: • Strategic progress; • Business delivery and financial performance; • Risk and control; • Stakeholder management; and • People management See page 52 for further details	No change.
Long-term incentive	Awards granted over shares which vest at the end of a three year period subject to performance conditions being met. Provision for clawback prior to vesting. Additional six month holding period post vesting.	Maximum under plan rules is 400% of salary. 2013 LTIP awards will be granted subject to an overall cap of 300% of salary at grant. Each of the four performance elements has the potential to deliver shares worth 100% of salary at grant. However, there is an overall cap on vesting equivalent to 300% of salary at grant. The notional value of these awards would be 45% of face value, which is 135% of salary.	Performance conditions measured over three financial years. Performance measures and relative weightings are: • Core Bank Economic Profit - 25% • Total Shareholder Return (TSR) relative to comparator group of international banks - 25% • Balance sheet and risk - 25% • Strategic scorecard - 25% • Financial and risk performance underpin. The LTIP measures have been selected in consultation with shareholders. The objective is to have a balanced range of measures that encourage the building of a safer, stronger and more sustainable business. See page 53 for further details on the measures.	No change.
Benefits (including pension)	Flexible benefits opportunity as for all employees. Pension allowance. Opportunity to sacrifice salary into defined contribution pension scheme.	Pension allowance of 35% of salary.	N/A	No change.

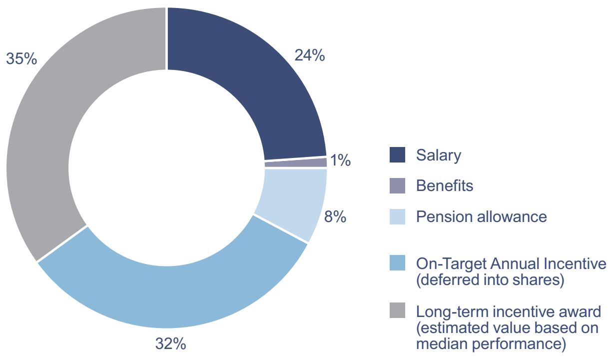
Directors' shareholding requirements

During 2012, the Committee agreed that it would be appropriate to strengthen the shareholding requirements for executive directors and to introduce new shareholding requirements for members of the Group's Executive Committee. The target shareholding level for the Group Chief Executive is 250% of salary and 125% of salary for other executive directors and members of the Group Executive Committee, in each case excluding any unvested share awards in the calculation. A period of five years is allowed in which to build up shareholdings to meet the required levels. To date, the executive directors have not sold any shares that they have received under the Group's share plans, other than to meet tax liabilities on vesting.

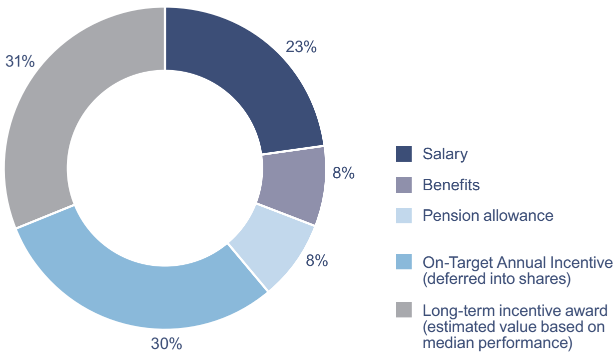
The mix of executive directors' remuneration

The charts below show the composition of remuneration opportunity for on-target annual performance, with the long-term incentive awards shown at median performance vesting. Annual incentive payments earned in relation to 2013 performance will be deferred and will vest, subject to satisfactory performance. The actual value of the long term incentive awards will depend on performance over the period 2013 to 2015 and the share price at the time the awards vest.

Group Chief Executive - Stephen Hester

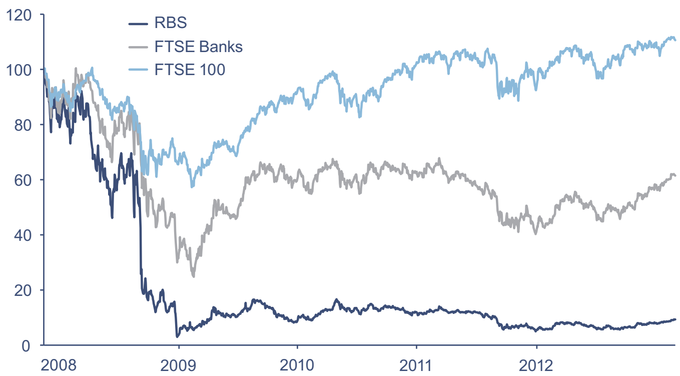


Group Finance Director - Bruce Van Saun



Total Shareholder Return performance

The graph below shows the performance of the company over the past five years in terms of TSR compared with that of the companies comprising the FTSE 100 Index. This index has been selected because it represents a cross-section of leading UK companies. The TSR for FTSE banks for the same period has been added for comparison. The TSR for the company and the indices have been rebased to 100 for 1 January 2008. The second graph shows the same performance of the company during 2012.



Implementation of the Group's recovery plan started in January 2009 with the publication of the preliminary 2008 losses. The share price reached a closing low point of 10.3p per share (103p per share on a post share consolidation basis) on the news.

From January 2009 to 27 February 2013, the day the Group's 2012 results announcement was approved, the Group's share price has risen 237% which compares to 104% and 55% respectively for the FTSE banks index and the FTSE 100 index as a whole.

RBS shares had a strong start and outperformed the market for the majority of the first half of the year partly due to a continuing reduction in size and de-risking of non-core helping to re-balance the balance sheet and the announced re-structuring of our investment bank. The Eurozone economies were in focus throughout the year in terms of concerns over their financial health and stability. Fiscal instability within peripheral Eurozone countries, particularly Spain and Greece, increased investor concerns on UK and European banks and their exposure to these countries. This impacted the RBS share price in line with other UK and European peers. Towards the end of the year sentiment on the Eurozone improved, with RBS shares outperforming the market.

Summary remuneration report *continued*

Annual incentive awards - performance criteria for 2013

The executive directors' annual performance objectives, as set out below, are approved by the Committee. The risk objectives are reviewed by the Board Risk Committee.

Core objectives	Stephen Hester	Bruce Van Saun
Strategic progress	Revise original Strategic Plan to respond to significant changes in the macro environment. Deliver execution of revised strategy including focus on brand values and fair outcomes for customers. Develop strategy for implementation of ring-fencing. Progress plans towards Government exit.	Monitor and improve the Group and divisional strategic plans. Drive effective design and implementation of revised plan.
Business delivery and financial performance	Lead delivery of overall performance, including measures relating to ROE, cost management, Core Tier 1 capital ratio, funding and risk profile, lending, and EU mandated disposals.	Ensure statutory, regulatory and management reporting is compliant with all external and internal standards. Continue to improve 'best in class' external reporting. Provide strong Group Finance Director role to the business through strategic planning, budgeting, forecasting and reporting. Monitor and control Group budget. Ensure a robust capital and funding planning framework. Drive efficiency. Successful further Direct Line Insurance Group plc 'selldown' and re-plan of EU mandated branch disposals.
Risk and control	Delivery of measures relating to wholesale funding reliance, liquidity reserves and leverage ratio. Further progress on risk appetite, risk frameworks and conduct risk, in support of the continued culture change across the Group.	Progress on key risk requirements. Implementation of effective regulatory changes impacting capital, funding, and liquidity. Improve quality of risk and financial data. Continue development of Group Internal Audit function.
Stakeholder management	Achievement of customer performance measures. Build/maintain strong and effective relationships with external stakeholders, including senior leaders in the new UK regulatory framework.	Continue to develop effective external relationships, including investors, rating agencies and regulators.
People management	Ensure each division/function has a people plan. Embed the Group's purpose, vision and values through high quality leadership teams. Build talent management and performance management. Maintain leadership and employee engagement as measured by the employee survey.	Lead upgraded team and build positive culture and sense of purpose. Contribute to overall Group management. Partner colleagues in leading the Group's purpose, vision and values to support culture change.

The Committee will determine the actual value of any award by reference to the extent to which executive directors have met the performance targets. Awards will be paid entirely in shares and will vest in two equal tranches on the first and second anniversaries of the date of grant. Clawback provisions will apply prior to the vesting of the shares. An additional six month holding period will apply post vesting.

LTIP awards - performance criteria for awards to be granted in 2013 and due to vest in 2016

Awards that will be granted to executive directors in 2013 will be subject to four performance categories, each with equal weighting. These are set out below.

Core bank economic profit (25%)

The Economic Profit measure is focused on the Core bank to ensure that performance reflects enduring earnings for the bank. Economic Profit, being a risk-adjusted financial measure, is consistent with the FSA Code and also provides a balance between measuring growth and the cost of capital employed in delivering that growth. Core bank Economic Profit is defined as Core bank Operating Profit after Tax less attributed equity multiplied by the cost of equity, where:

Core bank Operating Profit after Tax is Core Operating Profit taxed at a standard tax rate.

Attributed Equity is defined as equity allocated to the Core businesses, calculated as a function of the Core businesses risk-weighted asset base.

Current Cost of Equity is 11.5%, which is subject to review at least annually.

Details of the actual targets, and performance against these, will be disclosed retrospectively once the awards vest.

Relative Total Shareholder Return (25%)

The relative TSR measure provides a direct connection between executive directors' awards and relative performance delivered to shareholders. The measure compares the Group's performance against a group of comparator banks from the UK and overseas, weighted towards those companies most similar to the Group. Performance is measured over a three year performance period.

Relative TSR Comparator Group

		Weighting
1	Barclays	200%
2	Lloyds Banking Group	
3	HSBC	150%
4	Standard Chartered	
5 to 20	Bank of America, BBVA, BNP Paribas, Citigroup, Credit Agricole, Credit Suisse Group, Deutsche Bank, JP Morgan Chase, National Australia Bank Limited, Royal Bank of Canada, Santander, Societe Generale, The Toronto-Dominion Bank Group, UBS, Unicredito, Wells Fargo & Company	50%

- 20% of the award will vest if the Group's TSR is at the median of the companies in the comparator group.
- 100% of the award will vest if the Group's TSR is at the upper quartile of the companies in the comparator group.

Balance Sheet & Risk (25%)

The Balance Sheet & Risk measures have a particular focus on risk reduction, the resolution of the Non-Core business and the building of a sustainable and responsible franchise for the Group.

Strategic Scorecard (25%)

The balanced Strategic Scorecard rewards management for delivering a robust basis for future growth in terms of the strength of our franchise, efficiency, reputation, and the engagement of employees.

Performance measures	
Balance Sheet and Risk measures and targets	Non-Core Run-Down Core Tier 1 capital ratio Wholesale funding Liquidity reserves Leverage ratio Loan:deposit ratio Earnings volatility
Strategic Scorecard measures and targets	Customer franchise Cost:income ratio in Core bank Lending targets Sustainability performance Progress in people issues

Both quantitative and qualitative strategic measures are used, including measures relating to reputation, customer excellence, organisational capability and sustainability, given that these will support the long-term goals of the business. Targets for each measure are set at the start of the performance period and, where applicable, are aligned with the Group's Strategic Plan targets. Commentary will be provided on an annual basis in relation to progress against the targets, where these are not commercially sensitive.

Vesting point		Indicative performance
Does not meet	0%	Over half of objectives not met
Partially meets	25%	Half of objectives met
Significantly meets	62.5%	Two-thirds of objectives met
Fully meets	100%	Objectives met or exceeded in all material respects

Qualified by Group Performance and Remuneration Committee discretion taking into account changes in circumstances over the performance period, the relative importance of the measures, the margin by which individual targets have been missed or exceeded, and any other relevant factors.

Risk underpin and clawback

The Committee will also review financial and operational performance against the Strategic Plan and risk performance prior to agreeing vesting of awards. In assessing this, the Committee will be advised independently by the Board Risk Committee. If the Committee considers that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect the Group's underlying financial results or if the Committee considers that the financial results have been achieved with excessive risk, then the terms of the awards allow for an underpin to be used to reduce vesting of an award, or to allow the award to lapse in its entirety. All awards are subject to clawback.

Service contracts and exit payment policy

The company's policy in relation to the duration of contracts with directors is that executive directors' contracts generally continue until termination by either party, subject to the required notice, or until retirement. The notice period under the service contracts of executive directors will not normally exceed twelve months.

In relation to newly recruited executive directors, subject to the prior approval of the Committee, the notice period may be extended beyond twelve months if there is a clear case for this. Where a longer period of notice is initially approved on appointment, it will normally be structured such that it will automatically reduce to twelve months in due course. All new service contracts for executive directors are subject to approval by the Committee.

Those contracts normally include standard clauses covering remuneration arrangements and discretionary incentive schemes, the performance review process, the company's normal disciplinary procedure, and terms for dismissal in the event of failure to perform or in situations involving actions in breach of the Group's policies and standards.

Any compensation payment made in connection with the departure of an executive director will be subject to approval by the Committee, having regard to the terms of the service contract and the reasons for termination.

Information regarding the executive directors' service contracts is shown below:

	Date of current contract	Notice period - from the company	Notice period - from executive
Stephen Hester	4 November 2008	12 months	12 months
Bruce Van Saun	8 September 2009	12 months	12 months

Except as noted below, in the event of severance where any contractual notice period is not worked, the employing company may pay a sum to the executive in lieu of the notice period. In the event of situations involving breach of the employing company's policies resulting in dismissal, reduced or no payments may be made to the executive. Depending on the circumstances of the termination of employment, the executive may be entitled, or the Committee may allow, outstanding awards under long-term incentive arrangements to vest, subject to the rules of the relevant plan.

Stephen Hester

In the event of his personal underperformance, the company is entitled, after giving reasonable opportunity to remedy any failure, to terminate Stephen Hester's contract by giving written notice with immediate effect and without making any payment in lieu of notice and Stephen Hester will forfeit any unvested stock awards. In the event that Stephen Hester's employment is terminated by the company (other than by reason of his personal underperformance or in circumstances where the company is entitled to dismiss without notice), or if he resigns in response to a fundamental breach of contract by the company, he will be entitled to receive a payment in lieu of notice to the value of base salary, annual incentive and benefits (including pension contributions). If he resigns voluntarily and the company does not require him to work out his notice period, Stephen Hester may receive a payment in lieu of notice based on salary only (i.e. no annual incentive or benefits). In both cases the treatment of any other unvested stock awards will be determined by the Committee and the Board, having due regard to the circumstances of the departure.

Bruce Van Saun

In the event of his personal underperformance, the company is entitled, after giving reasonable opportunity to remedy any failure, to terminate Bruce Van Saun's contract by giving written notice with immediate effect and without making any payment in lieu of notice and Bruce Van Saun will forfeit any unvested stock awards. Any payment in lieu of notice that may be made to Bruce Van Saun would be based on salary only (i.e. no annual incentive or benefits). The company has agreed that, provided certain conditions are met, on leaving employment, Bruce Van Saun will not forfeit awards under the rules of the Group's share plans.

The table below has been prepared in line with the anticipated reporting requirements proposed by the Department for Business, Innovation and Skills. The purpose is to reflect the fixed elements of pay that have been earned during the year and, as far as is possible, to value performance related pay where performance has been assessed.

The following tables and explanatory notes on this page detail the remuneration of each director for the year ended 31 December 2012 and have been audited by the company's auditors, Deloitte LLP.

Total remuneration for executive directors

					Performance related pay			Total remuneration	
	Salary £000	Benefits £000	Pension £000	Subtotal £000	Annual incentive (1) £000	LTIP (2) £000	Subtotal £000	2012 £000	2011 £000
Stephen Hester	1,200	26	420	1,646	—	—	—	1,646	1,646
Bruce Van Saun (3)	750	134	408	1,292	980	—	980	2,272	2,119

Notes:
(1) Stephen Hester waived any annual incentive entitlement for the 2012 performance year. Bruce Van Saun has been awarded an annual incentive of £980,000 which will be granted as an award entirely in shares in March 2013 and will vest in March 2014 and 2015. For subsequent reporting years, the shares awarded to Bruce Van Saun will be detailed in the Deferred Awards table (see page 340 of the 2012 Report and Accounts). Further details of the performance assessment of the executive directors in 2012 is outlined on pages 333 and 334 of the 2012 Report and Accounts.
(2) The nil value under the LTIP column reflects awards granted under the Medium-term Performance Plan and Executive Share Option Plan in 2009. The awards did not vest in 2012 as a result of the performance conditions not being met.
(3) Bruce Van Saun resigned as a non-executive director of ConvergEx Holdings LLC during 2012 and received a pro rated fee of US$62,500 for 2012. Mr Van Saun was appointed as a non-executive director of Lloyd's of London Franchise Board during 2012 for which he received a pro rated fee of £19,450. He is also a non-executive director of Direct Line Insurance Group plc , the fees for which are paid direct to the Group and is a non-executive director of Worldpay (Ship Midco Limited) for which no fees are payable. Mr Van Saun makes contributions towards his pension through a salary sacrifice arrangement to an Unfunded Unapproved Retirement Benefit Scheme, which operates on a defined contribution basis. The total contribution to the defined contribution arrangements amounted to £408,000 in 2012 (£403,000 in 2011). The rate of return on his accrued contributions is determined annually by the Committee to reflect a long-term low risk investment return on an unsecured basis. For 2012 this rate was 6.2% reflecting December 2011 CPI plus 2%.

Other directors' remuneration

	Salary/ fees £000	Benefits £000	2012 Total £000	2011 Total £000
Chairman				
Philip Hampton	750	—	750	750

The level of remuneration for non-executive directors reflects their responsibility and time commitment and the level of fees paid to non-executive directors of comparable major UK companies. Non-executive directors do not participate in any incentive or performance plan. Non-executive directors' fees are reviewed regularly.

	Board fees £000	Board Committee fees £000	2012 Total £000	2011 Total £000
Non-executive directors				
Sandy Crombie	150	—	150	150
Alison Davis	73	41	114	43
Tony Di Iorio	73	55	128	43
Penny Hughes	150	—	150	150
Joe MacHale (1)	73	60	133	133
Brendan Nelson	150	—	150	150
Baroness Noakes	73	51	124	43
Art Ryan (2)	73	20	93	95
Philip Scott	150	—	150	150
Former non-executive director				
John McFarlane (3)	18	8	26	103

Notes:
(1) Board Committee fee includes membership of the Asset Protection Scheme Senior Oversight Committee.
(2) Art Ryan is a non-executive director of RBS Citizens Financial Group, Inc. for which he received fees of US$131,000 during 2012.
(3) Retired from the Board with effect from 31 March 2012.

There have been no payments made for loss of office.

Penny Hughes
Chair of the Group Performance and Remuneration Committee
27 February 2013

Financial results

Summary financial statement

Important note

This summary financial statement is a summary of information in the 2012 Report and Accounts (the “R&A”). It does not contain sufficient information to allow for a full understanding of the results of the Group or of the state of affairs of the company and of its policies and arrangements concerning directors’ remuneration. The Group's results and financial condition could be adversely affected by certain risks and uncertainties, including the outcome of litigation and investigations. For further information, the 2012 R&A, the Auditor’s report on those accounts and the Report of the directors should be consulted.

You can obtain a copy of the R&A and may also elect to receive all future R&As, free of charge, by contacting our Registrar, details of which can be found on page 65. A copy can be viewed on the Group’s website www.rbs.com

Summary directors’ report

Activities and business review

A review of the activities and business of the Group for the year ended 31 December 2012, of recent events and of likely future developments is contained on pages 2 to 35.

Going concern

Having reviewed the Group’s forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

Directors

The names and brief biographical details of the current directors are shown on pages 37 to 40.

Report of the auditor

The auditor’s report on the full accounts and the auditable part of the Directors’ remuneration report for the year ended 31 December 2012 was unqualified and did not include an emphasis of matter or a statement under sections 498(2) (inadequate accounting records or returns or accounts or Directors’ remuneration report not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Companies Act 2006. The auditor’s statement under section 496 (whether the information in the Report of the directors’ was consistent with the accounts) was unqualified.

Additional information

Where not provided elsewhere, the following additional information is required to be disclosed by Paragraph 14 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Share capital

Details of the ordinary and preference share capital as at 31 December 2012 are provided below.

Allotted, called up and fully paid	£m	Number of shares - thousands
Ordinary shares of £1	6,071	6,070,765
B shares of £0.01	510	51,000,000
Dividend access share of £0.01(1)	—	—
Non-cumulative preference shares of US$0.01	1	209,609
Non-cumulative convertible preference shares of US$0.01	—	65
Non-cumulative preference shares of €0.01	—	2,044
Non-cumulative convertible preference shares of £0.01	—	15
Non-cumulative preference shares of £1	—	54
Cumulative preference shares of £1	1	900

Note:
(1) One Dividend Access Share in issue.

The rights and obligations attaching to the company’s ordinary shares and preference shares are set out in the company’s Articles of Association, copies of which can be obtained from Companies House in the UK or can be found on the Group’s website www.rbs.com

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares or cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held. The voting rights of holders of non-cumulative preference shares are set out on page 57. The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.015% and the non-cumulative preference shares represent less than 0.675% of the total voting rights of the company respectively, the remainder being represented by the ordinary shares.

The B shares do not generally carry voting rights at general meetings of ordinary shareholders. Following the subdivision and consolidation of ordinary shares in 2012 and subject to anti-dilution adjustments, each B share is entitled to one tenth of the cash dividend of an ordinary share and may be converted at any time at the option of the holder into ordinary shares at the rate of ten B shares for each ordinary share.

The dividend access share entitles the holder to dividends equal to the greater of 7% of the aggregate issue price of B shares issued to HM Treasury 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 conversion. Dividends on the dividend access share are discretionary unless a dividend has been paid on the ordinary shares, in which case dividends became mandatory. The dividend access share does not generally carry voting rights at general meetings of ordinary shareholders and is not convertible into ordinary shares.

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws). Pursuant to the Listing Rules of the FSA, certain employees of the company require the approval of the company to deal in the company's shares.

The rules governing the powers of directors, including in relation to issuing or buying back shares and their appointment are set out in the company's Articles of Association. It will be proposed at the 2013 Annual General Meeting that the directors be granted authorities to allot shares under the Companies Act 2006. The company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

A number of the company's share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

Except in relation to the Dividend Access Share, the company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank and Ulster Bank Dublin Trust Company as Trustees. Voting rights are exercised by the Trustees on receipt of participants' instructions. If a participant does not submit an instruction to the Trustee, no vote is registered.

The Royal Bank of Scotland plc 1992 Employee Share Trust, The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of the Group's employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.
Awards granted under the company's employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company's employee benefits trust.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company's employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

Non-cumulative preference shares

Non-cumulative preference shares entitle the holders thereof (subject to the terms of issue) to receive periodic non-cumulative cash dividends at specified fixed rates for each Series payable out of distributable profits of the company.

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

Class of preference share	Number of shares in issue	Interest rate	Redemption date on or after	Redemption price per share	Debt/ equity (1)
Non-cumulative preference shares of US$0.01					
Series F	6.3 million	7.65%	31 March 2007	US$25	Debt
Series H	9.7 million	7.25%	31 March 2004	US$25	Debt
Series L	30.0 million	5.75%	30 September 2009	US$25	Debt
Series M	23.1 million	6.4%	30 September 2009	US$25	Equity
Series N	22.1 million	6.35%	30 June 2010	US$25	Equity
Series P	9.9 million	6.25%	31 December 2010	US$25	Equity
Series Q	20.6 million	6.75%	30 June 2011	US$25	Equity
Series R	10.2 million	6.125%	30 December 2011	US$25	Equity
Series S	26.4 million	6.6%	30 June 2012	US$25	Equity
Series T	51.2 million	7.25%	31 December 2012	US$25	Equity
Series U	10,130	7.64%	29 September 2017	US$100,000	Equity
Non-cumulative convertible preference shares of US$0.01					
Series 1	64,772	9.118%	31 March 2010	US$1,000	Debt
Non-cumulative preference shares of €0.01					
Series 1	1.25 million	5.5%	31 December 2009	€1,000	Equity
Series 2	784,989	5.25%	30 June 2010	€1,000	Equity
Series 3	9,429	7.0916%	29 September 2017	€50,000	Equity
Non-cumulative convertible preference shares of £0.01					
Series 1	14,866	7.387%	31 December 2010	£1,000	Debt
Non-cumulative preference shares of £1					
Series 1	54,442	3 month LIBOR + 2.33%	5 October 2012	£1,000	Equity

Note:
(1) Those preference shares where the Group has an obligation to pay dividends are classified as debt; those where distributions are discretionary are classified as equity. The conversion rights attaching to the convertible preference shares may result in the Group delivering a variable number of equity shares to preference shareholders; these convertible preference shares are treated as debt.

In the event that the non-cumulative convertible preference shares are not redeemed on or before the redemption date, the holder may convert them into ordinary shares in the company at the prevailing market price.

Under existing arrangements, no redemption or purchase of any non-cumulative preference shares may be made by the company without the prior consent of the UK Financial Services Authority.

On a winding-up or liquidation of the company, the holders of the non-cumulative preference shares will be entitled to receive out of any surplus assets available for distribution to the company's shareholders (after payment of arrears of dividends on the cumulative preference shares up to the date of repayment) pari passu with the cumulative preference shares and all other shares of the company ranking pari passu with the non-cumulative preference shares as regards participation in the surplus assets of the company, a liquidation distribution per share equal to the applicable redemption price detailed in the table above, together with an amount equal to dividends for the then current dividend period accrued to the date of payment, before any distribution or payment may be made to holders of the ordinary shares as regards participation in the surplus assets of the company.

Except as described above, the holders of the non-cumulative preference shares have no right to participate in the surplus assets of the company.

Holders of the non-cumulative preference shares are not entitled to receive notice of or attend general meetings of the company except if any resolution is proposed for adoption by the shareholders of the company to vary or abrogate any of the rights attaching to the non-cumulative preference shares or proposing the winding-up or liquidation of the company. In any such case, they are entitled to receive notice of and to attend the general meeting of shareholders at which such resolution is to be proposed and are entitled to speak and vote on such resolution (but not on any other resolution). In addition, in the event that, prior to any general meeting of shareholders, the company has failed to pay in full the three most recent quarterly dividend payments due on the non-cumulative dollar preference shares (other than Series U), the two most recent semi-annual dividend payments due on the non-cumulative convertible dollar preference shares and the most recent dividend payments due on the non-cumulative euro preference shares, the non-cumulative sterling preference shares, the Series U non-cumulative dollar preference shares and the non-cumulative convertible sterling preference shares, the holders shall be entitled to receive notice of, attend, speak and vote at such meeting on all matters together with the holders of the ordinary shares. In these circumstances only, the rights of the holders of the non-cumulative preference shares so to vote shall continue until the company shall have resumed the payment in full of the dividends in arrears.

The Group had undertaken that, unless otherwise agreed with the European Commission, neither the company nor any of its direct or indirect subsidiaries (excluding companies in the RBS Holdings N.V. Group, which are subject to different restrictions) would pay external investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier 2 instruments) from 30 April 2010 for a period of two years thereafter ("the Deferral Period"), or exercise any call rights in relation to these capital instruments between 24 November 2009 and the end of the Deferral Period, unless there was a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 were generally not subject to the restriction on dividend or coupon payments or call options. On 30 April 2012, the Deferral Period for RBS Group instruments ended and in May 2012, the Group determined that it was in a position to recommence payments on these instruments. Future coupons and dividends will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Shareholdings

The table below shows shareholders that have notified the Group that they hold more than 3% of the total voting rights of the company at 31 December 2012.

Solicitor For The Affairs of Her Majesty's Treasury as Nominee for Her Majesty's Treasury	Number of shares (millions)	% of share class held	% of total voting rights held
Ordinary shares	3,964	65.3	64.9
B shares (non-voting)	51,000	100.0	—

On 1 February 2013, the Group was notified that Her Majesty's Treasury's shareholding of ordinary shares represented 65.28% of the total voting rights. The increase was as a result of a change in the total voting rights.

Independent auditor's statement to the members of The Royal Bank of Scotland Group plc

We have examined the summary financial statement for the year ended 31 December 2012 which comprises the summary consolidated income statement, the summary consolidated statement of comprehensive income, the summary consolidated balance sheet, the summary directors' report and the summary remuneration report.

This report is made solely to the company's members, as a body, in accordance with section 428 of the Companies Act 2006. Our work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, for our audit report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

The directors are responsible for preparing the Annual Review and Summary Financial Statement in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the summary financial statement within the Annual Review and Summary Financial Statement with the full annual accounts, the Report of the directors and the Directors' remuneration report, and its compliance with the relevant requirements of section 428 of the Companies Act 2006 and the regulations made thereunder.

We also read the other information contained in the Annual Review and Summary Financial Statement and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the summary financial statement.

Basis of opinion

We conducted our work in accordance with Bulletin 2008/3 issued by the Auditing Practices Board. Our report on the Group's full annual accounts describes the basis of our audit opinion on those accounts, the Directors' remuneration report and the Report of the directors.

Opinion

In our opinion, the summary financial statement is consistent with the full annual accounts, the Report of the directors and the Directors' remuneration report of The Royal Bank of Scotland Group plc for the year ended 31 December 2012 and complies with the applicable requirements of section 428 of the Companies Act 2006, and the regulations made thereunder.

Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
27 February 2013

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Financial results *continued*

Summary consolidated income statement for the year ended 31 December 2012

	2012 £m	2011 £m
Net interest income	11,402	12,303
Non-interest income	6,539	12,348
Total income	17,941	24,651
Administrative expenses	(16,025)	(15,295)
Depreciation and amortisation	(1,802)	(1,839)
Operating expenses*	(17,827)	(17,134)
Profit before impairment losses	114	7,517
Impairment losses	(5,279)	(8,707)
Operating loss before tax	(5,165)	(1,190)
Tax charge	(469)	(1,127)
Loss from continuing operations	(5,634)	(2,317)
(Loss)/profit from discontinued operations, net of tax	(172)	348
Loss for the year	(5,806)	(1,969)
Loss attributable to:		
Non-controlling interests	(123)	28
Preference shareholders	273	—
Paid-in equity holders	15	—
Ordinary and B shareholders	(5,971)	(1,997)
	(5,806)	(1,969)
Basic and diluted loss per ordinary and B share from continuing operations (1,2)	(53.7p)	(21.3p)
Basic and diluted loss per ordinary and B share from continuing and discontinued operations (1,2)	(54.3p)	(18.5p)

* Integration and restructuring costs included in operating expenses comprise:

	2012 £m	2011 £m
Administrative expenses	1,273	1,005
Depreciation and amortisation	142	11
	1,415	1,016

Notes:
(1) B shares rank pari-passu with ordinary shares.
(2) Prior year has been adjusted for the sub-division and one-for-ten consolidation of ordinary shares in 2012.

Summary consolidated statement of comprehensive income for the year ended 31 December 2012

	2012 £m	2011 £m
Loss for the year	(5,806)	(1,969)
Other comprehensive income		
Available-for-sale financial assets	645	2,258
Cash flow hedges	1,006	1,424
Currency translation	(900)	(440)
Actuarial losses on defined benefit plans	(2,270)	(581)
Other comprehensive (loss)/income before tax	(1,519)	2,661
Tax credit/(charge)	228	(1,472)
Other comprehensive (loss)/income after tax	(1,291)	1,189
Total comprehensive loss for the year	(7,097)	(780)
Total comprehensive loss is attributable to:		
Non-controlling interests	(116)	(24)
Preference shareholders	273	—
Paid-in equity holders	15	—
Ordinary and B shareholders	(7,269)	(756)
	(7,097)	(780)

Directors' remuneration	2012 £000	2011 £000
Non-executive directors emoluments	1,218	1,137
Chairman and executive directors		
- emoluments	3,853	4,671
- contributions and allowances in respect of money purchase schemes	408	403
	5,479	6,211
- amounts receivable under long-term incentive plans	1,223	1,594
	6,702	7,805

No directors are accruing benefits under defined benefit schemes (2011 - nil). One director is accruing benefits under a money purchase scheme (2011 - one).

Financial results continued

Summary consolidated balance sheet as at 31 December 2012

	2012 £m	2011 £m
Assets		
Cash and balances at central banks	79,290	79,269
Loans and advances to banks	63,951	83,310
Loans and advances to customers	500,135	515,606
Debt securities	157,438	209,080
Equity shares	15,232	15,183
Settlement balances	5,741	7,771
Derivatives	441,903	529,618
Intangible assets	13,545	14,858
Property, plant and equipment	9,784	11,868
Deferred tax	3,443	3,878
Prepayments, accrued income and other assets	7,820	10,976
Assets of disposal groups	14,013	25,450
Total assets	1,312,295	1,506,867
Liabilities		
Deposits by banks	101,405	108,804
Customer accounts	521,279	502,955
Debt securities in issue	94,592	162,621
Settlement balances	5,878	7,477
Short positions	27,591	41,039
Derivatives	434,333	523,983
Accruals, deferred income and other liabilities	14,801	23,125
Retirement benefit liabilities	3,884	2,239
Deferred tax	1,141	1,945
Insurance liabilities	—	6,312
Subordinated liabilities	26,773	26,319
Liabilities of disposal groups	10,170	23,995
Total liabilities	1,241,847	1,430,814
Non-controlling interests	2,318	1,234
Owners' equity	68,130	74,819
Total equity	70,448	76,053
Total liabilities and equity	1,312,295	1,506,867
Memorandum items		
Contingent liabilities and commitments	247,645	278,819

At 31 December 2012, provisions for loan impairment amounted to £21,250 million (2011 - £19,883 million).

The summary financial statement on pages 56 to 62 was approved by the Board of directors on 27 February 2013.

Philip Hampton
Chairman

Stephen Hester
Group Chief Executive

Bruce Van Saun
Group Finance Director

Shareholder information

Analyses of ordinary shareholders

At 31 December 2012	Shareholdings	Number of shares - millions	%
Individuals	206,589	128.8	2.1
Banks and nominee companies	13,320	5,837.9	96.2
Investment trusts	117	3.9	0.1
Insurance companies	136	0.5	—
Other companies	851	24.7	0.4
Pension trusts	32	2.1	—
Other corporate bodies	395	72.9	1.2
	221,440	6,070.8	100.0
Range of shareholdings:			
1 - 1,000	191,185	48.5	0.8
1,001 - 10,000	28,382	65.1	1.1
10,001 - 100,000	1,212	33.0	0.5
100,001 - 1,000,000	444	150.3	2.5
1,000,001 - 10,000,000	179	559.6	9.2
10,000,001 and over	38	5,214.3	85.9
	221,440	6,070.8	100.0

Financial calendar

Annual General Meeting

14 May 2013
RBS Conference Centre
RBS Gogarburn
Edinburgh EH12 1HQ

Interim results

2 August 2013

Dividends

Payment dates

Cumulative preference shares	31 May and 31 December 2013
Non-cumulative preference shares	28 March, 28 June, 30 September 31 December 2013

Ex-dividend date

Cumulative preference shares	1 May 2013

Record date

Cumulative preference shares	3 May 2013

For further information on the payment of dividends, see page 58.

Shareholder information *continued*

Shareholder enquiries
Shareholdings in the company may be checked by visiting the 'Managing your shareholding' section of our website www.rbs.com/managing_shareholding. You will need the shareholder reference number printed on your share certificate or tax voucher to gain access to this information.

Alternatively you may check your shareholding by contacting our Registrar, Computershare via the contact details provided on page 65.

Investor Relations
Shareholders can access updated information on RBS via our website www.rbs.com/ir

Annual Sustainability Report
If you wish to obtain a copy please contact:

Group Sustainability
The Royal Bank of Scotland Group plc
PO Box 1000
Gogarburn
Edinburgh EH12 1HQ

It is also available on our website www.rbs.com/sustainability

Braille and audio Annual Review and Summary Financial Statement
Shareholders requiring a Braille or audio version of the Annual Review and Summary Financial Statement should contact the Registrar on +44 (0)870 702 0135.

ShareGift
The company is aware that shareholders who hold a small number of shares may be retaining these shares because dealing costs make it uneconomical to dispose of them. ShareGift, the charity share donation scheme, is a free service operated by The Orr Mackintosh Foundation (registered charity 1052686) to enable shareholders to donate shares to charity.

Donating your shares in this way will not give rise to either a gain or a loss for UK capital gains tax purposes and you may be able to reclaim UK income tax on gifted shares. Further information can be obtained from HM Revenue & Customs.

Should you wish to donate your shares to charity in this way you should contact ShareGift for further information:

ShareGift, The Orr Mackintosh Foundation
17 Carlton House Terrace, London SW1Y 5AH
Telephone:+44 (0) 20 7930 3737
www.sharegift.org

Share Fraud Warning
Share fraud includes scams where investors are called out of the blue and offered shares that often turn out to be worthless or non-existent, or an inflated price for shares they own. These calls come from fraudsters operating in 'boiler rooms' that are mostly based abroad. While high profits are promised, those who buy or sell shares in this way usually lose their money. The Financial Services Authority (FSA) has found most share fraud victims are experienced investors who lose an average of £20,000, with around £200 million lost in the UK each year.

Protect yourself
If you are offered unsolicited investment advice, discounted shares, a premium price for shares you own, or free company or research reports, you should take these steps before handing over any money;

- get the name of the person and organisation contacting you;
- check the FSA Register at www.fsa.gov.uk/fsaregister to ensure they are authorised;
- use the details on the FSA Register to contact the firm;
- call the FSA Consumer Helpline on +44 (0) 845 606 1234 if there are no contact details on the Register or you are told they are out of date;
- search the FSA's list of unauthorised firms and individuals to avoid doing business with; and
- remember if it sounds too good to be true, it probably is.

If you use an unauthorised firm to buy or sell shares or other investments, you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme (FSCS) if things go wrong.

Report a scam
If you are approached about a share scam you should tell the FSA using the share fraud reporting form at www.fsa.gov.uk/scams, where you can find out about the latest investment scams. You can also call the Consumer Helpline on +44 (0) 845 606 1234. If you have already paid money to share fraudsters you should contact Action Fraud on +44 (0) 300 123 2040.

Important addresses

Shareholder enquiries

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Facsimile: +44 (0)870 703 6009
Website: www.investorcentre.co.uk/contactus

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