ROYAL BANK OF SCOTLAND GROUP PLC
Form 6-K
March 11, 2014

Form 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of

the Securities Exchange Act of 1934

11 March 2014

The Royal Bank of Scotland Group plc

Gogarburn

PO Box 1000

Edinburgh EH12 1HQ

Scotland

United Kingdom

(Address of principal executive offices)

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

Form 20-F X Form 40-F __

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

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

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

Yes __ No X

If "Yes" is marked, indicate below the file number assigned to

the registrant in connection with Rule 12g3-2(b): 82-_______

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(File Nos. 333-184147 and 333-184147-01) and to be a part thereof from the date which it was filed, to the extent not superseded by documents or reports subsequently filed or furnished.

Contents

1

Forward-looking statements

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

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

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: global economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the simplification of the Group’s structure, the divestment of Citizens Financial Group and the exiting of assets in RBS Capital Resolution as well as the disposal of certain other assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislation and regulation in the United Kingdom (UK), the European Union (EU) and the United States (US); the implementation of key legislation and regulation including the UK Financial Services (Banking Reform Act) 2013 and the proposed EU Recovery and Resolution Directive; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of LIBOR and other interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group's operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the Group; reputational risk; the conversion of the B Shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

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

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

Presentation of information

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

Non-GAAP financial information

The directors manage the Group's performance by class of business, before certain reconciling items, as is presented in the segmental analysis on pages 104 to 108 (the "managed basis"). Discussion of the Group's performance focuses on the managed basis as the Group believes that such measures allow a more meaningful analysis of the Group's financial condition and the results of its operations. These measures are non-GAAP financial measures. A body of generally accepted accounting principles such as IFRS is commonly referred to as 'GAAP'. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Reconciliations of these non-GAAP measures are presented throughout this document or in the segmental analysis on pages 104 to 108. These non-GAAP financial measures are not a substitute for GAAP measures. Furthermore, RBS has divided its operations into "Core" and "Non-Core". Certain measures disclosed in this document for Core operations and used by RBS management are non-GAAP financial measures as they represent a combination of all reportable segments with the exception of Non-Core. In addition, RBS has further divided parts of the Core business into "Retail & Commercial" consisting of the UK Retail, UK Corporate, Wealth, International Banking, Ulster Bank and US Retail & Commercial divisions. This is a non-GAAP financial measure. Furthermore, RBS has presented certain measures "excluding RBS Capital Resolution (RCR)" which are deemed non-GAAP measures. Lastly, the Basel III net stable funding ratio, fully loaded Basel III ratio, liquidity coverage ratio, stressed outflow coverage and further metrics included in the Risk and balance sheet management section of this document represent non-GAAP financial measures given they are metrics that are not yet required to be disclosed by a government, governmental authority or self-regulatory organisation.

Revisions

Direct Line Group

The Group sold the first tranche of ordinary shares representing 34.7% of the share capital of Direct Line Group (DLG) in October 2012 via an Initial Public Offering. On 13 March 2013, the Group sold a further 16.8% of ordinary shares in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013. On 20 September 2013, the Group sold a further 20% of the ordinary shares in DLG which is a further step towards complete disposal by the end of 2014, as required by the European Commission. At 31 December 2013, the Group held 28.5% of the issued share capital in DLG.

In accordance with IFRS 5, DLG was classified as a discontinued operation in 2012. From 13 March 2013, DLG was classified as an associate and at 31 December 2013 the Group's interest in DLG was transferred to disposal groups.

Revised allocation of Business Services costs

In the first quarter of 2013, the Group reclassified certain costs between direct and indirect expenses for all divisions. Comparatives have been restated accordingly; the revision did not affect total expenses or operating profit.

Presentation of information

Revisions (continued)

Implementation of IAS 19 'Employee Benefits' (revised)

The Group implemented IAS 19 with effect from 1 January 2013. IAS 19 requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £21 million for the quarter ended 31 December 2012 and £84 million for the year ended 31 December 2012. This also resulted in an increase in the loss per ordinary and B share of 0.2p for the quarter ended 31 December 2012 and 0.8p for the year ended 31 December 2012. Prior periods have been restated accordingly.

Implementation of IFRS 10 'Consolidated Financial Statements'

The Group implemented IFRS 10 with effect from 1 January 2013. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity so as to vary returns for the reporting entity. IFRS 10 requires retrospective application. Following implementation of IFRS 10, certain entities that have trust preferred securities in issue are no longer consolidated by the Group. As a result there has been a reduction in non-controlling interests of £0.5 billion with a corresponding increase in Owners' equity (Paid-in equity); prior periods have been restated accordingly.

Recent developments

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

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

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

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

Directorate change

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

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

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

Condensed consolidated income statement

for the period ended 31 December 2013

	Year ended			Quarter ended	
	31 December 2013	31 December 2012*	**31 December 2013**	30 September 2013	31 December 2012*
	£m	£m	**£m**	£m	£m
Interest receivable	**16,740**	18,530	**3,973**	4,207	4,439
Interest payable	**(5,759)**	(7,128)	**(1,209)**	(1,427)	(1,666)
Net interest income	**10,981**	11,402	**2,764**	2,780	2,773
Fees and commissions receivable	**5,460**	5,709	**1,370**	1,382	1,374
Fees and commissions payable	**(942)**	(834)	**(244)**	(238)	(245)
Income from trading activities	**2,685**	1,675	**177**	444	474
Gain/(loss) on redemption of own debt	**175**	454	**(29)**	13	-
Other operating income/(loss)	**1,398**	(465)	**31**	35	227
Non-interest income	**8,776**	6,539	**1,305**	1,636	1,830
Total income	**19,757**	17,941	**4,069**	4,416	4,603
Staff costs	**(7,163)**	(8,188)	**(1,541)**	(1,895)	(1,656)
Premises and equipment	**(2,348)**	(2,232)	**(700)**	(544)	(592)
Other administrative expenses	**(7,244)**	(5,593)	**(3,960)**	(1,103)	(2,506)
Depreciation and amortisation	**(1,410)**	(1,802)	**(336)**	(338)	(498)
Write-down of goodwill and other intangible assets	**(1,403)**	(124)	**(1,403)**	-	(124)
Operating expenses	**(19,568)**	(17,939)	**(7,940)**	(3,880)	(5,376)
Profit/(loss) before impairment losses	**189**	2	**(3,871)**	536	(773)
Impairment losses	**(8,432)**	(5,279)	**(5,112)**	(1,170)	(1,454)
Operating loss before tax	**(8,243)**	(5,277)	**(8,983)**	(634)	(2,227)
Tax credit/(charge)	**(382)**	(441)	**377**	(81)	(39)
Loss from continuing operations	**(8,625)**	(5,718)	**(8,606)**	(715)	(2,266)

Profit/(loss) from discontinued operations, net of tax						
- Direct Line Group	**127**	(184)		**-**	-	(351)
- Other	**21**	12		**15**	(5)	6
Profit/(loss) from discontinued operations,						
net of tax	**148**	(172)		**15**	(5)	(345)
Loss for the period	**(8,477)**	(5,890)		**(8,591)**	(720)	(2,611)
Non-controlling interests	**(120)**	136		**3**	(6)	108
Preference share and other dividends	**(398)**	(301)		**(114)**	(102)	(115)
Loss attributable to ordinary and						
B shareholders	**(8,995)**	(6,055)		**(8,702)**	(828)	(2,618)
Basic and diluted loss per ordinary and equivalent						
B share from continuing operations	**(81.3p)**	(54.5p)		**(77.3p)**	(7.4p)	(21.6p)
Basic and diluted loss per ordinary and equivalent						
B share from continuing and discontinued operations	**(80.3p)**	(55.0p)		**(77.3p)**	(7.4p)	(23.6p)

* Restated - see page 92.

Core summary consolidated income statement

for the period ended 31 December 2013

	Year ended			Quarter ended	
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
Net interest income	**11,091**	11,173	**2,805**	2,826	2,723
Non-interest income	**8,697**	10,624	**1,728**	2,187	2,151
Total income	**19,788**	21,797	**4,533**	5,013	4,874
Operating expenses	**(12,708)**	(12,910)	**(3,108)**	(3,141)	(2,741)
Profit before impairment losses	**7,080**	8,887	**1,425**	1,872	2,133
Impairment losses	**(3,856)**	(3,056)	**(1,948)**	(589)	(751)
Operating profit/(loss)	**3,224**	5,831	**(523)**	1,283	1,382
Key metrics					
Core performance ratios					
- Net interest margin	**2.23%**	2.15%	**2.28%**	2.24%	2.15%
- Cost:income ratio	**64%**	59%	**69%**	63%	56%
- Return on equity	**4.6%**	8.9%	**(4.6%)**	7.7%	8.2%

Analysis of results is set out on pages 26 to 35.

Highlights

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

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

RBS has, on 27 February 2014, updated on its comprehensive business review, aimed at transforming the bank (see page 22).

Key points

Building a bank that is trusted by its customers

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

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

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

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

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

Future performance will be reported against customer and financial measures. Further details are set out on page 24.

Restructuring our balance sheet

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

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

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

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

Highlights

Key points (continued)

FY 2013 operating results

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

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

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

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

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

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

Q4 2013 operating results

Operating loss in Q4 2013 totalled £8,983 million. On a managed basis, operating profit was £204 million, excluding the impact of the creation of RCR.

Retail & Commercial operating losses in the fourth quarter were £388 million compared with a profit of £1,125 million in Q4 2012. Excluding the impact of the creation of RCR of £1,385 million, operating profits in the fourth quarter were £997 million, down 11% from Q4 2012, with all divisions except Ulster Bank showing a deterioration from the prior year.

Markets operating profit was £39 million compared with £139 million in Q4 2012. Excluding the impact of the creation of RCR of £18 million, operating profit was £57 million which reflected seasonal slower trading together with the impact of the business's smaller balance sheet and reduced risk envelopes.

Non-Core operating losses were £3,896 million compared with £942 in Q4 2012. Excluding the impact of the creation of RCR of £3,220 million, operating losses narrowed to £676 million, with costs and impairments falling in line with the reducing asset base.

Highlights

Key points (continued)

Delivering our capital plan

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

RCR was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate run-down of these exposures to free up capital for the bank. The revised strategy to run down high risk loans faster led to an increased impairment charge. When originally announced, RCR assets were projected to be £38 billion at the end of 2013, but accelerated disposals and increased impairments have reduced this total to £29 billion. Further details about RCR are set out on page 25 and in Appendix 1.

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

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

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

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

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

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

Legacy conduct issues

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

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

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

Highlights

Key points (continued)

Serving our customers

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

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

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

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

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

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

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

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

Notes:

(1) Includes the impact of business exits such as Citizens Financial Group and Williams & Glyn; bank levy; restructuring costs; and, from 2015, the EU resolution fund charge.

(2) During the year the Group recognised £4,823 million of impairment and other losses related to the establishment of RCR. This comprises impairment losses of £4,490 million (of which £173 million relate to core Ulster Bank assets which were not transferred to RCR but are subject to the same strategy) and £333 million reduction in income reflecting asset valuation adjustments.

Highlights

Outlook

We continue to see signs that the UK economic recovery is gaining traction and have observed higher levels of activity and confidence amongst our customers; we are increasing and improving our front line capacity in order to handle higher levels of new business more efficiently. We expect a lag between the economic recovery and our core franchises starting to grow, given continued low interest rates, excess liquidity and our continued deleveraging in commercial real estate and shipping.

We expect margins to be slightly up in 2014 but anticipate lower securities gains from our liquidity portfolio. While the strategic repositioning of Markets announced in 2013 has progressed well, the external and regulatory environment remains challenging.

The actions following our strategic review will start to drive cost reductions and improve efficiency during 2014. Whilst it will take two to three years to fully implement these we expect our underlying cost base to be £1 billion lower in 2014.

RCR has made a strong start. Its initial balance sheet, at £29 billion of third party assets, is £9 billion lower than the original guidance of £38 billion, and RCR has a strong pipeline in the early months of 2014. Having recognised significant impairment losses due to the revised strategy we expect our credit losses to revert to more normal levels of around 0.6% of loans in 2014.

We are working through our legacy conduct and litigation issues; the timings and amounts of any redress or settlements however remain uncertain.

With the announcement of our strategic review, we expect elevated restructuring costs in the next two years to get the bank’s customer service and costs back to best in class levels in all respects.

Chairman's letter to shareholders

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

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

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

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

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

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

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

Chairman's letter to shareholders

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

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

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

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

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

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

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

Philip Hampton

27 February 2014

Chief Executive's message

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

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

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

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

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

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

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

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

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

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

Chief Executive's message

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

This needs to change.

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

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

2013 FINANCIAL PERFORMANCE

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

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

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

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

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

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

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

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

Chief Executive's message

WHY WE MUST CHANGE

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

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

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

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

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

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

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

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

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

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

Chief Executive's message

OUR NEW STRATEGY

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

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

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

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

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

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

This will be a highly effective bank and in the medium term we will aim to deliver a cost:income ratio (including bank levy, restructuring charges and, from 2015, the EU resolution fund charge) of around 55%, falling in the long term to around 50%.

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

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

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

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

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

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

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

Chief Executive’s message

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

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

UPDATE ON CAPITAL PLAN

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

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

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

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

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

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

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

Chief Executive's message

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

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

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

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

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

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

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

MEASURES THAT MATTER

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

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

Measure 1: Customer:

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

Measure 2: Efficiency:

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

Chief Executive's message

Measure 3: Returns

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

Measure 4: Capital strength

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

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

HOW WE'LL DO BUSINESS

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

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

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

Serving customers

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

Working together

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

Doing the right thing

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

Thinking long term

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

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

Chief Executive's message

CONCLUSION:

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

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

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

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

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

Ross McEwan

27 February 2014

Strategic review

On 1 November 2013 RBS announced a full review of its customer-facing businesses, its IT and operations, and its organisational and decision-making structures. As a result of this review, announced on 27 February 2014, a refreshed strategic direction with the ambition of building a bank that earns its customers' trust by serving them better than any other bank.

Business structure

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

- Personal & Business Banking will serve UK personal and affluent customers together with small businesses (generally reporting up to £2 million turnover), with more business bankers moving back into branches.
- Commercial & Private Banking will serve commercial and mid-corporate customers and high net worth individuals, deepening relationships with commercial clients, operating overseas through its market-leading trade and foreign exchange services, while connecting our private banking brands more effectively to successful business owners and entrepreneurs.
- Corporate & Institutional Banking will serve our corporate and institutional clients primarily in the UK and Western Europe , as well as those US and Asian multinationals with substantial trade and investment links in the region, with debt financing, risk management and trade services, focusing on core product capabilities that are of most relevance to our clients.

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

	Personal & Business Banking	**Commercial & Private Banking**	**Corporate & Institutional Banking**
CEO	Les Matheson	Alison Rose	Donald Workman
RWAs profile (%)[1]	~35%	~30%	~35%
Operating profit profile (%)[1]	~50%	~30%	~20%

Target RoE(1)	15%+	15%+	~10%(2)

Notes:

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

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

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

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

Strategic review

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

Addressing costs and returns

Key to achieving this is a significant reduction in RBS's costs and complexity. Transforming the bank to deliver this involves rationalising and simplifying systems, based on a target architecture with improved resilience. Examples of these measures include:

- The number of technology platforms we use will be reduced by over 50%.
- We will move from 50 core banking systems to around 10.
- From 80 payment systems currently maintained we will move to approximately 10.
- Our property portfolio will be reduced from 25 million square feet to 18 million square feet, including significant reductions in central London.
- We will maintain a similar level of investment spending but directed at customer-facing process improvements, instead of maintaining inefficient legacy infrastructure.

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

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

23

Strategic review

Measures

Future performance will be reported against both customer and financial measures.

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

Notes:

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

RBS Capital Resolution

In June 2013, in response to a recommendation by the Parliamentary Commission on Banking Standards, the UK Government announced it would review the case for an external 'bad bank', based on three objectives as originally outlined by the Chancellor:

- accelerating the return of RBS to the private sector;
- supporting the British economy; and
- best value for the taxpayer.

Following this announcement, RBS worked closely with HM Treasury ('HMT') and its advisers to identify a pool of assets with particularly high long-term capital intensity, credit risk, low returns and/or potential stress loss in varying scenarios. The balance of this identified pool was £47 billion as at 30 June 2013. The pool was forecast to be c.£38 billion of assets as at 31 December 2013, which together with derivatives were forecast to attract c.£116 billion of RWA equivalents.

HMT published its report on 1 November 2013. The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified. It also concluded that "RBS's existing provisions and levels of capital deducted suggested that projected future losses are appropriately covered".

As a result, and in line with its new strategic direction set out on 1 November 2013, RBS announced the creation of RBS Capital Resolution ('RCR') to separate and wind down RBS's high capital intensive assets.

For further information refer to Appendix 1.

Analysis of results

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Net interest income	**£m**	£m		**£m**	£m	£m
Net interest income	**10,981**	11,402		**2,764**	2,780	2,773
Average interest-earning assets	**543,376**	593,270		**523,743**	538,748	565,982
Net interest margin						
- Group	**2.02%**	1.92%		**2.09%**	2.05%	1.95%
- Retail & Commercial (1)	**2.94%**	2.92%		**2.99%**	2.95%	2.91%
- Non-Core	**(0.19%)**	0.31%		**(0.36%)**	(0.35%)	0.29%

Note:

(1) Retail & Commercial (R&C) comprises the UK Retail, UK Corporate, Wealth, International Banking, Ulster Bank and US R&C divisions.

Key points

2013 compared with 2012

- Net interest income decreased by £421 million, 4%, with deposit repricing initiatives only partly mitigating the impact of lower assets. Retail & Commercial net interest income decreased by £391 million and Non-Core net interest income decreased by £343 million due to a fall in interest earning assets driven by run-off and disposals, partially offset by lower treasury and funding costs.

- Average interest-earning assets decreased by £49.9 billion to £543.4 billion, reflecting reductions in Markets and Non-Core loans and advances to customers as well as strategic sale and run-down of debt securities.

- Group net interest margin (NIM) increased by 10 basis points to 2.02%, driven by moves to reprice deposits in a number of divisions, partially offset by roll-off in holdings of higher yielding securities.

Q4 2013 compared with Q3 2013

- Net interest income decreased by £16 million, 1%. Retail & Commercial net interest income increased by £17 million due to deposit repricing. Markets net interest income increased by £21 million due to one-offs. These uplifts were offset by an increase in liquidity and funding costs driven by bond issuance and assets-for-sale portfolio sales.

- Average interest-earning assets decreased by £15.0 billion to £523.7 billion, principally relating to Non-Core.

- Group NIM increased by 4 basis points to 2.09%, primarily driven by deposit repricing in Retail & Commercial, where NIM rose 4 basis points, partially offset by roll-off of higher yielding assets in US R&C.

Q4 2013 compared with Q4 2012

- Net interest income was flat, with stronger margins (up 5 basis points) offset by the declining asset base.

Analysis of results

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

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Non-interest income	**£m**	£m		**£m**	£m	£m
Fees and commissions receivable	**5,460**	5,709		**1,370**	1,382	1,374
Fees and commissions payable						
- managed basis	**(942)**	(833)		**(244)**	(238)	(244)
- RFS Holdings minority interest	**-**	(1)		**-**	-	(1)
Statutory basis	**(942)**	(834)		**(244)**	(238)	(245)
Net fees and commissions						
- managed basis	**4,518**	4,876		**1,126**	1,144	1,130
- RFS Holdings minority interest	**-**	(1)		**-**	-	(1)
Statutory basis	**4,518**	4,875		**1,126**	1,144	1,129
Income from trading activities						
- managed basis	**2,651**	3,533		**162**	599	571
- Asset Protection Scheme	**-**	(44)		**-**	-	-
- own credit adjustments*	**35**	(1,813)		**15**	(155)	(98)
- RFS Holdings minority interest	**(1)**	(1)		**-**	-	1
Statutory basis	**2,685**	1,675		**177**	444	474
Gain/(loss) on redemption of own debt	**175**	454		**(29)**	13	-
Other operating income/(loss)						
- managed basis	**1,281**	2,259		**(115)**	368	365
- own credit adjustments*	**(155)**	(2,836)		**(15)**	(341)	(122)
- Strategic disposals**	**161**	113		**168**	(7)	(16)
- RFS Holdings minority interest	**111**	(1)		**(7)**	15	-
Statutory basis	**1,398**	(465)		**31**	35	227

Total non-interest income – managed	**8,450**	10,668		**1,173**	2,111	2,066
Total non-interest income – statutory	**8,776**	6,539		**1,305**	1,636	1,830
* Own credit adjustments impact:						
Income from trading activities	**35**	(1,813)		**15**	(155)	(98)
Other operating income	**(155)**	(2,836)		**(15)**	(341)	(122)
Own credit adjustments	**(120)**	(4,649)		**-**	(496)	(220)
**Strategic disposals						
(Loss)/gain on sale and provision for loss on						
disposal of investments in:						
- Direct Line Group	**(13)**	-		**-**	(13)	-
- WorldPay	**159**	-		**159**	-	-
- RBS Aviation Capital	**-**	189		**-**	-	(8)
- Other	**15**	(76)		**9**	6	(8)
	161	113		**168**	(7)	(16)

27

Analysis of results

Key points

2013 compared with 2012

- Non-interest income increased by £2,237 million to £8,776 million reflecting a lower accounting charge in relation to own credit adjustments. On a managed basis non-interest income decreased by £2,218 million to £8,450 million.

- The charge for own credit adjustments fell significantly from £4,649 million to £120 million as the Group's credit spreads tightened modestly.

- On a managed basis, the majority of the decline in income was in Markets, where income from trading activities was £1,001 million lower as the division managed down the scale of the balance sheet and reduced risk. This was partially offset by a £506 million improvement in Non-Core trading losses.

- Within other operating income, Non-Core recorded a loss of £334 million excluding rental income. This primarily related to fair value adjustments associated with investment properties.

- A £392 million reduction in operating lease income largely reflects the disposal of RBS Aviation Capital in Q2 2012. This was partially offset by lower depreciation.

Q4 2013 compared with Q3 2013

- Non-interest income decreased by £331 million to £1,305 million reflecting a lower accounting charge in relation to own credit adjustments partially offset by increased disposal gains. On a managed basis non-interest income decreased by £938 million to £1,173 million, principally driven by declining Markets income from trading activities and £277 million of fair value adjustments in Non-Core.

- Lower income was booked on central treasury hedges, and gains on available-for-sale securities were also lower (see Central items, page 73).

- A £159 million gain was recorded on the disposal of RBS's remaining interest in WorldPay.

Q4 2013 compared with Q4 2012

- Non-interest income decreased by £525 million to £1,305 million reflecting a lower accounting charge in relation to own credit adjustments partially offset by the WorldPay gain on sale.

- On a managed basis non-interest income decreased by £893 million, reflecting the lower central treasury hedge income and valuation adjustments in Non-Core.

Analysis of results

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

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Operating expenses	**£m**	£m		**£m**	£m	£m
Staff expenses						
- managed basis	**6,882**	7,377		**1,539**	1,758	1,379
- integration and restructuring costs	**280**	812		**1**	137	277
- RFS Holdings minority interest	**1**	(1)		**1**	-	-
Statutory basis	**7,163**	8,188		**1,541**	1,895	1,656
Premises and equipment						
- managed basis	**2,233**	2,096		**614**	540	524
- integration and restructuring costs	**115**	136		**86**	4	70
- RFS Holdings minority interest	**-**	-		**-**	-	(2)
Statutory basis	**2,348**	2,232		**700**	544	592
Other administrative expenses						
- managed basis	**2,947**	2,899		**785**	683	685
- Payment Protection Insurance costs	**900**	1,110		**465**	250	450
- Interest Rate Hedging Products redress and						
related costs	**550**	700		**500**	99	700
- regulatory and legal actions	**2,394**	381		**1,910**	-	381
- integration and restructuring costs	**255**	325		**101**	70	114
- bank levy	**200**	175		**200**	-	175
- RFS Holdings minority interest	**(2)**	3		**(1)**	1	1
Statutory basis	**7,244**	5,593		**3,960**	1,103	2,506
Depreciation and amortisation						
- managed basis	**1,251**	1,482		**309**	305	360
	153	178		**35**	39	32

- amortisation of purchased intangible assets						
- integration and restructuring costs	**6**	142		**(8)**	(6)	106
Statutory basis	**1,410**	1,802		**336**	338	498
Write-down of goodwill	**1,059**	18		**1,059**	-	18
Write-down of other intangible assets	**344**	106		**344**	-	106
Operating expenses - managed basis	**13,313**	13,854		**3,247**	3,286	2,948
Operating expenses - statutory basis	**19,568**	17,939		**7,940**	3,880	5,376

Key points

2013 compared with 2012

- Operating expenses increased by £1,629 million, 9%, to £19,568 million principally as a result of £2,394 million of regulatory and litigation provisions, which primarily related to mortgage-backed and other securities litigation, and the write-down of goodwill partially offset by lower integration and restructuring costs. On a managed basis operating expenses decreased by £541 million, 4%, to £13,313 million. Markets decreased by £327 million, 11%, to £2,610 million and Non-Core by £339 million, 36%, to £605 million, driven by lower staff numbers and reduced central support requirements on run-down.
- Staff expenses decreased by 13% to £7,163 million. On a managed basis staff expenses were down by 7%, at £6,882 million, with headcount down by 4,400, principally in UK Retail, Non-Core and Markets.
- Restructuring charges fell by £759 million to £656 million, with most of the charges relating to programme costs for the Rainbow branch disposal, Retail transformation and the reduction in size of Markets.

Analysis of results

Key points (continued)

2013 compared with 2012 (continued)

- Provisions for Payment Protection Insurance (PPI) redress and related costs totalled £900 million, down £210 million from 2012. Out of the cumulative provision of £3.1 billion, £2.2 billion had been utilised at 31 December 2013. The remaining provision of £0.9 billion covers approximately twelve months at current levels of redress and administrative expenses.

- Provisions of £550 million were booked for Interest Rate Hedging Product redress and administration costs, down £150 million from 2012. The cumulative charge was £1.25 billion at 31 December 2013.

- Write-down of goodwill of £1,059 million related to International Banking following an impairment review. Write-down of other intangible assets, including software, of £344 million related to Markets.

Q4 2013 compared with Q3 2013

- Operating expenses increased by £4,060 million to £7,940 million principally due to the additional provision of £1,910 million to cover various claims and conduct related matters affecting Group companies, primarily those related to mortgage-backed securities and securities related litigation, and the write-down of goodwill of £1,059 million.

- An additional £465 million provision was booked for PPI redress and related costs in addition to £250 million in Q3. Q4 2013 claims experience continued at previous rates rather than declining as anticipated and claims are now expected to continue for a longer period.

- There was also a further £500 million provision for Interest Rate Hedging Products redress and related costs. The increase in provision reflected both higher volumes and anticipated redress payments, recalibration of our methodology based on experience during Q4 2013, and additional administration charges.

- On a managed basis operating expenses were broadly flat, with offsetting movements across a number of divisions. UK Retail expenses were up £54 million to £722 million, principally due to conduct-related provisions of £50 million and an £18 million increase in Financial Services Compensation Scheme (FSCS) charges. Markets expenses were down £72 million to £553 million, with lower bonus accruals partly offset by additional legal fees. UK Corporate expenses were up £45 million to £585 million primarily due to customer remediation provisions.

-

Staff expenses were down 19% at £1,541 million. On a managed basis staff expenses were down by 12%, with headcount down 1,700, with reductions in Markets and Non-Core reflecting disposals, and in Business Services.

Q4 2013 compared with Q4 2012

- Operating expenses increased by £2,564 million to £7,940 million principally reflecting the increased regulatory and litigation provision and the goodwill write-down of £1,059 million.

- On a managed basis operating expenses rose by £299 million, 10%, to £3,247 million. Markets staff expenses were £105 million higher than in the fourth quarter of 2012, which included exceptional bonus clawbacks and releases following the LIBOR settlements. Q4 2013 expenses also included increased conduct charges of £32 million and FSCS costs of £44 million in UK Retail, and increased project and technology costs, partially offset by reduced costs in Non-Core.

Analysis of results

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
Impairment losses	**£m**	£m	**£m**	£m	£m
Loan impairment losses	**8,412**	5,315	**5,131**	1,120	1,402
Securities	**20**	(36)	**(19)**	50	52
Group impairment losses	**8,432**	5,279	**5,112**	1,170	1,454
Loan impairment losses					
- individually assessed	**6,919**	3,169	**4,867**	580	818
- collectively assessed	**1,464**	2,196	**443**	287	505
- latent	**44**	(73)	**(173)**	253	80
Customer loans	**8,427**	5,292	**5,137**	1,120	1,403
Bank loans	**(15)**	23	**(6)**	-	(1)
Loan impairment losses	**8,412**	5,315	**5,131**	1,120	1,402
Core	**3,766**	2,995	**1,924**	584	729
Non-Core	**4,646**	2,320	**3,207**	536	673
Group	**8,412**	5,315	**5,131**	1,120	1,402
of which RCR related (1)	**4,490**	-	**4,290**	200	-
Customer loan impairment charge as a % of					
gross loans and advances to customers (2)					
Group	**2.0%**	1.2%	**4.9%**	1.0%	1.2%
Core	**1.0%**	0.7%	**2.0%**	0.6%	0.7%

Non-Core	**12.8%**	4.2%		**35.3%**	5.2%	4.8%		

Notes:

(1) Pertaining to the creation of RCR and related strategy.
(2) Customer loan impairment charge as a percentage of gross customer loans and advances excludes reverse repurchase agreements and includes disposals groups.

Key points

RBS Capital Resolution ('RCR') was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate the run-down of these exposures over a three year period to free up capital for the bank. This revised strategy to run down high risk loans faster resulted in an increased impairment charge relating to impaired or non-performing assets transferred to RCR, reflecting adverse changes in our estimates of future cash flows. Further details about RCR are set out on page 25 and in Appendix 1.

2013 compared with 2012

- Group loan impairment losses rose by 58% to £8,412 million reflecting the increased provisions recognised in connection with the creation of RCR. Adjusting for this impairment, losses fell by £1,393 million (26%) to £3,922 million, driven by significant improvements in Non-Core, Ulster Bank and UK Retail, partially offset by increases in International Banking, US Retail & Commercial and Markets.

- Additional loan impairments arising from the RCR accelerated asset recovery strategy totalled £4,490 million, of which £3,118 million related to Non-Core, £892 million to Ulster Bank, £410 million to UK Corporate, £52 million to International Banking and £18 million to Markets.

Analysis of results

Key points (continued)

2013 compared with 2012 (continued)

- Excluding the impact of the creation of RCR, Core Ulster Bank loan impairments fell by £482 million to £882 million (35%), mainly as a result of continued improvement in retail mortgage debt-flow and in recovery trends. UK Retail loan impairments fell by £210 million (40%), primarily from lower default levels.

- Excluding the impact of the creation of RCR, Non-Core loan impairments fell by £792 million to £1,528 million, reflecting the continued reduction in the overall portfolio.

Q4 2013 compared with Q3 2013

- Excluding the impact of the creation of RCR, Core loan impairment losses decreased by £32 million, mainly as a result of improvements in Ulster Bank and International Banking partially offset by a small number of individual impairments in UK Corporate's real estate and shipping portfolios.

- Non-Core loan impairment losses, also excluding the impact of the creation of RCR, improved by £47 million due to decreases in Ulster Bank partially offset by an increase in UK Corporate loan impairments.

Q4 2013 compared with Q4 2012

- Core loan impairment losses, excluding the impact of the creation of RCR, decreased by £177 million, driven principally by an improvement in the performance of the Ulster Bank mortgage book.

- Non-Core loan impairment losses, excluding the impact of the creation of RCR, improved by £384 million compared with Q4 2012.

Analysis of results

Capital resources and ratios	31 December 2013	30 September 2013	31 December 2012
Current rules			
Core Tier 1 capital	**£42bn**	£48bn	£47bn
Tier 1 capital	**£51bn**	£57bn	£57bn
Total capital	**£64bn**	£67bn	£67bn
Risk-weighted assets (RWAs)	**£385bn**	£410bn	£460bn
Core Tier 1 ratio	**10.9%**	11.6%	10.3%
Tier 1 ratio	**13.1%**	13.8%	12.4%
Total capital ratio	**16.5%**	16.2%	14.5%
Fully loaded Capital Requirements Regulation estimates			
Common Equity Tier 1 (CET1) capital	**£37bn**	£41bn	£38bn
RWAs	**£429bn**	£453bn	£495bn
CET1 ratio	**8.6%**	9.1%	7.7%

Key points

31 December 2013 compared with 31 December 2012

- The Group's Core Tier 1 ratio, on a Basel 2.5 basis, was 60 basis points higher at 10.9%. On a fully loaded Basel III (FLB3) basis, the Common Equity Tier 1 ratio was 8.6%, 90 basis points higher.

- Group RWAs decreased by £75 billion to £385 billion, driven by the substantial reductions achieved in Markets (down £37 billion) and Non-Core (down £31 billion). Retail & Commercial RWAs were £11 billion lower.

- On a FLB3 basis, Group RWAs decreased by £66 billion to £429 billion, driven by Markets risk reduction and reshape and Non-Core disposals and run-off.

31 December 2013 compared with 30 September 2013

- The Group's Core Tier 1 ratio, on a Basel 2.5 basis, was 70 basis points lower at 10.9%. On a FLB3 basis, the Common Equity Tier 1 ratio was 50 basis points lower at 8.6%. The decline was due to the attributable loss for the quarter which outweighed the benefit of lower RWAs.

- Group RWAs decreased by £25 billion to £385 billion. Markets was £9 billion lower, driven by the strategic reduction in the division's balance sheet. Non-Core RWAs were down £12 billion, principally reflecting disposals and run-off. Retail & Commercial RWAs were broadly unchanged.

- On a FLB3 basis, Group RWAs decreased by £24 billion to £429 billion.

For further details of the Group's capital resources refer to page 141.

Analysis of results

Balance sheet	31 December 2013	30 September 2013	31 December 2012
Total assets	**£1,028bn**	£1,129bn	£1,312bn
Derivatives	**£288bn**	£323bn	£442bn
Funded balance sheet (1)	**£740bn**	£806bn	£870bn
Loans and advances to customers (2)	**£393bn**	£408bn	£432bn
Customer deposits (3)	**£418bn**	£434bn	£434bn
Loan:deposit ratio - Core (4)	**89%**	87%	90%
Loan:deposit ratio - Group (4)	**94%**	94%	100%

Notes:

(1) Funded balance sheet represents total assets less derivatives.
(2) Excludes reverse repurchase agreements and stock borrowing, and includes disposal groups.
(3) Excludes repurchase agreements and stock lending, and includes disposal groups.
(4) Net of provisions, including disposal groups and excluding repurchase agreements. Excluding disposal groups, the loan:deposit ratios of Core and Group at 31 December 2013 were 90% and 94% respectively (30 September 2013 - 87% and 94%; 31 December 2012 - 90% and 99%)

Key points

31 December 2013 compared with 31 December 2012

- Funded assets fell by £130 billion to £740 billion as a result of Non-Core disposals and run-off, and the downsizing of Markets business in order to reduce risk and focus on its core strengths.

- The Group's customer funding surplus increased significantly from £2 billion to £25 billion over the year. The Group loan:deposit ratio was 94% compared with 100% at the end of 2012 and the Core loan:deposit ratio at 89% was broadly unchanged.

- Loans and advances to customers fell by £39 billion to £393 billion, driven by £22 billion of run-off and disposals in Non-Core.

- Customer deposits fell by £16 billion to £418 billion, as several businesses repriced their deposit product suites, reflecting the bank's excess liquidity position.

31 December 2013 compared with 30 September 2013

- Funded assets fell to £740 billion, a reduction of £66 billion on the quarter, principally reflecting the managing down of Markets balance sheet and sales and run-off in Non-Core.

- Retail & Commercial loans and advances declined 3% to £339 billion, with reductions in International Banking due to the netting of pooled accounts and in US Retail & Commercial, where the dollar weakening against the pound affected balances. This was partially offset by growth in UK Retail loan balances, up £0.6 billion.

- Customer deposits declined by £16 billion to £418 billion, driven by repricing of non-relationship deposits.

Analysis of results

Funding and liquidity metrics	31 December 2013	30 September 2013	31 December 2012
Deposits (1)	**£453bn**	£473bn	£491bn
Deposits as a percentage of funded balance sheet	**61%**	59%	56%
Short-term wholesale funding (2)	**£32bn**	£35bn	£42bn
Wholesale funding (2)	**£108bn**	£114bn	£150bn
Short-term wholesale funding as a percentage of funded balance sheet	**4%**	4%	5%
Short-term wholesale funding as a percentage of total wholesale funding	**30%**	31%	28%
Liquidity portfolio	**£146bn**	£151bn	£147bn
Liquidity portfolio as a percentage of funded balance sheet	**20%**	19%	17%
Liquidity portfolio as a percentage of short-term wholesale funding	**456%**	431%	350%
Net stable funding ratio	**122%**	119%	117%

Notes:

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

Key points

31 December 2013 compared with 31 December 2012

- The bank remains highly liquid with short-term wholesale funding covered more than 4.5 times by its liquidity portfolio as at 31 December 2013, compared with 3.5 times as at 31 December 2012.

-

Short-term wholesale funding decreased by £10 billion over the year to £32 billion. As the bank continued to pay down these balances with excess cash, total wholesale funding fell by £42 billion to £108 billion.

- The liquidity portfolio remained stable at £146 billion as deleveraging in Non-Core and Markets continued to generate cash, offset by initiatives to reprice non-relationship deposits that generate higher liquidity coverage requirements, as well as by liability management exercises undertaken over the course of the year.

- Deposits declined by £38 billion to £453 billion as initiatives to re-price and to improve the behavioural characteristics of the deposit base took effect. These initiatives included repricing wholesale and other deposit types with a low liquidity or relationship value, further improving the bank’s liquidity position and net interest margin.

31 December 2013 compared with 30 September 2013

- Short-term wholesale funding fell by £3 billion in the quarter to £32 billion, representing 4% of the Group’s funded balance sheet.

- The liquidity portfolio declined by £5 billion in the quarter, driven by lower deposit balances as a result of the repricing of corporate and wholesale customer balances with higher liquidity coverage requirements.

For further details of the Group’s funding and liquidity metrics refer to page 150.

Divisional performance

The operating profit/(loss) of each division is shown below.

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	£m	£m		**£m**	£m	£m
Operating profit/(loss) by division						
UK Retail	**1,943**	1,891		**472**	517	513
UK Corporate	**1,060**	1,796		**(115)**	422	424
Wealth	**221**	243		**49**	60	76
International Banking	**279**	594		**60**	83	155
Ulster Bank	**(1,457)**	(1,040)		**(996)**	(132)	(243)
US Retail & Commercial	**647**	754		**142**	142	200
Retail & Commercial	**2,693**	4,238		**(388)**	1,092	1,125
Markets	**620**	1,509		**39**	210	139
Central items	**(89)**	84		**(174)**	(19)	118
Core	**3,224**	5,831		**(523)**	1,283	1,382
Non-Core	**(5,527)**	(2,879)		**(3,896)**	(845)	(942)
Managed basis	**(2,303)**	2,952		**(4,419)**	438	440
Reconciling items:						
Own credit adjustments	**(120)**	(4,649)		**-**	(496)	(220)
Payment Protection Insurance costs	**(900)**	(1,110)		**(465)**	(250)	(450)
Interest Rate Hedging Products redress and related						
costs	**(550)**	(700)		**(500)**	-	(700)
Regulatory and legal actions	**(2,394)**	(381)		**(1,910)**	(99)	(381)
Integration and restructuring costs	**(656)**	(1,415)		**(180)**	(205)	(567)
Gain/(loss) on redemption of own debt	**175**	454		**(29)**	13	-
Write-down of goodwill	**(1,059)**	(18)		**(1,059)**	-	(18)

Asset Protection Scheme	**-**	(44)		**-**	-	-
Amortisation of purchased intangible assets	**(153)**	(178)		**(35)**	(39)	(32)
Strategic disposals	**161**	113		**168**	(7)	(16)
Bank levy	**(200)**	(175)		**(200)**	-	(175)
Write-down of other intangible assets	**(344)**	(106)		**(344)**	-	(106)
RFS Holdings minority interest	**100**	(20)		**(10)**	11	(2)
Statutory basis	**(8,243)**	(5,277)		**(8,983)**	(634)	(2,227)

Impairment losses/(recoveries) by division						
UK Retail	**324**	529		**73**	82	93
UK Corporate	**1,188**	838		**659**	150	234
Wealth	**29**	46		**21**	1	16
International Banking	**229**	111		**47**	28	37
Ulster Bank	**1,774**	1,364		**1,067**	204	318
US Retail & Commercial	**156**	91		**46**	59	23
Retail & Commercial	**3,700**	2,979		**1,913**	524	721
Markets	**92**	37		**34**	(1)	22
Central items	**64**	40		**1**	66	8
Core	**3,856**	3,056		**1,948**	589	751
Non-Core	**4,576**	2,223		**3,164**	581	703
Group impairment losses – managed and statutory basis	**8,432**	5,279		**5,112**	1,170	1,454
Of which RCR related (1)	**4,490**	-		**4,290**	200	-

Note:

(1) Pertaining to the creation of RCR and related strategy.

Divisional performance

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	%	%		**%**	%	%
Net interest margin by division						
UK Retail	**3.57**	3.58		**3.60**	3.62	3.60
UK Corporate	**3.07**	3.06		**3.13**	3.09	2.97
Wealth	**3.56**	3.73		**3.70**	3.56	3.69
International Banking	**1.59**	1.64		**1.54**	1.47	1.62
Ulster Bank	**1.91**	1.88		**2.10**	1.86	1.93
US Retail & Commercial	**2.95**	2.97		**2.98**	2.99	2.90
Retail & Commercial	**2.94**	2.92		**2.99**	2.95	2.91
Non-Core	**(0.19)**	0.31		**(0.36)**	(0.35)	0.29
Group net interest margin	**2.02**	1.92		**2.09**	2.05	1.95

	31 December	30 September	31 December
	2013	2013	2012
	£bn	£bn	£bn
Total funded assets by division			
UK Retail	**117.6**	117.0	117.4
UK Corporate	**105.0**	107.0	110.2
Wealth	**21.0**	21.0	21.4
International Banking	**48.5**	53.3	53.0
Ulster Bank	**28.0**	29.2	30.6
US Retail & Commercial	**71.3**	71.4	72.1
Retail & Commercial	**391.4**	398.9	404.7
Markets	**212.8**	248.2	284.5

Central items	**106.7**	120.5	110.3
Core	**710.9**	767.6	799.5
Non-Core	**28.0**	37.3	57.4
	738.9	804.9	856.9
Direct Line Group	**-**	-	12.7
RFS Holdings minority interest	**0.9**	0.9	0.8
Group	**739.8**	805.8	870.4

Divisional performance

	31 December 2013	30 September 2013		31 December 2012	
	£bn	£bn	Change	£bn	Change
Risk-weighted assets by division					
UK Retail	**43.9**	44.8	(2%)	45.7	(4%)
UK Corporate	**86.1**	87.2	(1%)	86.3	(0%)
Wealth	**12.0**	12.1	(1%)	12.3	(2%)
International Banking	**49.0**	48.4	1%	51.9	(6%)
Ulster Bank	**30.7**	31.8	(3%)	36.1	(15%)
US Retail & Commercial	**56.1**	56.1	-	56.5	(1%)
Retail & Commercial	**277.8**	280.4	(1%)	288.8	(4%)
Markets	**64.5**	73.2	(12%)	101.3	(36%)
Other (primarily Group Treasury)	**10.1**	11.6	(13%)	5.8	74%
Core	**352.4**	365.2	(4%)	395.9	(11%)
Non-Core	**29.2**	40.9	(29%)	60.4	(52%)
Group before RFS Holdings minority interest	**381.6**	406.1	(6%)	456.3	(16%)
RFS Holdings minority interest	**3.9**	3.9	-	3.3	18%
Group	**385.5**	410.0	(6%)	459.6	(16%)

Employee numbers by division **(full time equivalents rounded to the nearest hundred)**	31 December 2013	30 September 2013	31 December 2012
UK Retail	**23,700**	23,900	26,000
UK Corporate	**13,700**	13,700	13,300
Wealth	**4,800**	5,000	5,100
International Banking	**4,700**	4,800	4,600

Ulster Bank	**4,700**	4,800	4,500
US Retail & Commercial	**18,500**	18,300	18,700
Retail & Commercial	**70,100**	70,500	72,200
Markets	**10,300**	10,900	11,300
Group Centre	**7,400**	7,300	6,800
Core	**87,800**	88,700	90,300
Non-Core	**1,400**	1,900	3,100
	89,200	90,600	93,400
Business Services	**29,200**	29,500	29,100
Integration and restructuring	**200**	200	500
Group	**118,600**	120,300	123,000

UK Retail

	Year ended			Quarter ended		
	31 December	31 December		31 December	30 September	31 December
	2013	2012		2013	2013	2012
	£m	£m		£m	£m	£m
Income statement						
Net interest income	**3,979**	3,990		**1,014**	1,013	1,011
Net fees and commissions	**919**	884		**249**	243	202
Other non-interest income	**39**	95		**4**	11	17
Non-interest income	**958**	979		**253**	254	219
Total income	**4,937**	4,969		**1,267**	1,267	1,230
Direct expenses						
- staff	**(707)**	(811)		**(172)**	(177)	(186)
- other	**(562)**	(372)		**(198)**	(137)	(90)
Indirect expenses	**(1,401)**	(1,366)		**(352)**	(354)	(348)
	(2,670)	(2,549)		**(722)**	(668)	(624)
Profit before impairment losses	**2,267**	2,420		**545**	599	606
Impairment losses	**(324)**	(529)		**(73)**	(82)	(93)
Operating profit	**1,943**	1,891		**472**	517	513
Analysis of income by product						
Personal advances	**923**	916		**247**	233	228
Personal deposits	**468**	661		**116**	125	150
Mortgages	**2,606**	2,367		**665**	664	610
Cards	**838**	863		**206**	213	214
Other	**102**	162		**33**	32	28
Total income	**4,937**	4,969		**1,267**	1,267	1,230

Analysis of impairments by sector						
Mortgages	**30**	92		**(13)**	18	5
Personal	**180**	307		**61**	34	64
Cards	**114**	130		**25**	30	24
Total impairment losses	**324**	529		**73**	82	93
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Mortgages	**-**	0.1%		**(0.1%)**	0.1%	-
Personal	**2.2%**	3.5%		**3.0%**	1.7%	2.9%
Cards	**2.0%**	2.3%		**1.7%**	2.1%	1.7%
Total	**0.3%**	0.5%		**0.3%**	0.3%	0.3%

39

UK Retail

Key metrics					
	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
Performance ratios					
Return on equity (1)	**26.3%**	24.4%	**25.5%**	28.0%	27.2%
Net interest margin	**3.57%**	3.58%	**3.60%**	3.62%	3.60%
Cost:income ratio	**54%**	51%	**57%**	53%	51%

	31 December 2013	30 September 2013		31 December 2012	
	£bn	£bn	Change	£bn	Change
Capital and balance sheet					
Loans and advances to customers (gross)					
- mortgages	**99.3**	98.9	-	99.1	-
- personal	**8.1**	8.1	-	8.8	(8%)
- cards	**5.8**	5.7	2%	5.7	2%
	113.2	112.7	-	113.6	-
Loan impairment provisions	**(2.1)**	(2.2)	(5%)	(2.6)	(19%)
Net loans and advances to customers	**111.1**	110.5	1%	111.0	-
Risk elements in lending	**3.6**	3.8	(5%)	4.6	(22%)
Provision coverage (2)	**59%**	59%	-	58%	100bp
Customer deposits					
- Current accounts	**32.6**	31.5	3%	28.9	13%
- Savings	**82.3**	81.9	-	78.7	5%

Total customer deposits	**114.9**	113.4	1%		107.6	7%
Assets under management (excluding deposits)	**5.8**	5.9	(2%)		6.0	(3%)
Loan:deposit ratio (excluding repos)	**97%**	97%	-		103%	(600bp)
Risk-weighted assets (3)						
- Credit risk (non-counterparty)	**36.1**	37.0	(2%)		37.9	(5%)
- Operational risk	**7.8**	7.8	-		7.8	-
Total risk-weighted assets	**43.9**	44.8	(2%)		45.7	(4%)

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

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

(3) Divisional RWAs are based on a long-term conservative average secured mortgage probability of default methodology rather than the current lower point in time basis required for regulatory reporting.

UK Retail

Key points

In March 2013 UK Retail announced its strategy to become a simpler and more customer-focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Good progress has been made with £180 million of investment during 2013 through a number of initiatives directed at enhancing customer service and simplification of products and services. These have included:

- Improvements to Mobile and Digital Banking which continue to evolve in line with how customers prefer to conduct their business. One example of this is the enhancements in the mobile application allowing customers to pay their mobile phone contacts and obtain cash without using their debit card with the award winning ‘Get Cash’. Investment in digital products and services continued in 2013, with 50% of eligible customers now banking online or on mobile. We currently have 5.6 million online users and 2.9 million customers using our mobile app with over 100 million transactions made in 2013. Branch counter transactions were 31 million or 11% lower across the same period. In addition, UK Retail now has over 2.5 million active mobile users, using the service 28 times a month on average. Mobile net promoter scores continued to increase in 2013.

- During the year UK Retail invested in the introduction of a new integrated telephony system, increased training and the professional development of our staff. We spent more time on each call to support excellent customer service and to promote relevant offerings, including self service.

- During Q1 2013 mortgage advisors attended extensive training courses to help ensure customers receive the best possible outcome to meet their needs. The training affected balance growth during H1 2013; however, application volumes have rebounded quickly with the launch of competitively priced products and the ‘NatYes’ and ‘RBYES’ advertising campaigns leading to H2 2013 applications being 30% higher than H1 2013. RBS was the first bank to be ready to deliver the second phase of the UK Government’s Help To Buy scheme, launched in early October 2013. Extended opening hours in branches helped to deliver more than 3,000 approvals assisting young people and families across Britain buy their home. Gross mortgage lending increased 3% year-on-year to £14.3 billion with Q4 2013 25% higher than Q4 2012.

- Significant focus on streamlining processes has benefited all distribution channels, with the capacity created allowing more time for staff coaching and resulting in advisors spending more time and having better conversations with customers.

- In addition, our product range has been simplified down from 56 to 46 with several products winning awards. A highlight of this UK Retail strategy is the success of the new instant saver product launched in Q4 2012, which at the end of 2013 had more than £10 billion in balances. Furthermore, nearly 800,000 customers have registered for Cashback Plus online since launch in Q3 2013 and are being rewarded for using their debit cards with selected retailers.

- A major branch refurbishment programme is under way with over one quarter completed. 350 branches now have a digital banking zone where customers can use in-branch technology to access online banking. Wi-Fi in-branch allows customers to access their account via their own devices.

UK Retail

Key points (continued)

During 2013 good progress has been made with FCA (Financial Conduct Authority) reportable complaints, which declined 22%. In addition, the provision relating to historic Payment Protection Insurance (PPI) mis-selling was increased by £860 million, bringing the total to £3.0 billion. The PPI expense is not included in the operating profit of UK Retail.

In 2014, UK Retail will aim to maintain a leading position in digital banking, launching new capability and customer proposition through mobile devices.

2013 compared with 2012

- Operating profit increased by 3% to £1,943 million driven by a 39% decline in impairment losses. Net interest income was broadly stable, though investment advice income was adversely impacted following changes introduced by the Retail Distribution Review (RDR). Costs increased primarily because of a higher FSCS levy and other regulatory charges totalling £116 million in the year, conduct-related provisions of £63 million and additional technology investment of £45 million.

- Mortgage balance growth was affected in H1 2013 by mortgage advisor training; however, balances recovered during H2 2013 assisted by early adoption of the second phase of the UK Government's Help To Buy scheme. Gross lending increased to £8.9 billion in H2 2013. Customer deposits increased by 7%, above the UK market average of 4% due to strong growth in both current accounts (13%) and instant access savings accounts (15%).

- Net interest income was broadly flat.

  Mortgage new business margins reduced in line with market conditions; however, overall book margins improved.
  Deposit margins declined reflecting the impact of continued lower rates on current account hedges. Savings margins, however, have increased over 2013 with improved market pricing.

- Non-interest income fell by 2% to £958 million due to subdued advice income post RDR.

- Direct costs increased by 7% due to higher FSCS levy and other regulatory charges and conduct-related provisions of £63 million. This was partly offset by lower staff costs due to a reduction in headcount of 2,300. Indirect costs increased by 3%, largely due to investment in technology.

- Impairments declined by 39% to £324 million due to lower customer defaults across all products reflecting continued improvement in asset quality.

- Risk-weighted assets declined by 4% to £43.9 billion largely reflecting balance reductions across the unsecured portfolio and quality improvements.

Q4 2013 compared with Q3 2013

- Operating profit declined 9% due to additional conduct-related provisions and an increased charge for FSCS levy, partially offset by lower staff costs and impairments.

- Mortgage balances continued to increase as the second phase of Help to Buy launched with a high volume of applications received. Deposit balances increased 1% with current account growth of 3% as customers continue to favour convenience over price.

- Net interest income remained flat at £1,014 million with improving savings margins offset by lower income from unsecured products and lower current account hedge returns.

UK Retail

Key points (continued)

Q4 2013 compared with Q3 2013 (continued)

- Direct costs increased 18% to £370 million due to conduct-related provisions of £50 million and an £18 million increase in the FSCS levy charge. Indirect costs were broadly flat.
- Impairments declined 11% to £73 million due to lower customer default rates and higher house prices improving recovery expectations on defaulted mortgage assets.
- Risk-weighted assets declined slightly due to small quality improvements.

Q4 2013 compared with Q4 2012

- Operating profit was 8% lower at £472 million as income growth of 3% and a 22% decline in impairments were more than offset by higher charges for FSCS levy of £44 million and additional conduct-related provisions of £32 million.
- Net interest income increased slightly to £1,014 million due to overall mortgage margin improvement.
- Non-interest income increased 16% to £253 million due to higher current account-related fee income partly offset by lower investment and advice income.
- Direct costs were 34% higher at £370 million due to FSCS levy and conduct-related provisions as well as additional investment in technology. Staff costs were 8% lower as headcount declined 9%.
- Impairments declined 22% to £73 million reflecting lower customer default rates.

UK Corporate

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	£m	£m		**£m**	£m	£m
Income statement						
Net interest income	**2,874**	2,974		**728**	725	717
Net fees and commissions	**1,310**	1,365		**326**	328	349
Other non-interest income	**283**	384		**75**	59	107
Non-interest income	**1,593**	1,749		**401**	387	456
Total income	**4,467**	4,723		**1,129**	1,112	1,173
Direct expenses						
- staff	**(912)**	(940)		**(229)**	(229)	(226)
- other	**(442)**	(364)		**(134)**	(90)	(99)
Indirect expenses	**(865)**	(785)		**(222)**	(221)	(190)
	(2,219)	(2,089)		**(585)**	(540)	(515)
Profit before impairment losses	**2,248**	2,634		**544**	572	658
Impairment losses	**(1,188)**	(838)		**(659)**	(150)	(234)
Operating profit	**1,060**	1,796		**(115)**	422	424
Analysis of income by business						
Corporate and commercial lending	**2,557**	2,636		**639**	631	672
Asset and invoice finance	**671**	685		**168**	169	176
Corporate deposits	**350**	568		**106**	88	87
Other	**889**	834		**216**	224	238
Total income	**4,467**	4,723		**1,129**	1,112	1,173
Analysis of impairments/(recoveries) by sector						

Financial institutions	**10**	15		**4**	5	3
Hotels and restaurants	**53**	52		**16**	7	23
Housebuilding and construction	**39**	143		**12**	9	25
Manufacturing	**50**	49		**20**	17	10
Private sector education, health, social work,						
recreational and community services	**138**	37		**33**	36	2
Property	**439**	252		**236**	41	71
Wholesale and retail trade, repairs	**74**	112		**15**	20	47
Asset and invoice finance	**32**	40		**21**	5	10
Shipping	**341**	82		**310**	(1)	42
Other	**12**	56		**(8)**	11	1
Total impairment losses	**1,188**	838		**659**	150	234
Of which RCR related (1)	**410**	-		**410**	-	-

Note:

(1) Pertaining to the creation of RCR and related strategy.

UK Corporate

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Financial institutions	**0.2%**	0.3%		**0.3%**	0.4%	0.2%
Hotels and restaurants	**1.1%**	0.9%		**1.4%**	0.5%	1.6%
Housebuilding and construction	**1.3%**	4.2%		**1.7%**	1.2%	2.9%
Manufacturing	**1.2%**	1.0%		**1.9%**	1.6%	0.9%
Private sector education, health, social work, recreational and community services	**1.6%**	0.4%		**1.6%**	1.7%	0.1%
Property	**2.0%**	1.0%		**4.3%**	0.7%	1.1%
Wholesale and retail trade, repairs	**0.9%**	1.3%		**0.7%**	1.0%	2.2%
Asset and invoice finance	**0.3%**	0.4%		**0.7%**	0.2%	0.4%
Shipping	**5.2%**	1.1%		**19.1%**	(0.1%)	2.2%
Other	**-**	0.2%		**(0.1%)**	0.2%	-
Total	**1.2%**	0.8%		**2.6%**	0.6%	0.9%

Key metrics

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Performance ratios						
Return on equity (1)	**7.9%**	14.5%		**(3.4%)**	12.4%	13.2%
Net interest margin	**3.07%**	3.06%		**3.13%**	3.09%	2.97%

Cost:income ratio	**50%**	44%		**52%**	49%	44%

Note:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

UK Corporate

	31 December 2013	30 September 2013		31 December 2012	
	£bn	£bn	Change	£bn	Change
Capital and balance sheet					
Loans and advances to customers (gross)					
- financial institutions	**5.5**	4.7	17%	5.8	(5%)
- hotels and restaurants	**4.7**	5.5	(15%)	5.6	(16%)
- housebuilding and construction	**2.9**	2.9	-	3.4	(15%)
- manufacturing	**4.2**	4.3	(2%)	4.7	(11%)
- private sector education, health, social work, recreational and community services	**8.5**	8.6	(1%)	8.7	(2%)
- property	**22.0**	23.1	(5%)	24.8	(11%)
- wholesale and retail trade, repairs	**8.2**	8.4	(2%)	8.5	(4%)
- asset and invoice finance	**11.7**	11.6	1%	11.2	4%
- shipping	**6.5**	7.0	(7%)	7.6	(14%)
- other	**28.3**	27.7	2%	26.7	6%
	102.5	103.8	(1%)	107.0	(4%)
Loan impairment provisions	**(2.8)**	(2.3)	22%	(2.4)	17%
Net loans and advances to customers	**99.7**	101.5	(2%)	104.6	(5%)
Total third party assets	**105.0**	107.0	(2%)	110.2	(5%)
Risk elements in lending	**6.2**	6.0	3%	5.5	13%
Provision coverage (1)	**46%**	39%	700bp	45%	100bp
Customer deposits	**124.7**	124.9	-	127.1	(2%)
Loan:deposit ratio (excluding repos)	**80%**	81%	(100bp)	82%	(200bp)
Risk-weighted assets					
- Credit risk (non-counterparty)	**77.7**	78.8	(1%)	77.7	-
- Operational risk	**8.4**	8.4	-	8.6	(2%)

	86.1	87.2	(1%)	86.3	-

Note:

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

Key points

2013 was a year in which UK Corporate underlined its commitment to support the UK economy and played an active role in the communities it operates in.

As part of this commitment the Bank appointed Sir Andrew Large to undertake a thorough and independent review of the lending standards and practices used by RBS and NatWest. UK Corporate will implement all of the Independent Lending Review's recommendations and is adopting a revised strategy and capabilities to enhance support to SMEs and the wider UK economic recovery while maintaining sound lending practices.

As part of the division's concerted effort to support its SME customers, UK Corporate has been proactively reviewing the business needs of SME customers to understand if they could benefit from the offer of additional facilities. In 2013, over 12,000 customers were identified for additional funding under UK Corporate's 'Statements of Appetite' initiative. The initiative resulted in approximately £6 billion of new funding being offered to customers.

UK Corporate

Key points (continued)

The division has continued to support the government-backed Funding for Lending Scheme (FLS) and as at 31 December 2013 had allocated in excess of £4.7 billion of new FLS-related lending to almost 25,000 customers, £3.1 billion of which has been drawn since the scheme was launched. Mid-sized manufacturers are being offered targeted support, with interest rates reduced by more than 1% in some cases. SME customers benefited from both lower interest rates and the removal of arrangement fees.

As well as delivering a range of lending initiatives, UK Corporate continued to develop new propositions for its customers. Following a successful pilot UK Corporate launched a leading business-to-business online community platform, Bizcrowd, to support independent needs matching. By the end of 2013 Bizcrowd had over 27,000 users and is now helping to bring businesses together across the UK.

During the course of 2013 UK Corporate's Business Banking Enterprise Programme helped over 40,000 entrepreneurs through over 1,000 events. Through its combination of nationwide start-up surgeries, mobile business schools and business academies, the programme offers support and advice to aspiring entrepreneurs, new start-up businesses and established SMEs looking to grow. Combined with UK Corporate's skills-based volunteering scheme, a programme offering all employees five days to volunteer with a charitable organisation, UK Corporate continued to deliver on its on-going commitment to communities.

2013 compared with 2012

- The business delivered a return on equity of 11.0% excluding the impact of increased impairment losses related to the creation of RCR, primarily property and shipping exposures, which reduced return on equity by 3.1%.

- Net interest income was 3% lower at £2,874 million, as increased income from re-pricing initiatives was offset by the lower rate environment impacting deposit returns, the non-repeat of 2012 deferred income recognition revisions (£58 million) and reduced lending volumes, as loan repayments coupled with run-off in property and shipping sectors outpaced new lending.

- Non-interest income reduced 9% to £1,593 million, primarily from lower Markets revenue share income, a decline in operating lease income (offset by an associated reduction of operating lease depreciation in expenses), lower lending fees and higher derivative close-out costs associated with impaired assets.

- Expenses, increased 6% to £2,219 million, primarily as a result of remediation provisions of £68 million, an increased share of branch network costs and an uplift in investment spend. This was offset by the reduction in operating lease depreciation, a decline in Markets revenue share related costs and lower staff incentive expenditure.

- Whilst full year impairments include the additional impact of increased impairment losses related to the creation of RCR (£410 million), underlying impairments improved by £60 million, or 7%, to £778 million due to lower individual and collectively assessed provisions in the SME business, partially offset by higher individual cases in the mid-to-large corporate business.

- Risk-weighted assets were broadly in line with 2012 at £86.1 billion as reduced asset volumes and movements into default offset increases resulting from the implementation of risk model changes.

UK Corporate

Key points (continued)

Q4 2013 compared with Q3 2013

- Q4 2013 operating profit was down 27% at £307 million, excluding the impact of increased losses relating to the creation of RCR. Underlying income increased 3%, which was offset by higher impairments and customer remediation provisions.
- Net interest income was in line with Q3 2013 as the increase from re-pricing initiatives was offset by a 1% decline in lending volumes from run-off in the property and shipping sectors.
- Non-interest income increased 4% to £401 million due to higher equity gains and lower derivative close-out costs associated with impaired assets.
- Total expenses excluding customer remediation provisions were broadly flat.
- Underlying impairments, excluding the impact of increased losses relating to the creation of RCR, increased by £99 million to £249 million reflecting a small number of individual cases in the mid-to-large corporate business.

Q4 2013 compared with Q4 2012

- Operating profit, excluding the impact of increased losses relating to the creation of RCR, was 28% lower at £307 million, reflecting higher impairments, the allocation of branch network costs and the increased customer remediation provisions.
- Net interest income increased 2% to £728 million as the uplift from re-pricing activity was only partially offset by lower yields on current accounts and lower asset volumes.
- Non-interest income was 12% lower at £401 million reflecting the reduced operating lease and Markets revenue share income and lower lending fees.
- Total expenditure included the higher remediation charges and the increased share of retail branch network costs, which were partially offset by the reduced costs in relation to operating lease depreciation and Markets revenue share.
- Impairments, excluding the increased losses relating to the creation of RCR, were 6% higher at £249 million, reflecting the increased individual provisions in the mid-to-large corporate business.

Wealth

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	£m	£m		**£m**	£m	£m
Income statement						
Net interest income	**674**	720		**174**	169	178
Net fees and commissions	**355**	366		**85**	90	89
Other non-interest income	**64**	84		**18**	12	18
Non-interest income	**419**	450		**103**	102	107
Total income	**1,093**	1,170		**277**	271	285
Direct expenses						
- staff	**(405)**	(419)		**(85)**	(102)	(85)
- other	**(124)**	(162)		**(43)**	(30)	(34)
Indirect expenses	**(314)**	(300)		**(79)**	(78)	(74)
	(843)	(881)		**(207)**	(210)	(193)
Profit before impairment losses	**250**	289		**70**	61	92
Impairment losses	**(29)**	(46)		**(21)**	(1)	(16)
Operating profit	**221**	243		**49**	60	76
Analysis of income						
Private banking	**894**	956		**225**	222	230
Investments	**199**	214		**52**	49	55
Total income	**1,093**	1,170		**277**	271	285
Key metrics	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December

	2013	2012		2013	2013	2012
Performance ratios						
Return on equity (1)	**12.0%**	13.1%		**10.9%**	13.1%	16.7%
Net interest margin	**3.56%**	3.73%		**3.70%**	3.56%	3.69%
Cost:income ratio	**77%**	75%		**75%**	77%	68%

Note:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

49

Wealth

	31 December 2013	30 September 2013		31 December 2012	
	£bn	£bn	Change	£bn	Change
Capital and balance sheet					
Loans and advances to customers (gross)					
- mortgages	**8.7**	8.7	-	8.8	(1%)
- personal	**5.6**	5.6	-	5.5	2%
- other	**2.5**	2.6	(4%)	2.8	(11%)
	16.8	16.9	(1%)	17.1	(2%)
Loan impairment provisions	**(0.1)**	(0.1)	-	(0.1)	-
Net loans and advances to customers	**16.7**	16.8	(1%)	17.0	(2%)
Risk elements in lending	**0.3**	0.3	-	0.2	50%
Provision coverage (1)	**43%**	38%	500bp	44%	(100bp)
Assets under management (excluding deposits)	**29.7**	30.5	(3%)	28.9	3%
Customer deposits	**37.2**	38.1	(2%)	38.9	(4%)
Loan:deposit ratio (excluding repos)	**45%**	44%	100bp	44%	100bp
Risk-weighted assets					
- Credit risk					
- non-counterparty	**10.0**	10.1	(1%)	10.3	(3%)
- counterparty	**-**	0.1	(100%)	-	-
- Market risk	**0.1**	-	100%	0.1	-
- Operational risk	**1.9**	1.9	-	1.9	-
	12.0	12.1	(1%)	12.3	(2%)

Note:

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

Key points

2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review (RDR). Clients welcomed Coutts' new fully compliant advice-led model where Coutts requires its advisers to achieve the more stringent Level 6 rating, in excess of the FCA's minimum Level 4 requirement. Coutts has received a number of industry accolades for its levels of service, such as 'UK Private Bank of the Year' (The Banker Global Private Banking Awards). Total assets under advice grew to approximately £3 billion over the year.

Following the deposit re-pricing strategy implemented in the second half of 2013 deposit margins have significantly improved. Lending volumes have remained resilient despite pay-downs in line with best-advice policy under RDR. In addition, a new international trust strategy was announced, strengthening the client offering by positioning it as a market-leading, client-centric trust business. This was achieved by the creation of a centre of excellence in Jersey, accompanied by withdrawal from the Cayman Islands and restructuring of the Geneva trust business.

Work continued on streamlining client-facing processes and driving increased benefits from the division's global technology platform, including significant enhancements to Coutts' online and digital client channels. A streamlining of the London property footprint from 11 buildings to 2 was also concluded, alongside further office rationalisation in the International business.

Wealth

Key points (continued)

2013 compared with 2012

- Operating profit was 9% lower at £221 million, driven by lower income partially offset by a decrease in expenses and impairment losses.
- Income declined by 7% to £1,093 million, with the reduction in net interest income reflecting the lower spread earned on deposits as a result of lower Group funding requirements.
- Non-interest income fell by 7% to £419 million due to the disposal of the Latin American, Caribbean and African businesses for a profit of £15 million in H1 2012 together with a decline in fee income in the International business.
- Expenses were 4% lower at £843 million as a result of reduced headcount, tight discretionary cost management and the non-recurrence of two regulatory fines totalling £26 million incurred during 2012. This was partially offset by a one-off UK tax treaty charge in the International business.
- Client assets and liabilities managed by the division declined by 2%, with a £1.7 billion reduction in deposits following re-pricing initiatives in the UK in line with the wider Group funding strategy. Assets under management increased by 3% due to positive market movements. Lending was 2% lower, reflecting increased levels of repayments in the UK.
- Impairments were £17 million lower at £29 million, largely reflecting a small number of specific impairments.

Q4 2013 compared with Q3 2013

- Operating profit was £11 million lower at £49 million, driven by higher impairment losses partially offset by an increase in income and decrease in expenses.
- Income was £6 million, 2%, higher at £277 million reflecting an increase in deposit margins following the implementation of product re-pricing in the UK.
- Expenses of £207 million were 1% lower primarily due to lower staff incentive costs, partially offset by a one-off UK tax treaty charge in the International business
- Client assets and liabilities were 2% lower with the decrease in assets under management mainly driven by low margin custody asset outflows and negative market movements. Deposits were

£0.9 billion lower following re-pricing action in the UK. Lending remained broadly flat.

- Impairments increased by £20 million reflecting a single specific impairment.

Q4 2013 compared with Q4 2012

- Operating profit decreased by 36% as income decreased by £8 million to £277 million and expenses increased by £14 million to £207 million.

- Net interest income decreased by £4 million, primarily driven by the lower spread earned on a number of deposit products. Non-interest income also fell £4 million as a result of lower transaction and investment volumes in the International business.

- Expenses increased by £14 million, 7% to £207 million, reflecting increased investment in strategic and regulatory projects, partially offset by the continued tight management of discretionary costs.

- Impairments were £5 million higher at £21 million.

International Banking

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
Income statement					
Net interest income from banking activities	**713**	922	**173**	166	201
Funding costs of rental assets	**-**	(9)	**-**	-	-
Net interest income	**713**	913	**173**	166	201
Non-interest income	**1,135**	1,209	**271**	288	283
Total income	**1,848**	2,122	**444**	454	484
Direct expenses					
- staff	**(530)**	(580)	**(123)**	(137)	(103)
- other	**(171)**	(164)	**(58)**	(41)	(20)
Indirect expenses	**(639)**	(673)	**(156)**	(165)	(169)
	(1,340)	(1,417)	**(337)**	(343)	(292)
Profit before impairment losses	**508**	705	**107**	111	192
Impairment losses	**(229)**	(111)	**(47)**	(28)	(37)
Operating profit	**279**	594	**60**	83	155
Of which:					
Ongoing businesses	**279**	602	**60**	83	150
Run-off businesses	**-**	(8)	**-**	-	5
Analysis of income by product					
Cash management	**738**	943	**185**	189	205
Trade finance	**295**	291	**77**	77	70
Loan portfolio	**814**	865	**182**	188	207
Ongoing businesses	**1,847**	2,099	**444**	454	482

Run-off businesses	**1**	23		**-**	-	2
Total income	**1,848**	2,122		**444**	454	484
Analysis of impairments/(recoveries) by sector						
Manufacturing and infrastructure	**147**	42		**20**	-	21
Property and construction	**15**	7		**-**	20	-
Transport and storage	**55**	(3)		**23**	8	1
Telecommunications, media and technology	**(7)**	12		**-**	-	3
Banks and financial institutions	**(15)**	43		**(15)**	-	-
Other	**34**	10		**19**	-	12
Total impairment losses	**229**	111		**47**	28	37
Of which RCR related (1)	**52**	-		**52**	-	-
Loan impairment charge as % of gross						
customer loans and advances (excluding						
reverse repurchase agreements)	**0.6%**	0.3%		**0.5%**	0.3%	0.4%

Note:

(1) Pertaining to the creation of RCR and related strategy.

52

International Banking

Key metrics	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Performance ratios (ongoing businesses)						
Return on equity (1)	**3.9%**	9.1%		**3.4%**	4.7%	8.3%
Net interest margin	**1.59%**	1.64%		**1.54%**	1.47%	1.62%
Cost:income ratio	**73%**	66%		**76%**	76%	61%

	31 December	30 September			31 December	
	2013	2013			2012	
	£bn	£bn	Change		£bn	Change
Capital and balance sheet						
Loans and advances to customers (gross) (2)						
- manufacturing and infrastructure	**13.6**	15.0	(9%)		15.8	(14%)
- property and construction	**2.4**	2.2	9%		2.4	-
- transport and storage	**3.3**	3.2	3%		2.5	32%
- telecommunications, media and technology	**2.8**	2.3	22%		2.2	27%
- banks and financial institutions	**6.5**	8.4	(23%)		9.1	(29%)
- other	**7.4**	10.8	(31%)		10.2	(27%)
	36.0	41.9	(14%)		42.2	(15%)
Loan impairment provisions	**(0.3)**	(0.3)	-		(0.4)	(25%)
Net loans and advances to customers	**35.7**	41.6	(14%)		41.8	(15%)
Loans and advances to banks	**8.0**	5.5	45%		4.8	67%
Securities	**2.4**	2.4	-		2.6	(8%)
Cash and eligible bills	**0.3**	0.3	-		0.5	(40%)
Other	**2.1**	3.5	(40%)		3.3	(36%)

Total third party assets (excluding derivatives					
mark-to-market)	**48.5**	53.3	(9%)	53.0	(8%)
Risk elements in lending	**0.5**	0.5	-	0.4	25%
Provision coverage (3)	**69%**	64%	500bp	93%	(2,400bp)
Customer deposits (excluding repos)	**39.3**	47.6	(17%)	46.2	(15%)
Bank deposits (excluding repos)	**6.5**	5.3	23%	5.6	16%
Loan:deposit ratio (excluding repos)	**91%**	87%	400bp	91%	-
Risk-weighted assets					
- Credit risk (non-counterparty)	**44.3**	43.7	1%	46.7	(5%)
- Operational risk	**4.7**	4.7	-	5.2	(10%)
	49.0	48.4	1%	51.9	(6%)

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for the ongoing businesses.

(2) Excludes disposal groups.

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

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
Run-off businesses (1)					
Total income	**1**	23	**-**	-	2
Direct expenses	**(1)**	(31)	**-**	-	3
Operating profit/(loss)	**-**	(8)	**-**	-	5

Note:

(1) Run-off businesses consist of the exited corporate finance business.

53

International Banking

Key points

International Banking provides for the needs of its customers through its offering of debt financing, risk management and transaction services across its network. Business conditions remain challenging as themes of low interest rates and margin compression continue. International Banking remained focused on cost discipline throughout 2013 and continued to strengthen its balance sheet. Despite credit model uplifts, risk-weighted assets reduced 6% year on year.

The strength of the division's efforts in serving its customers' needs is reflected in recent external industry awards and recognition, including:

- Best Trade Finance Bank, UK, and Best Supply Chain Finance Provider, Western Europe – Global Finance. Global Trade Review magazine's 'Leaders in Trade' award for Best Bank for Documentary Processing 2013, making this the 4th consecutive win for the bank.
- A good performance in the Euromoney 2013 Cash Management Survey, particularly in Europe, ranking #1 in the Netherlands, #2 in the UK and #2 in Western Europe. International Banking improved on last year's performance in APAC, achieving a #8 ranking, and retained a #9 ranking in North America and a #6 ranking globally.
- Received the 'Most Innovative Investment Bank for Loans' award at The Banker Investment Banking Awards 2013 providing a further indication that RBS is putting customers at the heart of its business.
- Best Debt House, UK - Euromoney.

2013 compared with 2012

- Operating profit, decreased by £315 million as lower income and higher impairments, including £52 million in relation to the accelerated asset recovery strategy associated with RCR, were only partially offset by lower costs.
- Income was 13% lower:

Cash management was 22% lower reflecting a decline in three-month LIBOR rates as well as increased funding costs of liquidity buffer requirements.
Loan portfolio decreased by 6%, in line with a smaller balance sheet.

- Expenses, were down £77 million, or 5%, reflecting continued emphasis on cost control and timely run-off of discontinued business.
  11
- Impairment losses were £118 million higher than in 2012, including two large single-name provisions and £52 million in relation to the impact of the accelerated RCR asset recovery strategy.

- Third party assets were down 8% due to reductions in the loan portfolio following increased levels of customer repayments partially offset by an increase in Asia trade volume.

- Customer deposits declined by 15% in line with a change in Group funding strategy.

- Risk-weighted assets decreased by 6% primarily as a result of management action to mitigate credit model increases and a smaller balance sheet.

- Return on equity was 4% or 5% excluding the impact of the accelerated RCR asset recovery strategy compared with 9% in 2012.

International Banking

Key points (continued)

Q4 2013 compared with Q3 2013

- Excluding the impact of the accelerated asset recovery strategy of £52 million, operating profit was up 35% with lower non-RCR-related impairments offsetting weaker income.
- Expenses decreased 2% through continued cost discipline.
- Excluding the impact of increased impairment losses related to the creation of RCR, impairments were £33 million lower driven by recoveries in Q4 2013.
- Third party assets were down 9%, driven by a reduction in overdrafts, which mainly reflected netting of pooled accounts.
- Customer deposits were 17% lower in line with the divisional funding strategy.

Q4 2013 compared with Q4 2012

- Operating profit was down 28%, excluding the impact of the accelerated asset recovery strategy, driven by lower income and higher costs.
- Income was 8% lower:

  Loan portfolio income declined 12% due to lower revenues from a smaller balance sheet.
  Cash management income was 10% lower, driven by increased liquidity buffer costs and margin compression from falling interest rates.
  Trade income was up 10%, driven by volume growth in Asia and EMEA.

- Expenses increased by £45 million, including a £9 million write-off of technology intangibles. There was a larger bonus accrual release in Q4 2012.
- Excluding the impact of increased impairment losses related to the creation of RCR, impairments were £42 million lower, driven by two large single name impairments in Q4 2012 and recoveries in Q4 2013.

Ulster Bank

	Year ended		Quarter ended		
	31 December 2013	31 December 2012	**31 December 2013**	30 September 2013	31 December 2012
	£m	£m	**£m**	£m	£m
Income statement					
Net interest income	**631**	649	**169**	154	161
Net fees and commissions	**141**	145	**37**	35	36
Other non-interest income	**99**	51	**1**	25	15
Non-interest income	**240**	196	**38**	60	51
Total income	**871**	845	**207**	214	212
Direct expenses					
- staff	**(239)**	(214)	**(51)**	(64)	(53)
- other	**(63)**	(49)	**(21)**	(15)	(14)
Indirect expenses	**(252)**	(258)	**(64)**	(63)	(70)
	(554)	(521)	**(136)**	(142)	(137)
Profit before impairment losses	**317**	324	**71**	72	75
Impairment losses	**(1,774)**	(1,364)	**(1,067)**	(204)	(318)
Operating loss	**(1,457)**	(1,040)	**(996)**	(132)	(243)
Analysis of income by business					
Corporate	**315**	360	**69**	76	85
Retail	**408**	360	**98**	101	93
Other	**148**	125	**40**	37	34
Total income	**871**	845	**207**	214	212
Analysis of impairments by sector					

Mortgages	**235**	646		**24**	30	135
Commercial real estate						
- investment	**593**	221		**392**	104	52
- development	**153**	55		**115**	12	17
Other corporate	**771**	389		**534**	51	97
Other lending	**22**	53		**2**	7	17
Total impairment losses	**1,774**	1,364		**1,067**	204	318
Of which RCR related (1)	**892**	-		**892**	-	-
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Mortgages	**1.2%**	3.4%		**0.5%**	0.6%	2.8%
Commercial real estate						
- investment	**17.4%**	6.1%		**46.1%**	11.6%	5.8%
- development	**21.9%**	7.9%		**65.7%**	6.9%	9.7%
Other corporate	**10.9%**	5.0%		**30.1%**	2.8%	5.0%
Other lending	**1.8%**	4.1%		**0.7%**	2.3%	5.2%
Total	**5.6%**	4.2%		**13.6%**	2.6%	3.9%

Note:

(1) Pertaining to the creation of RCR and related strategy.

56

Ulster Bank

Key metrics	Year ended			Quarter ended		
	31 December 2013	31 December 2012		**31 December 2013**	30 September 2013	31 December 2012
Performance ratios						
Return on equity (1)	**(32.4%)**	(21.8%)		**(98.1%)**	(12.0%)	(20.9%)
Net interest margin	**1.91%**	1.88%		**2.10%**	1.86%	1.93%
Cost:income ratio	**64%**	62%		**66%**	66%	65%

	31 December 2013 £bn	30 September 2013 £bn		Change	31 December 2012 £bn	Change
Capital and balance sheet						
Loans and advances to customers (gross)						
Mortgages	**19.0**	19.2		(1%)	19.2	(1%)
Commercial real estate						
- investment	**3.4**	3.6		(6%)	3.6	(6%)
- development	**0.7**	0.7		-	0.7	-
Other corporate	**7.1**	7.2		(1%)	7.8	(9%)
Other lending	**1.2**	1.2		-	1.3	(8%)
	31.4	31.9		(2%)	32.6	(4%)
Loan impairment provisions	**(5.4)**	(4.5)		20%	(3.9)	38%
Net loans and advances to customers	**26.0**	27.4		(5%)	28.7	(9%)
Risk elements in lending						
- Mortgages	**3.2**	3.3		(3%)	3.1	3%
- Commercial real estate						
- investment	**2.3**	2.1		10%	1.6	44%
- development	**0.5**	0.4		25%	0.4	25%

- Other corporate	**2.3**	2.5		(8%)	2.2	5%
- Other lending	**0.2**	0.2		-	0.2	-
Total risk elements in lending	**8.5**	8.5		-	7.5	13%
Provision coverage (2)	**64%**	52%		1,200bp	52%	1,200bp
Customer deposits	**21.7**	22.2		(2%)	22.1	(2%)
Loan:deposit ratio (excluding repos)	**120%**	123%		(300bp)	130%	(1,000bp)
Risk-weighted assets						
- Credit risk						
- non-counterparty	**28.2**	29.6		-	33.6	(16%)
- counterparty	**0.3**	0.4		(25%)	0.6	(50%)
- Market risk	**0.5**	0.1		400%	0.2	150%
- Operational risk	**1.7**	1.7		-	1.7	-
	30.7	31.8		(3%)	36.1	(15%)
Spot exchange rate - €/£	**1.201**	1.196			1.227	

Notes:

(1) Divisional return on equity is based on divisional operating loss after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

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

Ulster Bank

Key points

The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. The creation of RCR resulted in additional charges of £911 million in Ulster Bank’s results in Q4 2013.

Operating loss was £1,457 million compared with £1,040 in 2012. Operating performance for 2013, excluding the impact of the creation of RCR, improved by £494 million or 48% versus prior year primarily reflecting higher income and a 64% reduction in mortgage impairment losses driven by enhanced collections effectiveness, the development of programmes to assist customers in financial difficulty and a modest improvement in economic conditions.

Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers. The bank made considerable progress during 2013 in its commitment to building a really good bank that serves customers well.

Simplifying Banking

Ulster Bank delivered a number of improvements for personal and business customers in 2013:

- The launch of initiatives such as “Get Cash”, “Pay Your Contacts” and “Emergency Cash” provided a new range of simple and convenient services for customers to access their cash and make payments online and via mobile.

- Further development of online and mobile banking for business customers focused on providing an efficient and effective day-to-day banking service. Enhancements during 2013 included a speedy and simplified account application process; registration for Anytime Banking via telephone; ability to manage personal and business accounts together and access to extended transaction history.

- The efficiency and effectiveness of Ulster Bank’s digital offering was evidenced by a 55% increase in mobile app registrations and more than 100 million transactions were carried out via digital channels during 2013. Over 315,000 customers regularly use mobile app banking services and 640,000 customers make regular use of online Anytime banking services.

Supporting Enterprise and the Community:

Supporting entrepreneurship and the growth of small businesses in the local community is a long term commitment of Ulster Bank. Highlights in 2013 included:

The Community Impact Fund and Business Woman Can initiative which facilitated women in local communities to set up their own business. The bank also supported a number of projects in schools across the island of Ireland through its MoneySense programme.

Ulster Bank's dedicated SME teams offer professional support and a range of products to help customers meet their banking challenges and grow their business. The agri–specialist team has introduced a number of initiatives during 2013 to support the farming sector.

The 'One Week in June' initiative raised £430,000 for a number of Irish charities through a series of fundraising events involving both customers and staff.

In partnership with Concern Worldwide and Disasters Emergency Committee, Ulster Bank ATMs, branches and online banking facilitated donations to the Philippines Typhoon emergency appeals.

Helping Customers out of Financial Difficulty:

Ulster Bank is committed to working with all customers in financial difficulty to find a solution. The Bank continued to invest in its Problem Debt Management Unit and further developed a range of solutions to make it easier for customers to enter into arrangements. As a consequence, the number of mortgage customers in arrears of 90 days or more has decreased every month since March 2013.

Ulster Bank

Key points (continued)

2013 compared with 2012

- Excluding the impact of the creation of RCR, operating result improved by £494 million or 48% primarily due to a higher income and lower impairment losses on the mortgage portfolio.
- Total income increased by £26 million or 3% to £871 million primarily reflecting hedging gains on the mortgage portfolio. Net interest margin for 2013 increased by 3 basis points to 1.91% although net interest income was £18 million lower at £631 million, largely driven by lower interest-earning assets and a higher cost of funding.
- Total expenses increased by £33 million or 6% to £554 million driven by the costs of mandatory change programmes such as the Single Euro Payment Area, £18 million, an investment of £10 million in programmes to support customers in financial difficulty and an accelerated depreciation charge of £12 million.
- Impairment losses, excluding the impact of RCR, were £482 million, 35% lower. This was predominantly due to a sharp reduction in losses on the mortgage portfolio which reduced by £411 million or 64% due to a decline in arrears levels driven by an improved collections performance and the development of programmes to assist customers in financial difficulty, coupled with stabilising residential property prices.
- The loan:deposit ratio reduced from 130% to 120% during 2013 reflecting continued customer deleveraging and low levels of demand for new lending. Retail and SME deposit balances increased by 2% during 2013, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.
- Risk-weighted assets decreased by 15% reflecting a smaller performing loan book and stabilising credit metrics.

Q4 2013 compared with Q3 2013

- Net interest margin increased 24 basis points in the quarter to 2.10% driving a £15 million or 10% increase in net interest income to £169 million mainly reflecting initiatives to reduce the bank’s cost of funding.
- Non-interest income declined by £22 million to £38 million primarily driven by an increased provision on a counterparty swap exposure related to the creation of RCR.
- Total expenses reduced by £6 million or 4% to £136 million, principally attributable to a pension service cost reduction for 2013 and despite an accelerated depreciation charge of £12 million.
- Impairment losses continued to fall, from £204 million to £175 million, excluding the impact of the creation of RCR, reflecting an improvement in property values and falling levels of arrears.
- The loan:deposit ratio reduced from 123% to 120% in the quarter largely driven by a reduction in net loan balances to customers.

Risk-weighted assets decreased by £1.1 billion or 3% primarily reflecting the impact of newly defaulted RCR assets.

Q4 2013 compared with Q4 2012

Operating result improved by £158 million or 65%, excluding the impact of the creation of RCR, driven by a reduction in impairment losses on the mortgage portfolio.
Total income decreased by £5 million or 2% reflecting the increased provision on a counterparty swap exposure related to the creation of RCR largely offset by the benefits of re-pricing initiatives coupled with hedging gains on the mortgage portfolio.
Whilst total expenses reduced by £1 million reflecting the benefits of cost saving initiatives, there were a number of significant offsetting items in Q4 2013 and Q4 2012. These included the cost of mandatory change programmes, an accelerated depreciation charge, a pension service cost adjustment and an impairment charge on own property assets.

US Retail & Commercial (£ Sterling)

	Year ended			Quarter ended	
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
Income statement					
Net interest income	**1,916**	1,932	**479**	493	465
Net fees and commissions	**761**	791	**182**	197	197
Other non-interest income	**312**	368	**58**	66	78
Non-interest income	**1,073**	1,159	**240**	263	275
Total income	**2,989**	3,091	**719**	756	740
Direct expenses					
- staff	**(1,065)**	(1,013)	**(244)**	(264)	(227)
- other	**(972)**	(1,014)	**(246)**	(249)	(263)
- litigation settlement	**-**	(88)	**-**	-	-
Indirect expenses	**(149)**	(131)	**(41)**	(42)	(27)
	(2,186)	(2,246)	**(531)**	(555)	(517)
Profit before impairment losses	**803**	845	**188**	201	223
Impairment losses	**(156)**	(91)	**(46)**	(59)	(23)
Operating profit	**647**	754	**142**	142	200
Average exchange rate - US$/£	**1.565**	1.585	**1.619**	1.551	1.606
Analysis of income by product					
Mortgages and home equity	**458**	540	**100**	109	134
Personal lending and cards	**411**	402	**101**	106	102
Retail deposits	**763**	852	**187**	197	199
Commercial lending	**679**	609	**169**	175	154

Commercial deposits	**403**	434		**100**	103	101
Other	**275**	254		**62**	66	50
Total income	**2,989**	3,091		**719**	756	740
Analysis of impairments by sector						
Residential mortgages	**28**	(1)		**-**	16	2
Home equity	**65**	95		**1**	27	13
Corporate and commercial	**(23)**	(77)		**25**	(13)	(20)
Other consumer	**81**	65		**20**	24	24
Securities	**5**	9		**-**	5	4
Total impairment losses	**156**	91		**46**	59	23
Loan impairment charge as % of gross						
customer loans and advances (excluding						
reverse repurchase agreements) by sector						
Residential mortgages	**0.5%**	-		**-**	1.1%	0.1%
Home equity	**0.5%**	0.7%		**-**	0.9%	0.4%
Corporate and commercial	**(0.1%)**	(0.3%)		**0.4%**	(0.2%)	(0.3%)
Other consumer	**0.9%**	0.8%		**0.9%**	1.1%	1.2%
Total	**0.3%**	0.2%		**0.4%**	0.4%	0.2%

60

US Retail & Commercial (£ Sterling)

Key metrics						
	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Performance ratios						
Return on equity (1)	**7.2%**	8.3%		**6.5%**	6.3%	9.0%
Net interest margin	**2.95%**	2.97%		**2.98%**	2.99%	2.90%
Cost:income ratio	**73%**	73%		**74%**	73%	70%

	31 December	30 September			31 December	
	2013	2013			2012	
	£bn	£bn	Change		£bn	Change
Capital and balance sheet						
Loans and advances to customers (gross)						
- residential mortgages	**5.8**	5.6	4%		5.8	-
- home equity	**12.1**	12.5	(3%)		13.3	(9%)
- corporate and commercial	**24.1**	24.1	-		23.8	1%
- other consumer	**8.6**	8.6	-		8.4	1%
	50.6	50.8	-		51.3	(2%)
Loan impairment provisions	**(0.3)**	(0.3)	-		(0.3)	-
Net loans and advances to customers	**50.3**	50.5	-		51.0	(2%)
Total third party assets	**71.7**	71.9	-		72.8	(2%)
Investment securities	**12.9**	12.9	-		12.0	8%
Risk elements in lending						
- retail	**0.9**	0.9	-		0.8	13%

- commercial	**0.1**	0.2	(50%)		0.3	(67%)
Total risk elements in lending	**1.0**	1.1	(9%)		1.1	(9%)
Provision coverage (2)	**26%**	25%	100bp		25%	100bp
Customer deposits (excluding repos)	**55.1**	58.0	(5%)		59.2	(7%)
Bank deposits (excluding repos)	**2.0**	0.7	186%		1.8	11%
Loan:deposit ratio (excluding repos)	**91%**	87%	400bp		86%	500bp
Risk-weighted assets						
- Credit risk						
- non-counterparty	**50.7**	50.6	-		50.8	-
- counterparty	**0.5**	0.6	(17%)		0.8	(38%)
- Operational risk	**4.9**	4.9	-		4.9	-
	56.1	56.1	-		56.5	(1%)
Spot exchange rate - US$/£	**1.654**	1.618			1.616	

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Key points

Sterling strengthened against the US Dollar, with the spot exchange rate at 31 December 2013 increasing 2.4% compared with 31 December 2012.

Performance is described in full in the US dollar-based financial statements set out on pages 62 to 67.

US Retail & Commercial (US Dollar)

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	$m	$m		**$m**	$m	$m
Income statement						
Net interest income	**2,998**	3,062		**781**	760	747
Net fees and commissions	**1,190**	1,253		**298**	302	315
Other non-interest income	**489**	584		**97**	101	127
Non-interest income	**1,679**	1,837		**395**	403	442
Total income	**4,677**	4,899		**1,176**	1,163	1,189
Direct expenses						
- staff	**(1,667)**	(1,605)		**(400)**	(406)	(365)
- other	**(1,521)**	(1,609)		**(402)**	(382)	(422)
- litigation settlement	**-**	(138)		**-**	-	-
Indirect expenses	**(233)**	(206)		**(66)**	(65)	(42)
	(3,421)	(3,558)		**(868)**	(853)	(829)
Profit before impairment losses	**1,256**	1,341		**308**	310	360
Impairment losses	**(244)**	(145)		**(75)**	(91)	(38)
Operating profit	**1,012**	1,196		**233**	219	322
Analysis of income by product						
Mortgages and home equity	**716**	856		**164**	168	215
Personal lending and cards	**643**	637		**165**	164	164
Retail deposits	**1,194**	1,348		**306**	302	319
Commercial lending	**1,062**	965		**275**	269	247
Commercial deposits	**631**	689		**163**	159	163
Other	**431**	404		**103**	101	81

Total income	**4,677**	4,899		**1,176**	1,163	1,189
Analysis of impairments by sector						
Residential mortgages	**44**	(2)		**1**	24	3
Home equity	**101**	150		**2**	43	21
Corporate and commercial	**(36)**	(120)		**38**	(21)	(31)
Other consumer	**127**	104		**33**	38	39
Securities	**8**	13		**1**	7	6
Total impairment losses	**244**	145		**75**	91	38
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Residential mortgages	**0.5%**	-		**-**	1.1%	0.1%
Home equity	**0.5%**	0.7%		**-**	0.9%	0.4%
Corporate and commercial	**(0.1%)**	(0.3%)		**0.4%**	(0.2%)	(0.3%)
Other consumer	**0.9%**	0.8%		**0.9%**	1.1%	1.2%
Total	**0.3%**	0.2%		**0.4%**	0.4%	0.2%

62

US Retail & Commercial (US Dollar)

Key metrics					
	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
Performance ratios					
Return on equity (1)	**7.2%**	8.3%	**6.5%**	6.3%	9.0%
Net interest margin	**2.95%**	2.97%	**2.98%**	2.99%	2.90%
Cost:income ratio	**73%**	73%	**74%**	73%	70%

	31 December	30 September		31 December	
	2013	2013		2012	
	$bn	$bn	Change	$bn	Change
Capital and balance sheet					
Loans and advances to customers (gross)					
- residential mortgages	**9.6**	9.1	5%	9.4	2%
- home equity	**20.1**	20.2	-	21.5	(7%)
- corporate and commercial	**39.8**	39.0	2%	38.5	3%
- other consumer	**14.1**	13.9	1%	13.5	4%
	83.6	82.2	2%	82.9	1%
Loan impairment provisions	**(0.4)**	(0.4)	-	(0.5)	(20%)
Net loans and advances to customers	**83.2**	81.8	2%	82.4	1%
Total third party assets	**118.7**	116.4	2%	117.7	1%
Investment securities	**21.3**	20.9	2%	19.5	9%
Risk elements in lending					
- retail	**1.5**	1.4	7%	1.3	15%

- commercial	**0.2**	0.3	(33%)		0.6	(67%)
Total risk elements in lending	**1.7**	1.7	-		1.9	(11%)
Provision coverage (2)	**26%**	25%	100bp		25%	100bp
Customer deposits (excluding repos)	**91.1**	93.9	(3%)		95.6	(5%)
Bank deposits (excluding repos)	**3.3**	1.1	200%		2.9	14%
Loan:deposit ratio (excluding repos)	**91%**	87%	400bp		86%	500bp
Risk-weighted assets						
- Credit risk						
- non-counterparty	**83.8**	81.9	2%		82.0	2%
- counterparty	**0.8**	0.9	(11%)		1.4	(43%)
- Operational risk	**8.2**	8.0	2%		7.9	4%
	92.8	90.8	2%		91.3	2%

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of monthly average of divisional RWAs, adjusted for capital deductions).

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

63

US Retail & Commercial (US Dollar)

Key points

On 1 November 2013, RBS announced plans to accelerate its previously announced partial initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. RBS intends to fully divest its position in RBSCFG by the end of 2016, leaving it as a standalone regional bank, owned by public shareholders.

RBSCFG has commenced a number of actions in 2013 aimed at improving financial performance. RBSCFG continued to drive profitable growth in its core business by focusing on the customer and delivering a differentiated experience. In addition, RBSCFG has launched a series of initiatives aimed at narrowing the performance gap with competitors, including selectively expanding lending areas where RBSCFG has proven capabilities (such as Mid-Corporate, Specialty Verticals) and selective expansion of risk appetite (moving from super-prime to prime in certain products).

RBSCFG has also launched transformational initiatives in 2013 including:

- A special initiative called Project 'TOP', 'Tapping Our Potential'. The project intends to improve the overall effectiveness and efficiency of the franchise by utilising ideas generated by our colleagues.

- On 7 January 2014, RBSCFG announced the sale of its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, the lead bank of U.S. Bancorp. RBSCFG will maintain a presence in Chicago through its commercial business lines and several national consumer business lines not included in the sale(1). The sale, expected to close in mid-2014 (subject to regulatory approval), includes 94 Charter One branches in the Chicago area, $5.3 billion in local deposits and $1.1 billion in locally originated loans for a deposit premium of approximately $315 million, or 6%. The proceeds will be reinvested in the remaining franchise, where we have stronger market positions and better long-term growth prospects.

Moreover, RBSCFG continued to grow its core franchise by consistently delivering a differentiated customer experience and leveraging its strong market presence (top 5 deposit market share in 8 of its top 10 Metropolitan Statistical Areas).

In 2013, Consumer Banking continued to improve customer convenience, address the shift in customer preference, and expand its distribution presence. Consumer Banking installed more than 900 intelligent deposit machines (enhanced ATMs), improved the web account opening process, simplified online banking log-in, and released a new mobile application optimised for the iPad. Consumer Banking also implemented a new branch image capture system throughout the network that automates teller processing and offers secure paperless transactions, debit card identification and clear receipts that provide on-the-spot balance availability.

US Retail & Commercial (US Dollar)

Key points (continued)

In recognition of the customer experience it offers, *Money* magazine named Citizens Bank one of the "Best Banks in America" in 2013. In addition to a "robust presence" defined by its many branches and ATMs, *Money* recognised RBSCFG's extended branch hours that include seven-day-a-week supermarket branches. *Money* also noted that RBSCFG's convenience options also extend to its mobile banking apps for Android and iPhone, which are generating positive customer feedback in the industry. An August report issued by Xtreme Labs noted that "Citizens Bank is the only bank with the highest rated apps on both Android (4.5 stars) and iOS (4.5 stars) platforms".

The Small Business Banking and Commercial Enterprise Banking divisions were integrated into one consolidated Business Banking division within Consumer Banking, targeting companies with up to $25 million in annual sales. The consolidation will enhance the customer experience, transform sales and service, and align products and processes.

Commercial Banking remained focused on growing and deepening relationships by providing thought leadership and improved product capabilities to clients. Commercial and Industry loan growth was 8.5% compared with the same time period a year ago, which was 1.3% higher than the market[(2)]. The strong results are partially due to the launch of several growth initiatives, which includes expanding our MidCorporate business nationally, as well as growing our Franchise Finance, Lender Finance and other key industry verticals.

Corporate Finance & Capital Markets continued to take market share from both regional competitors and large money centre banks. Commercial Banking moved up in the Overall Middle Market Bookrunner league table from an unranked position in 2009 to #6 by origination volume and #8 by number of transactions in Q4 2013.

Furthermore, the strategic alliance with Oppenheimer allowed Commercial bankers to deliver M&A ideas and solutions that are helping us provide comprehensive solutions to our clients. This alliance won the Barlow Research Associates' Monarch Innovation Award for "Most Innovative Product". The award highlights RBSCFG's commitment to making it easier for middle market companies to develop financial strategies that encompass both commercial banking and investment banking products and services.

As a result of our ongoing focus on providing thought leadership to our clients, our most recent client survey (Q3 2013) showed significant improvement in Middle Market customer satisfaction metrics over the same period a year ago. Net Promoter score increased from 36 to 50, which is well above the peer average of 42. "Proactively Provides Advice and Solutions" score was up from 62% to 85% and lead relationships as a percent of total relationships improved from 51% to 58%. Both metrics are strong indicators of our Commercial bankers' thought leadership capabilities.

Notes:

(1) RBSCFG will continue to operate several businesses in the Chicago market, including the consumer businesses lines of mortgage lending, Education Finance and Auto Finance. RBS Citizens, the bank's commercial banking division, will continue a diverse range of commercial banking operations in Chicago including Asset-Based Lending, Asset Finance, Equipment Leasing, Commercial Real Estate, Treasury Solutions, Capital Markets, Sponsor Finance, Franchise Finance and the majority of its corporate banking business.

(2) Source: SNL Financial. Based on most recent regulatory data as of Q3 2013. Market includes all US banks required to file regulatory reports.

US Retail & Commercial (US Dollar)

Key points (continued)

2013 compared with 2012

- Operating profit of £647 million ($1,012 million) was down £107 million ($184 million), or 14%. The operating environment and market conditions remained challenging, with intense competition for loans. An extended period of low short-term rates limited net interest margin expansion and the rise in long-term rates dramatically slowed mortgage refinance volumes.

- Net interest income was down 1% at £1,916 million ($2,998 million) due to a smaller investment portfolio, consumer loan run-off and the effect of prevailing economic conditions on asset yields partially offset by the benefit of interest rate swaps, commercial loan growth and favourable funding costs.

- Average loans and advances were flat, with commercial loan growth of 5% despite competition for lending opportunities offset by run-off of long-term fixed-rate consumer products.

- Average customer deposits were flat, with planned run-off of high priced time deposits and lower wholesale deposits offset by growth achieved in checking and money market balances. Consumer checking balances grew by 3% while small business checking balances grew by 7% over the year.

- Excluding the £47 million ($75 million) gross gain on the sale of Visa B shares in 2012, non-interest income was down £39 million ($83 million), or 4% at £1,073 million ($1,679 million), reflecting lower mortgage banking fees as refinancing volumes have slowed, and lower deposit fees. This was partially offset by higher securities gains and commercial banking fee income.

- Excluding the £88 million ($138 million) litigation settlement in 2012 relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010 and the £8 million ($13 million) litigation reserve associated with the sale of Visa B shares, total expenses of £2,186 million ($3,421 million) were broadly in line with prior year. This largely reflects a mortgage servicing rights impairment recapture driven by the increase in long-term rates offset by the cost of regulatory compliance and new technology investments and a one-off £21 million ($33 million) pension gain in 2012.

- Impairment losses increased by £65 million ($99 million) to £156 million ($244 million) for the year and represented 0.3% of loans and advances to customers.

Q4 2013 compared with Q3 2013

- Operating profit of £142 million ($233 million) remained flat. In US dollar terms operating profit increased by $14 million, or 6%, to $233 million, driven by higher income and lower impairments partially offset by higher expenses.

- Net interest income was down 3% to £479 million. In US dollar terms net interest income was up 3% to $781 million due to a larger investment portfolio, favourable funding costs and commercial loan growth.

- Higher rates led to investment security purchases resulting in portfolio growth of £0.4 billion ($1.5 billion) in the quarter and £2.5 billion ($3.9 billion) during the second half, reversing first half run-off.

- Average loans and advances were up 2%, driven by commercial loan growth, a strategic initiative to purchase residential mortgages and shift to hold more originations on the balance sheet.

- Non-interest income was down £23 million ($8 million), or 9% at £240 million ($395 million), reflecting lower deposit fees due to a change in the posting order of customer transactions and lower mortgage banking fees as originations continue to trend down (33% lower than prior quarter). Mortgage activity is slowing as market rates have risen leading to lower applications combined with gains at a lower level. Commercial banking fee income was flat to the prior quarter with strong capital markets fees offset by deterioration in leasing income.

US Retail & Commercial (US Dollar)

Key points (continued)

Q4 2013 compared with Q3 2013 (continued)

- Total expenses were down £24 million. In US dollar terms, total expenses were up $15 million, or 2% at $868 million, largely reflecting a litigation reserve in Q4 2013.
- Impairment losses decreased by £13 million ($16 million) to £46 million ($75 million) for the quarter.

Q4 2013 compared with Q4 2012

- Operating profit of £142 million ($233 million) decreased by £58 million ($89 million), or 29%, largely driven by higher expenses and impairments.
- Net interest income was up £14 million ($34 million), or 3% at £479 million ($781 million), driven by the benefit of both run-off of legacy and newly transacted interest rate swaps and deposit pricing discipline partially offset by consumer loan run-off.
- Non-interest income was down £35 million ($47 million), or 13% at £240 million ($395 million), driven by lower mortgage banking fees, down £26 million ($42 million).
- Total expenses were up £14 million ($39 million) at £531 million ($868 million) reflecting a one-off £21 million ($33 million) pension gain in Q4 2012.
- Impairment losses increased by £23 million ($37 million) to £46 million ($75 million) in the quarter.

Markets

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	£m	£m		**£m**	£m	£m
Income statement						
Net interest income	**157**	111		**61**	41	49
Net fees and commissions receivable	**75**	128		**20**	16	1
Income from trading activities	**3,057**	4,105		**542**	764	551
Other operating income	**33**	139		**3**	13	40
Non-interest income	**3,165**	4,372		**565**	793	592
Total income	**3,322**	4,483		**626**	834	641
Direct expenses						
- staff	**(1,177)**	(1,453)		**(192)**	(299)	(87)
- other	**(723)**	(722)		**(186)**	(148)	(207)
Indirect expenses	**(710)**	(762)		**(175)**	(178)	(186)
	(2,610)	(2,937)		**(553)**	(625)	(480)
Profit before impairment losses	**712**	1,546		**73**	209	161
Impairment losses (1)	**(92)**	(37)		**(34)**	1	(22)
Operating profit	**620**	1,509		**39**	210	139
Of which:						
Ongoing businesses (2)	**655**	1,431		**92**	217	269
Run-off and recovery businesses	**(35)**	78		**(53)**	(7)	(130)
Analysis of income by product						
Rates	**1,053**	1,922		**189**	390	323
Currencies	**1,000**	775		**214**	257	207
Asset-backed products	**943**	1,322		**204**	125	169

Credit markets	**699**	735		**143**	187	157
Total income ongoing businesses	**3,695**	4,754		**750**	959	856
Inter-divisional revenue share	**(612)**	(708)		**(132)**	(162)	(169)
Run-off and recovery businesses	**239**	437		**8**	37	(46)
Total income	**3,322**	4,483		**626**	834	641
Memo - Fixed income and currencies						
Total income ongoing businesses	**3,695**	4,754		**750**	959	856
Less: primary credit markets	**(561)**	(574)		**(128)**	(146)	(160)
Total fixed income and currencies	**3,134**	4,180		**622**	813	696

Notes:

(1) Includes £18 million pertaining to the creation of RCR and related strategy.
(2) The ongoing businesses comprise the Rates, Currencies, Asset backed products and Credit markets areas.

Markets

Key metrics	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Performance ratios						
Return on equity (1)	**5.0%**	9.6%		**1.5%**	7.0%	3.8%
Cost:income ratio	**79%**	66%		**88%**	75%	75%
Compensation ratio (2)	**35%**	32%		**31%**	36%	14%

	31 December	30 September			31 December	
	2013	2013			2012	
	£bn	£bn	Change		£bn	Change
Capital and balance sheet						
Loans and advances to customers (gross)	**25.4**	24.4	4%		29.8	(15%)
Loan impairment provisions	**(0.2)**	(0.2)	-		(0.2)	-
Net loans and advances to customers	**25.2**	24.2	4%		29.6	(15%)
Net loans and advances to banks	**12.5**	15.5	(19%)		16.6	(25%)
Reverse repos	**76.2**	95.6	(20%)		103.8	(27%)
Securities	**69.8**	71.4	(2%)		92.4	(24%)
Cash and eligible bills	**20.3**	19.6	4%		30.2	(33%)
Other	**8.8**	21.9	(60%)		11.9	(26%)
Total third party assets (excluding derivatives mark-to-market)	**212.8**	248.2	(14%)		284.5	(25%)
Net derivative assets (after netting)	**15.5**	18.6	(17%)		21.9	(29%)
Provision coverage (3)	**85%**	77%	800bp		77%	800bp

Customer deposits (excluding repos)	**21.5**	25.8	(17%)		26.3	(18%)
Bank deposits (excluding repos)	**23.8**	29.3	(19%)		45.4	(48%)
Risk-weighted assets						
- Credit risk						
- non-counterparty	**10.8**	10.5	3%		14.0	(23%)
- counterparty	**17.5**	26.5	(34%)		34.7	(50%)
- Market risk	**26.4**	26.4	-		36.9	(28%)
- Operational risk	**9.8**	9.8	-		15.7	(38%)
	64.5	73.2	(12%)		101.3	(36%)

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Compensation ratio is based on staff costs as a percentage of total income.
(3) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

Markets

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Income statement (ongoing business)	**£m**	£m		**£m**	£m	£m
Total income	**3,094**	4,076		**619**	800	691
Direct expenses	**(1,750)**	(1,902)		**(353)**	(408)	(247)
Indirect expenses	**(682)**	(753)		**(154)**	(176)	(183)
Impairment (losses)/recoveries	**(7)**	10		**(20)**	1	8
Operating profit	**655**	1,431		**92**	217	269
Performance ratios (ongoing business)						
Return on equity (1)	**6.8%**	11.5%		**4.6%**	9.3%	9.2%
Cost:income ratio	**79%**	65%		**82%**	73%	62%
Compensation ratio (2)	**35%**	31%		**29%**	34%	10%
				31 December	30 September	31 December
				2013	2013	2012
Balance sheet (ongoing business)				**£bn**	£bn	£bn
Total third party assets (excluding derivatives mark-to-market)				**198.8**	231.4	259.3
Risk-weighted assets				**52.1**	56.9	79.1

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for ongoing businesses.

(2) Compensation ratio is based on staff costs as a percentage of total income.

Key points

In 2013, Markets launched and executed a strategic repositioning of the business, aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths in fixed income products. The division met or exceeded all internal targets for reducing controllable costs, risk weighted assets and balance sheet, while meeting revenue and operating profit expectations. Controls were enhanced, trading was integrated into four financial hubs, the front-to-back operating model was simplified and an agreement was reached for the sale of the Investor Products and Equity Derivatives business. Market share in the four core product areas (Rates, Currencies, Asset Backed Products and Credit) remained broadly stable with high profile client transactions executed across the globe. As a result of the strategic repositioning, Markets ended 2013 better positioned for the changing regulatory and external environment.

Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment. Client activity was limited by the uncertainty that surrounded the much anticipated tapering of the Federal Reserve's programme of quantitative easing. This contrasted with 2012 when markets were boosted by the European Central Bank's Long Term Refinancing Operation. Nevertheless, Markets' core businesses remained resilient and continued to produce positive results. Currencies income increased significantly year on year and Corporate Debt Capital Markets reaffirmed its leading position in the GBP market.

Markets

Key points (continued)

2013 compared with 2012

- Operating profit fell by £889 million with income falling by 26%, partly offset by significant cost reductions. The de-risking of Markets resulted in a 36% reduction in risk-weighted assets.
- Rates actively repositioned the business during 2013, lowering the balance sheet and reducing risk. This, combined with a weak trading performance in H1 2013, resulted in subdued returns.
- Currencies income increased as the franchise remained resilient and FX Options benefited from opportunities in volatile FX and emerging markets.
- Asset Backed Products continued to perform well, although income was affected by investor concerns regarding tapering of the Federal Reserve's programme of quantitative easing and a reduction in the balance sheet and risk resources deployed by the business.
- Credit Markets reflected the previous year's de-risking of credit trading and witnessed a modest reduction in Debt Capital Markets income, although the business executed a number of significant transactions and retained its leading position in corporate GBP issuance.
- Costs fell by 11%, reflecting a reduction in headcount of 1,000 – split evenly between the front and back-office - and tightly controlled discretionary expenses, although this was offset by a higher level of legal costs, primarily related to legacy issues in the US Asset Backed Products business.
- The increase in impairments was driven predominantly by provisions against a single exposure in 2013.
- Reducing risk and refocusing the division on core fixed income and currencies products drove a substantial reduction in both balance sheet and risk capital. Third party assets were £72 billion lower than 31 December 2012 and risk-weighted assets, at £65 billion, were down £37 billion.

Q4 2013 compared with Q3 2013

- A small operating profit in Q4 2013 reflected the expected seasonal slow-down and a weaker trading performance in Rates, although this was mitigated by an improvement in Asset Backed Products.
- The fall in Rates reflected lower volumes and a robust trading performance in Q3 2013.

- Currencies income reduced as opportunities in FX Options were more limited following an exceptional period of volatility in both Q2 and Q3 2013.

- Asset Backed Products rebounded as positive economic news and increased clarity concerning the pace and timing of tapering of the Federal Reserve's programme of quantitative easing reassured markets.

- Lower Credit income was driven by fewer high value transactions in Debt Capital Markets following a spike in activity towards the end of Q3 2013.

- Costs fell by £72 million, driven by lower staff costs, including the impact of the strategic decision to focus resources on core fixed income and currencies products.

- The strategic reduction of the division's balance sheet and capital continued apace as third party assets and risk-weighted assets fell, respectively, by a further £35 billion and £9 billion over the quarter.

Markets

Key points (continued)

Q4 2013 compared with Q4 2012

- Operating profit fell by £100 million, driven by an exceptional reduction to variable compensation in the prior year.
- The reduction in both third party assets and risk-weighted assets was reflected in Rates lower income, although Asset Backed Products benefitted from renewed investor confidence as the market reacted to the Federal Reserve's clarification of intended pace and timing of tapering of quantitative easing.
- Headcount fell by 1,000 and significant cost reductions were implemented. This was more than offset, however, by the impact of the reduction to variable compensation in Q4 2012 following the Group's LIBOR settlement.

Central items

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
	£m	£m		**£m**	£m	£m
Central items not allocated	**(89)**	84		**(174)**	(19)	118

Note:

(1) Costs/charges are denoted by brackets.

Funding and operating costs have been allocated to operating divisions based on direct service usage, the requirement for market funding and other appropriate drivers where services span more than one division.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

Key points

2013 compared with 2012

- Central items not allocated, represented a debit of £89 million in 2013 compared with a credit of £84 million in 2012, a reduction of £173 million.
- This has been principally driven by higher unallocated Treasury and funding costs, £175 million higher, including volatile items under IFRS and lower gains on Treasury available-for-sale securities, down £156 million from £880 million in 2012 to £724 million in 2013.
- Central items included various legacy litigation and conduct provisions totalling £127 million for 2013, a reduction of £33 million compared with 2012, and a property-related impairment of £65 million which have been offset by the non-repeat of £175 million costs incurred in 2012 in relation to the technology incident and credits totalling £80 million recognised in relation to the Group's share of profit from its stake in Saudi Hollandi, which was held as a disposal group in 2012.

Q4 2013 compared with Q3 2013

- Central items not allocated represented a debit of £174 million in Q4 2013 compared with a debit of £19 million in Q3 2013, an increase of £155 million.

- This increase has been principally driven by higher unallocated Treasury and funding costs, up £197 million including volatile items under IFRS, along with lower gains on Treasury available-for-sale securities, down £36 million to £114 million for Q4 2013 compared with £150 million recognised in Q3 2013.

Q4 2013 compared with Q4 2012

- Central items not allocated represented a debit of £174 million compared with a credit of £118 million in Q4 2012.

- This has been principally driven by higher unallocated Treasury and funding costs, up £260 million including volatile items under IFRS, along with lower gains on Treasury available-for-sale securities, down £73 million to £114 million for Q4 2013 compared with £187 million in Q4 2012.

Non-Core

	Year ended			Quarter ended		
	31 December 2013	31 December 2012		**31 December 2013**	30 September 2013	31 December 2012
	£m	£m		**£m**	£m	£m
Income statement						
Net interest income	**(61)**	346		**(30)**	(33)	59
Funding costs of rental assets	**(38)**	(102)		**(8)**	(10)	(6)
Net interest income	**(99)**	244		**(38)**	(43)	53
Net fees and commissions	**55**	105		**11**	6	28
Loss from trading activities	**(148)**	(654)		**(218)**	(109)	(50)
Other operating income						
- rental income	**177**	510		**28**	49	47
- other (1)	**(331)**	83		**(376)**	(22)	(110)
Non-interest income	**(247)**	44		**(555)**	(76)	(85)
Total income	**(346)**	288		**(593)**	(119)	(32)
Direct expenses						
- staff	**(203)**	(276)		**(37)**	(50)	(50)
- operating lease depreciation	**(76)**	(246)		**(18)**	(17)	(51)
- other	**(128)**	(164)		**(34)**	(30)	(47)
Indirect expenses	**(198)**	(258)		**(50)**	(48)	(59)
	(605)	(944)		**(139)**	(145)	(207)
Loss before impairment losses	**(951)**	(656)		**(732)**	(264)	(239)
Impairment losses	**(4,576)**	(2,223)		**(3,164)**	(581)	(703)
Operating loss	**(5,527)**	(2,879)		**(3,896)**	(845)	(942)

Note:

(1) Includes losses on disposals (year ended 31 December 2013 - £221 million loss; year ended 31 December 2012 - £14 million loss; Q4 2013 - £79 million loss; Q3 2013 - £73 million loss; Q4 2012 - £115 million loss).

Non-Core

	Year ended			Quarter ended		
	31 December 2013	31 December 2012		**31 December 2013**	30 September 2013	31 December 2012
	£m	£m		**£m**	£m	£m
Analysis of (loss)/income by business						
Banking and portfolios	**(496)**	40		**(556)**	(84)	(111)
International businesses	**51**	250		**10**	(31)	29
Markets	**99**	(2)		**(47)**	(4)	50
Total (loss)/income	**(346)**	288		**(593)**	(119)	(32)
(Loss)/income from trading activities						
Monoline exposures	**(46)**	(205)		**(43)**	(21)	(35)
Credit derivative product companies	**(5)**	(205)		**(5)**	(9)	1
Asset-backed products	**103**	101		**60**	7	16
Other credit exotics	**32**	(28)		**4**	13	5
Equities	**2**	(2)		**-**	1	(5)
Banking book hedges	**3**	(38)		**-**	-	(2)
Other	**(237)**	(277)		**(234)**	(100)	(30)
	(148)	(654)		**(218)**	(109)	(50)
Impairment losses						
Banking and portfolios (1)	**4,646**	2,346		**3,201**	589	723
International businesses	**1**	56		**(9)**	4	15
Markets	**(71)**	(179)		**(28)**	(12)	(35)
Total impairment losses	**4,576**	2,223		**3,164**	581	703
Of which RCR related (2)	**3,118**	-		**2,918**	200	-
Loan impairment charge as % of gross						

customer loans and advances (excluding						
reverse repurchase agreements) (3)						
Banking and portfolios (4)	**12.9%**	4.2%		**35.9%**	5.2%	5.0%
International businesses	**0.5%**	5.1%		**(18.0%)**	4.0%	5.5%
Total	**12.8%**	4.2%		**35.3%**	5.2%	4.8%

Key metrics						
	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012		**2013**	2013	2012
Performance ratio						
Net interest margin	**(0.19%)**	0.31%		**(0.36%)**	(0.35%)	0.29%

Notes:

(1) Includes Ulster Bank impairment losses of £3,027 million (year ended 31 December 2012 - £983 million; Q4 2013 - £2,198 million; Q3 2013 - £398 million; Q4 2012 - £364 million).
(2) Pertaining to the creation of RCR and related strategy.
(3) Includes disposal groups.
(4) Ulster Bank - 26.1% (year ended 31 December 2012 - 7.6%; Q4 2013 - 75.8%; Q3 2013 - 13.2%; Q4 2012 - 11.3%). Banking and portfolios excluding Ulster Bank - 6.0% (year ended 31 December 2012 - 3.1%; Q4 2013 - 17.1%; Q3 2013 - 1.9%; Q4 2012 - 3.0%).

Non-Core

	31 December 2013	30 September 2013		31 December 2012	
	£bn	£bn	Change	£bn	Change
Capital and balance sheet					
Loans and advances to customers (gross) (1)	**35.6**	40.4	(12%)	55.4	(36%)
Loan impairment provisions	**(13.8)**	(11.3)	22%	(11.2)	23%
Net loans and advances to customers	**21.8**	29.1	(25%)	44.2	(51%)
Total third party assets (excluding derivatives)	**28.0**	37.3	(25%)	57.4	(51%)
Total third party assets (including derivatives)	**31.2**	41.1	(24%)	63.4	(51%)
Risk elements in lending (1)	**19.0**	19.8	(4%)	21.4	(11%)
Provision coverage (2)	**73%**	57%	1,600bp	52%	2,100bp
Customer deposits (1)	**2.2**	2.4	(8%)	2.7	(19%)
Risk-weighted assets					
- Credit risk					
- non-counterparty	**21.0**	29.2	(28%)	45.1	(53%)
- counterparty	**3.7**	6.5	(43%)	11.5	(68%)
- Market risk	**3.3**	4.0	(18%)	5.4	(39%)
- Operational risk	**1.2**	1.2	-	(1.6)	175%
	29.2	40.9	(29%)	60.4	(52%)

Notes:

(1) Excludes disposal groups.
(2) Provision coverage represents loan impairment provisions as a percentage of risk elements in lending.

	31 December	30 September	31 December
	2013	2013	2012
	£bn	£bn	£bn
Gross customer loans and advances			
Banking and portfolios	**35.4**	40.0	54.5
International businesses	**0.2**	0.4	0.9
	35.6	40.4	55.4
Risk-weighted assets			
Banking and portfolios	**26.2**	36.7	53.3
International businesses	**0.7**	1.0	2.4
Markets	**2.3**	3.2	4.7
	29.2	40.9	60.4
Third party assets (excluding derivatives)			
Banking and portfolios	**25.9**	34.8	51.1
International businesses	**0.3**	0.4	1.2
Markets	**1.8**	2.1	5.1
	28.0	37.3	57.4

Non-Core

Third party assets (excluding derivatives)

Year ended 31 December 2013	31 December 2012 £bn	Run-off £bn	Disposals/ restructuring £bn	Drawings/ roll overs £bn	Impairments £bn	FX £bn	**31 December 2013 £bn**
Commercial real estate	22.1	(5.3)	(2.3)	0.2	(4.1)	0.3	**10.9**
Corporate	25.5	(8.2)	(4.6)	0.8	(0.3)	(0.2)	**13.0**
SME	1.0	(0.5)	(0.2)	-	-	-	**0.3**
Retail	3.2	(0.6)	(0.6)	-	(0.2)	-	**1.8**
Other	0.5	(0.3)	-	-	-	-	**0.2**
Markets	5.1	(0.3)	(3.0)	-	-	-	**1.8**
Total (1)	57.4	(15.2)	(10.7)	1.0	(4.6)	0.1	**28.0**
Quarter ended 31 December 2013	30 September 2013 £bn	Run-off £bn	Disposals/ restructuring £bn	Drawings/ roll overs £bn	Impairments £bn	FX £bn	31 December 2013 £bn
Commercial real estate	16.0	(1.6)	(0.8)	0.2	(2.8)	(0.1)	**10.9**
Corporate	16.5	(1.4)	(1.7)	0.1	(0.3)	(0.2)	**13.0**
SME	0.4	(0.1)	-	-	-	-	**0.3**
Retail	2.1	(0.1)	-	-	(0.1)	(0.1)	**1.8**
Other	0.2	-	-	-	-	-	**0.2**
Markets	2.1	0.1	(0.4)	-	-	-	**1.8**
Total	37.3	(3.1)	(2.9)	0.3	(3.2)	(0.4)	**28.0**
	30 June	Run-off	Disposals/	Drawings/	Impairments	FX	30 September

	2013		restructuring	roll overs			2013
Quarter ended 30 September 2013	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Commercial real estate	18.3	(1.1)	(0.5)	-	(0.5)	(0.2)	16.0
Corporate	19.9	(2.0)	(1.0)	0.2	-	(0.6)	16.5
SME	0.5	(0.1)	-	-	-	-	0.4
Retail	3.0	(0.1)	(0.6)	-	(0.1)	(0.1)	2.1
Other	0.2	-	-	-	-	-	0.2
Markets	3.5	(0.1)	(1.1)	-	-	(0.2)	2.1
Total	45.4	(3.4)	(3.2)	0.2	(0.6)	(1.1)	37.3

Note:

(1) Disposals of £0.8 billion have been signed as at 31 December 2013 but are pending completion (30 September 2013 - £0.2 billion; 31 December 2012 - £0.2 billion).

	31 December	30 September	31 December
	2013	2013	2012
Commercial real estate third party assets	**£bn**	£bn	£bn
UK (excluding NI)	**4.7**	5.6	8.9
Ireland (ROI and NI)	**2.3**	4.7	5.8
Spain	**0.8**	1.2	1.4
Rest of Europe	**2.8**	4.0	4.9
USA	**0.3**	0.5	0.9
RoW	**-**	-	0.2
Total (excluding derivatives)	**10.9**	16.0	22.1

Non-Core

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
Impairment losses by donating division					
and sector (1)					
UK Retail					
Personal	**(1)**	4	**-**	-	-
Total UK Retail	**(1)**	4	**-**	-	-
UK Corporate					
Manufacturing and infrastructure	**60**	19	**66**	(3)	1
Property and construction	**228**	88	**89**	16	8
Transport	**40**	16	**4**	2	2
Financial institutions	**(8)**	(38)	**-**	-	(23)
Lombard	**(4)**	48	**(8)**	2	15
Other	**40**	107	**23**	9	53
Total UK Corporate	**356**	240	**174**	26	56
Ulster Bank					
Commercial real estate					
- investment	**837**	288	**679**	29	91
- development	**1,836**	611	**1,237**	356	256
Other corporate	**345**	77	**279**	12	16
Other EMEA	**9**	7	**3**	1	1
Total Ulster Bank	**3,027**	983	**2,198**	398	364
US Retail & Commercial					
Auto and consumer	**55**	49	**12**	15	19
Cards	**-**	1	**-**	-	(2)

SBO/home equity	**83**	130		**23**	14	22
Residential mortgages	**12**	21		**4**	5	4
Commercial real estate	**9**	(12)		**(1)**	4	(2)
Commercial and other	**(3)**	(12)		**(2)**	1	3
Total US Retail & Commercial	**156**	177		**36**	39	44
International Banking						
Manufacturing and infrastructure	**(42)**	3		**1**	9	3
Property and construction	**835**	623		**534**	92	96
Transport	**26**	199		**21**	(1)	51
Telecoms, media and technology	**24**	32		**19**	1	5
Financial institutions	**(49)**	(58)		**(2)**	(17)	75
Other	**245**	18		**184**	33	8
Total International Banking	**1,039**	817		**757**	117	238
Other						
Wealth	**(1)**	1		**(1)**	-	-
Central items	**-**	1		**-**	1	1
Total Other	**(1)**	2		**(1)**	1	1
Total impairment losses	**4,576**	2,223		**3,164**	581	703
Of which RCR related (2)	**3,118**	-		**2,918**	200	-

Notes:

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

(2) Pertaining to the creation of RCR and related strategy.

78

Non-Core

	31 December 2013	30 September 2013	31 December 2012
	£bn	£bn	£bn
Gross loans and advances to customers (excluding reverse repurchase agreements) by donating division and sector			
UK Corporate			
Manufacturing and infrastructure	**-**	-	0.1
Property and construction	**1.7**	2.2	3.6
Transport	**2.7**	3.5	3.8
Financial institutions	**-**	-	0.2
Lombard	**0.2**	0.2	0.4
Other	**1.2**	0.9	4.2
Total UK Corporate	**5.8**	6.8	12.3
Ulster Bank			
Commercial real estate			
- investment	**3.2**	3.4	3.4
- development	**6.9**	7.2	7.6
Other corporate	**1.5**	1.5	1.6
Other EMEA	**-**	-	0.3
Total Ulster Bank	**11.6**	12.1	12.9
US Retail & Commercial			
Auto and consumer	**0.2**	0.2	0.6
SBO/home equity	**1.5**	1.7	2.0
Residential mortgages	**0.3**	0.3	0.4
Commercial real estate	**0.2**	0.2	0.4
Commercial and other	**0.1**	0.1	0.1
Total US Retail & Commercial	**2.3**	2.5	3.5

International Banking			
Manufacturing and infrastructure	**1.4**	1.6	3.9
Property and construction	**7.5**	9.2	12.3
Transport	**1.4**	1.6	1.7
Telecoms, media and technology	**0.8**	0.7	0.4
Financial institutions	**2.9**	3.4	4.7
Other	**1.9**	2.4	3.7
Total International Banking	**15.9**	18.9	26.7
Other			
Wealth	**-**	0.1	-
Total Other	**-**	0.1	-
Gross loans and advances to customers (excluding reverse			
repurchase agreements)	**35.6**	40.4	55.4

Non-Core

Key points

Non-Core has successfully achieved and surpassed its five year Strategic Plan target, reducing third party assets from the opening £258 billion position to end 2013 significantly below the original c.£40 billion target at £28 billion. Over the life of Non-Core this represents an overall reduction of £230 billion, or 89%. This was achieved through a mixture of disposals, run-off and impairments. By the end of 2013, the Non-Core funded balance sheet was c.4% of the Group's funded balance sheet compared with 21% when the division was created. RWAs have reduced from £171 billion to £29 billion, or 83%, over the life of Non-Core.

Third party assets were reduced by £29 billion, or 51%, during the year. Approximately £3.1 billion of the reduction was due to increased impairments as a result of the change in the future run-down/disposal plan for the remaining Non-Core assets under the transition to RCR.

2013 is the final reporting period for the Non-Core division. Approximately £12 billion of assets which were managed by Non-Core are to be returned to the relevant Core divisions, with the remaining assets transferring to RCR from 1 January 2014.

2013 compared with 2012

- Third party assets declined by £29 billion, or 51%, reflecting run-off of £15 billion, disposals of £11 billion and impairments of £5 billion, of which £3.1 billion is driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans.

- Risk-weighted assets were £31 billion lower, driven by disposals and run-off.

- Operating loss of £5,527 million was £2,648 million higher than 2012, principally due to a £2,353 million increase in impairments. This was predominantly due to £3,118 million of 2013 impairments related to the creation of RCR, most significantly with £2,299 million in Ulster Bank and £742 million in International Banking, driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans, which has led to increased impairment losses on the non-performing assets.

- Operating loss before impairment losses was £295 million higher with a reduction in net interest income of £343 million, £207 million additional disposal losses and £104 million further fair value writedowns offset by £506 million lower losses from trading activities.

- The reduction in net interest income of £343 million was driven by a 31% fall in interest earning assets driven by run-off and disposals.

- Headcount declined by 1,700, or 55% to 1,400 of which 1,000 relates to operations in India and Romania, reflecting divestment activity and run-off.

Q4 2013 compared with Q3 2013

- Third party assets declined by £9 billion to £28 billion, driven by disposals of £3 billion, run-off of £3 billion and impairments of £3 billion (predominantly reflecting the new RCR strategy).

- Risk-weighted assets fell by £12 billion, driven by disposals and run-off.

- Operating loss of £3,896 million was £3,051 million higher than Q3 2013, principally due to higher impairments driven by the RCR increases noted above and includes £277 million RCR additional fair value losses.

Q4 2013 compared with Q4 2012

- Operating loss increased by £2,954 million, principally due to higher impairments related to the creation of RCR, and lower valuations for assets held at fair value.

Condensed consolidated income statement

for the period ended 31 December 2013

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
Interest receivable	**16,740**	18,530	**3,973**	4,207	4,439
Interest payable	**(5,759)**	(7,128)	**(1,209)**	(1,427)	(1,666)
Net interest income	**10,981**	11,402	**2,764**	2,780	2,773
Fees and commissions receivable	**5,460**	5,709	**1,370**	1,382	1,374
Fees and commissions payable	**(942)**	(834)	**(244)**	(238)	(245)
Income from trading activities	**2,685**	1,675	**177**	444	474
Gain on redemption of own debt	**175**	454	**(29)**	13	-
Other operating income/(loss)	**1,398**	(465)	**31**	35	227
Non-interest income	**8,776**	6,539	**1,305**	1,636	1,830
Total income	**19,757**	17,941	**4,069**	4,416	4,603
Staff costs	**(7,163)**	(8,188)	**(1,541)**	(1,895)	(1,656)
Premises and equipment	**(2,348)**	(2,232)	**(700)**	(544)	(592)
Other administrative expenses	**(7,244)**	(5,593)	**(3,960)**	(1,103)	(2,506)
Depreciation and amortisation	**(1,410)**	(1,802)	**(336)**	(338)	(498)
Write-down of goodwill and other intangible assets	**(1,403)**	(124)	**(1,403)**	-	(124)
Operating expenses	**(19,568)**	(17,939)	**(7,940)**	(3,880)	(5,376)
Profit/(loss) before impairment losses	**189**	2	**(3,871)**	536	(773)
Impairment losses	**(8,432)**	(5,279)	**(5,112)**	(1,170)	(1,454)
Operating loss before tax	**(8,243)**	(5,277)	**(8,983)**	(634)	(2,227)
Tax credit/(charge)	**(382)**	(441)	**377**	(81)	(39)
Loss from continuing operations	**(8,625)**	(5,718)	**(8,606)**	(715)	(2,266)

Profit/(loss) from discontinued operations, net of tax					
- Direct Line Group	**127**	(184)	**-**	-	(351)
- Other	**21**	12	**15**	(5)	6
Profit/(loss) from discontinued operations,					
net of tax	**148**	(172)	**15**	(5)	(345)
Loss for the period	**(8,477)**	(5,890)	**(8,591)**	(720)	(2,611)
Non-controlling interests	**(120)**	136	**3**	(6)	108
Preference share and other dividends	**(398)**	(301)	**(114)**	(102)	(115)
Loss attributable to ordinary and					
B shareholders	**(8,995)**	(6,055)	**(8,702)**	(828)	(2,618)
Basic and diluted loss per ordinary and equivalent					
B share from continuing operations	**(81.3p)**	(54.5p)	**(77.3p)**	(7.4p)	(21.6p)
Basic and diluted loss per ordinary and equivalent					
B share from continuing and discontinued operations	**(80.3p)**	(55.0p)	**(77.3p)**	(7.4p)	(23.6p)

* Restated - see page 93.

Condensed consolidated statement of comprehensive income

for the period ended 31 December 2013

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
Loss for the period	**(8,477)**	(5,890)	**(8,591)**	(720)	(2,611)
Items that do not qualify for reclassification					
Actuarial gains/(losses) on defined benefit plans	**446**	(2,158)	**446**	-	(2,158)
Tax	**(246)**	352	**(83)**	(163)	429
	200	(1,806)	**363**	(163)	(1,729)
Items that do qualify for reclassification					
Available-for-sale financial assets	**(406)**	645	**(103)**	430	(70)
Cash flow hedges	**(2,291)**	1,006	**(667)**	(88)	(126)
Currency translation	**(229)**	(900)	**(328)**	(1,211)	169
Tax	**1,014**	(152)	**203**	85	118
	(1,912)	599	**(895)**	(784)	91
Other comprehensive loss after tax	**(1,712)**	(1,207)	**(532)**	(947)	(1,638)
Total comprehensive loss for the period	**(10,189)**	(7,097)	**(9,123)**	(1,667)	(4,249)
Total comprehensive loss is attributable to:					
Non-controlling interests	**137**	(129)	**16**	(13)	(104)
Preference shareholders	**349**	273	**99**	98	99
Paid-in equity holders	**49**	28	**15**	4	16
Ordinary and B shareholders	**(10,724)**	(7,269)	**(9,253)**	(1,756)	(4,260)
	(10,189)	(7,097)	**(9,123)**	(1,667)	(4,249)

* Restated - see page 92.

Key points

- The movement in available-for-sale financial assets during the year and quarter reflects net realised gains on high quality UK, US and German sovereign bonds.
- Cash flow hedging losses in both the year and Q4 2013 largely result from increases in Sterling and US dollar swap rates in the main durations of the underlying portfolio.
- Currency translation losses during the year are principally due to the strengthening of Sterling

  against the US dollar, 2.3%, partially offset by weakening against the Euro, 2.1%. Currency translation losses during the fourth quarter arose mainly from the 2.2% strengthening of Sterling against the US dollar.
- Actuarial gains on defined benefit plans primarily relate to the higher value of assets of the UK pension schemes and changes in the discount rate. Both of these improvements were driven by improving market conditions, particularly yields on AA rated corporate bonds. These gains were partially offset by an increase in the assumed rate of inflation.

Condensed consolidated balance sheet

at 31 December 2013

	31 December 2013	30 September 2013	31 December 2012*
	£m	£m	£m
Assets			
Cash and balances at central banks	**82,659**	87,066	79,290
Net loans and advances to banks	**27,555**	28,206	29,168
Reverse repurchase agreements and stock borrowing	**26,516**	33,757	34,783
Loans and advances to banks	**54,071**	61,963	63,951
Net loans and advances to customers	**390,825**	406,927	430,088
Reverse repurchase agreements and stock borrowing	**49,897**	62,214	70,047
Loans and advances to customers	**440,722**	469,141	500,135
Debt securities	**113,599**	122,886	157,438
Equity shares	**8,811**	10,363	15,232
Settlement balances	**5,591**	18,099	5,741
Derivatives	**288,039**	323,657	441,903
Intangible assets	**12,368**	13,742	13,545
Property, plant and equipment	**7,909**	8,476	9,784
Deferred tax	**3,478**	3,022	3,443
Prepayments, accrued income and other assets	**7,614**	8,586	7,820
Assets of disposal groups	**3,017**	2,435	14,013
Total assets	**1,027,878**	1,129,436	1,312,295
Liabilities			
Bank deposits	**35,329**	38,601	57,073
Repurchase agreements and stock lending	**28,650**	32,748	44,332
Deposits by banks	**63,979**	71,349	101,405
Customer deposits	**414,396**	434,305	433,239
Repurchase agreements and stock lending	**56,484**	72,636	88,040
Customer accounts	**470,880**	506,941	521,279
Debt securities in issue	**67,819**	71,781	94,592
Settlement balances	**5,313**	18,514	5,878
Short positions	**28,022**	31,020	27,591
Derivatives	**285,526**	319,464	434,333
Accruals, deferred income and other liabilities	**16,017**	14,157	14,801

Retirement benefit liabilities	**3,210**	3,597	3,884
Deferred tax	**507**	514	1,141
Subordinated liabilities	**24,012**	23,720	26,773
Liabilities of disposal groups	**3,378**	249	10,170
Total liabilities	**968,663**	1,061,306	1,241,847
Equity			
Non-controlling interests	**473**	462	1,770
Owners' equity*			
Called up share capital	**6,714**	6,697	6,582
Reserves	**52,028**	60,971	62,096
Total equity	**59,215**	68,130	70,448
Total liabilities and equity	**1,027,878**	1,129,436	1,312,295
* Owners' equity attributable to:			
Ordinary and B shareholders	**53,450**	62,376	63,386
Other equity owners	**5,292**	5,292	5,292
	58,742	67,668	68,678

* Restated - see page 92.

Average balance sheet

	Year ended			Quarter ended	
	31 December	31 December		**31 December**	30 September
	2013	2012*		**2013**	2013
	%	%		**%**	%
Average yields, spreads and margins of the banking business					
Gross yield on interest-earning assets of banking business	**3.08**	3.12		**3.01**	3.10
Cost of interest-bearing liabilities of banking business	**(1.42)**	(1.54)		**(1.24)**	(1.40)
Interest spread of banking business	**1.66**	1.58		**1.77**	1.70
Benefit from interest-free funds	**0.36**	0.34		**0.32**	0.35
Net interest margin of banking business	**2.02**	1.92		**2.09**	2.05
Average interest rates					
The Group's base rate	**0.50**	0.50		**0.50**	0.50
London inter-bank three month offered rates					
- Sterling	**0.52**	0.82		**0.52**	0.51
- Eurodollar	**0.24**	0.43		**0.24**	0.26
- Euro	**0.27**	0.53		**0.24**	0.22

* Restated - see page 92.

Average balance sheet

	Year ended 31 December 2013			Year ended 31 December 2012*		
	Average balance	Interest	Rate	Average balance	Interest	Rate
	£m	£m	%	£m	£m	%
Assets						
Loans and advances to banks	**74,706**	**430**	**0.58**	73,998	493	0.67
Loans and advances to customers	**399,796**	**15,125**	**3.78**	429,323	16,188	3.77
Debt securities	**68,874**	**1,185**	**1.72**	89,949	1,849	2.06
Interest-earning assets						
- banking business (1)	**543,376**	**16,740**	**3.08**	593,270	18,530	3.12
- trading business (2)	**216,211**			240,131		
Non-interest earning assets	**467,779**			596,971		
Total assets	**1,227,366**			1,430,372		
Liabilities						
Deposits by banks	**23,651**	**406**	**1.72**	38,476	600	1.56
Customer accounts	**330,207**	**2,831**	**0.86**	328,213	3,491	1.06
Debt securities in issue	**49,324**	**1,307**	**2.65**	83,003	2,023	2.44
Subordinated liabilities	**23,260**	**886**	**3.81**	21,090	815	3.86
Internal funding of trading business	**(19,564)**	**329**	**(1.68)**	(9,148)	199	(2.18)
Interest-bearing liabilities						
- banking business	**406,878**	**5,759**	**1.42**	461,634	7,128	1.54
- trading business (2)	**223,264**			248,647		
Non-interest-bearing liabilities						
- demand deposits	**76,607**			74,320		
- other liabilities	**452,068**			571,963		
Owners' equity	**68,549**			73,808		
Total liabilities and owners' equity	**1,227,366**			1,430,372		

* Restated - see page 92.

Notes:

(1) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.

(2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

Average balance sheet

	Quarter ended 31 December 2013				Quarter ended 30 September 2013		
	Average balance	Interest	Rate		Average balance	Interest	Rate
	£m	£m	%		£m	£m	%
Assets							
Loans and advances to banks	**75,338**	**102**	**0.54**		74,222	106	0.57
Loans and advances to customers	**389,323**	**3,656**	**3.73**		397,115	3,829	3.83
Debt securities	**59,082**	**215**	**1.44**		67,411	272	1.60
Interest-earning assets							
- banking business (1)	**523,743**	**3,973**	**3.01**		538,748	4,207	3.10
- trading business (2)	**190,320**				209,517		
Non-interest earning assets	**393,827**				435,445		
Total assets	**1,107,890**				1,183,710		
Liabilities							
Deposits by banks	**20,086**	**88**	**1.74**		21,591	95	1.75
Customer accounts	**324,635**	**562**	**0.69**		330,405	692	0.83
Debt securities in issue	**43,386**	**294**	**2.69**		45,537	315	2.74
Subordinated liabilities	**22,149**	**216**	**3.87**		23,005	223	3.85
Internal funding of trading business	**(24,467)**	**49**	**(0.79)**		(17,216)	102	(2.35)
Interest-bearing liabilities							
- banking business	**385,789**	**1,209**	**1.24**		403,322	1,427	1.40
- trading business (2)	**199,273**				220,871		
Non-interest-bearing liabilities							
- demand deposits	**73,883**				78,912		
- other liabilities	**383,233**				411,798		
Owners' equity	**65,712**				68,807		
Total liabilities and owners' equity	**1,107,890**				1,183,710		

Notes:

(1) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.
(2) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

86

Condensed consolidated statement of changes in equity

for the period ended 31 December 2013

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012*		**2013**	2013	2012*
	£m	£m		**£m**	£m	£m
Called-up share capital						
At beginning of period	**6,582**	15,318		**6,697**	6,632	6,581
Ordinary shares issued	**132**	197		**17**	65	1
Share capital sub-division and consolidation	**-**	(8,933)		**-**	-	-
At end of period	**6,714**	6,582		**6,714**	6,697	6,582
Paid-in equity (1)						
At beginning and end of period	**979**	979		**979**	979	979
Share premium account						
At beginning of period	**24,361**	24,001		**24,628**	24,483	24,268
Ordinary shares issued	**306**	360		**39**	145	93
At end of period	**24,667**	24,361		**24,667**	24,628	24,361
Merger reserve						
At beginning and end of period	**13,222**	13,222		**13,222**	13,222	13,222
Available-for-sale reserve						
At beginning of period	**(346)**	(957)		**(252)**	(714)	(291)
Unrealised gains	**607**	1,939		**1**	592	136
Realised gains	**(891)**	(1,319)		**(122)**	(164)	(209)
Tax	**432**	50		**65**	34	77
Recycled to profit or loss on disposal of businesses (2)	**(110)**	-		**-**	-	-
Transfer to retained earnings	**-**	(59)		**-**	-	(59)
At end of period	**(308)**	(346)		**(308)**	(252)	(346)
Cash flow hedging reserve						

At beginning of period	**1,666**	879	**447**	491	1,746
Amount recognised in equity	**(967)**	2,093	**(271)**	163	162
Amount transferred from equity to earnings	**(1,324)**	(1,087)	**(396)**	(251)	(288)
Tax	**541**	(219)	**136**	44	46
At end of period	**(84)**	1,666	**(84)**	447	1,666
Foreign exchange reserve					
At beginning of period	**3,908**	4,775	**4,018**	5,201	3,747
Retranslation of net assets	**(325)**	(1,056)	**(417)**	(1,338)	147
Foreign currency gains on hedges of net assets	**105**	177	**88**	148	21
Transfer to retained earnings	**-**	(2)	**-**	-	(2)
Tax	**6**	17	**2**	7	(5)
Recycled to profit or loss on disposal of businesses	**(3)**	(3)	**-**	-	-
At end of period	**3,691**	3,908	**3,691**	4,018	3,908
Capital redemption reserve					
At beginning of period	**9,131**	198	**9,131**	9,131	9,131
Share capital sub-division and consolidation	**-**	8,933	**-**	-	-
At end of period	**9,131**	9,131	**9,131**	9,131	9,131
Contingent capital reserve					
At beginning of period	**(1,208)**	(1,208)	**(1,208)**	(1,208)	(1,208)
Transfer to retained earnings	**1,208**	-	**1,208**	-	-
At end of period	**-**	(1,208)	**-**	(1,208)	(1,208)

* Restated - see page 92.

For the notes to this table refer to page 89.

Condensed consolidated statement of changes in equity

for the period ended 31 December 2013

	Year ended			Quarter ended	
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
Retained earnings					
At beginning of period	**10,596**	18,929	**10,144**	11,105	15,216
Transfer to non-controlling interests	**-**	(361)	**-**	-	(361)
(Loss)/profit attributable to ordinary and B					
shareholders and other equity owners					
- continuing operations	**(8,708)**	(5,694)	**(8,592)**	(723)	(2,278)
- discontinued operations	**111**	(60)	**4**	(3)	(225)
Equity preference dividends paid	**(349)**	(273)	**(99)**	(98)	(99)
Paid-in equity dividends paid, net of tax	**(49)**	(28)	**(15)**	(4)	(16)
Transfer from available-for-sale reserve	**-**	59	**-**	-	59
Transfer from foreign exchange reserve	**-**	2	**-**	-	2
Transfer from contingent capital reserve	**(1,208)**	-	**(1,208)**	**-**	**-**
Termination of contingent capital agreement	**320**	-	**320**	**-**	**-**
Actuarial gains/(losses) recognised in retirement					
benefit schemes					
- gross	**446**	(2,158)	**446**	-	(2,158)
- tax	**(246)**	352	**(83)**	(163)	429
Loss on disposal of own shares held	**(18)**	(196)	**-**	-	-
Shares released for employee benefits	**(77)**	(87)	**(76)**	-	43
Share-based payments					
- gross	**48**	117	**26**	26	(19)
- tax	**1**	(6)	**-**	4	3
At end of period	**867**	10,596	**867**	10,144	10,596
Own shares held					
At beginning of period	**(213)**	(769)	**(138)**	(139)	(207)
Disposal/(purchase) of own shares	**75**	441	**1**	1	(6)
Shares released for employee benefits	**1**	115	**-**	-	-

At end of period	**(137)**	(213)		**(137)**	(138)	(213)
Owners' equity at end of period	**58,742**	68,678		**58,742**	67,668	68,678

* Restated - see page 92.

For the notes to this table refer to page 89.

Condensed consolidated statement of changes in equity

for the period ended 31 December 2013

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012*		**2013**	2013	2012*
	£m	£m		**£m**	£m	£m
Non-controlling interests						
At beginning of period	**1,770**	686		**462**	475	646
Currency translation adjustments and other movements	**(6)**	(18)		**1**	(21)	1
Profit/(loss) attributable to non-controlling interests						
- continuing operations	**83**	(24)		**(14)**	8	12
- discontinued operations	**37**	(112)		**11**	(2)	(120)
Dividends paid	**(5)**	-		**(5)**	-	-
Movements in available-for-sale securities						
- unrealised gains	**8**	3		**(3)**	2	(1)
- realised losses	**21**	22		**21**	-	4
- tax	**(1)**	-		**-**	-	-
- recycled to profit or loss on disposal of businesses (3)	**(5)**	-		**-**	-	-
Equity raised	**-**	875		**-**	-	874
Equity withdrawn and disposals	**(1,429)**	(23)		**-**	-	(7)
Transfer from retained earnings	**-**	361		**-**	-	361
At end of period	**473**	1,770		**473**	462	1,770
Total equity at end of period	**59,215**	70,448		**59,215**	68,130	70,448
Total comprehensive loss recognised in the						
statement of changes in equity is attributable to:						
Non-controlling interests	**137**	(129)		**16**	(13)	(104)
Preference shareholders	**349**	273		**99**	98	99
Paid-in equity holders	**49**	28		**15**	4	16

Ordinary and B shareholders	**(10,724)**	(7,269)		**(9,253)**	(1,756)	(4,260)
	(10,189)	(7,097)		**(9,123)**	(1,667)	(4,249)

* Restated - see page 92.

For an explanation of the movements in the available-for-sale, cash flow hedging and foreign exchange reserves, and pensions refer to page 82.

Notes:

(1) Paid-in equity was increased by £548 million on adoption of IFRS 10 - see page 92.
(2) Net of tax - £35 million charge.
(3) Net of tax - £1 million charge.

Key point

- On cancellation of the contingent capital agreement with HMT on 16 December 2013 the reserve of £1,208 million and £320 million in respect of the final year's instalment were transferred to retained earnings.

Condensed consolidated cash flow statement

for the year ended 31 December 2013

	2013	2012*
	£m	£m
Operating activities		
Operating loss before tax on continuing operations	**(8,243)**	(5,277)
Operating profit/(loss) before tax on discontinued operations	**177**	(111)
Adjustments for non-cash items	**6,561**	9,306
Net cash (outflow)/inflow from trading activities	**(1,505)**	3,918
Changes in operating assets and liabilities	**(28,780)**	(48,736)
Net cash flows from operating activities before tax	**(30,285)**	(44,818)
Income taxes paid	**(346)**	(295)
Net cash flows from operating activities	**(30,631)**	(45,113)
Net cash flows from investing activities	**21,183**	27,175
Net cash flows from financing activities	**(2,728)**	2,017
Effects of exchange rate changes on cash and cash equivalents	**512**	(3,893)
Net decrease in cash and cash equivalents	**(11,664)**	(19,814)
Cash and cash equivalents at beginning of year	**132,841**	152,655
Cash and cash equivalents at end of year	**121,177**	132,841

* Restated - see page 92.

Notes

1. Basis of preparation

The Group's condensed consolidated financial statements should be read in conjunction with the 2013 annual accounts which were prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS).

In accordance with IFRS 5, Direct Line Group (DLG) was classified as a discontinued operation in 2012. From 13 March 2013, DLG was classified as an associate and at 31 December 2013 the Group's interest in DLG was transferred to disposal groups.

Going concern

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group will continue in operational existence for the foreseeable future. Accordingly, the Annual Results for the year ended 31 December 2013 have been prepared on a going concern basis.

2. Accounting policies

There have been no significant changes to the Group's principal accounting policies as set out on pages 320 to 332 of its 2012 Annual 20-F apart from the adoption of a number of new and revised IFRSs that are effective from 1 January 2013 as described below.

IFRS 11 'Joint Arrangements', which supersedes IAS 31 'Interests in Joint Ventures', distinguishes between joint operations and joint ventures. Joint operations are accounted for by the investor recognising its assets and liabilities including its share of any assets held and liabilities incurred jointly and its share of revenues and costs. Joint ventures are accounted for in the investor's consolidated accounts using the equity method. IFRS 11 requires retrospective application.

IAS 27 'Separate Financial Statements' comprises those parts of the existing IAS 27 that deal with separate financial statements. IAS 28 'Investments in Associates and Joint Ventures' covers joint ventures as well as associates; both must be accounted for using the equity method. The mechanics of the equity method are unchanged.

IFRS 12 ‘Disclosure of Interests in Other Entities’ mandates the disclosures in annual financial statements in respect of investments in subsidiaries, joint arrangements, associates and structured entities that are not controlled by the Group.

IFRS 13 ‘Fair Value Measurement’ sets out a single IFRS framework for defining and measuring fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also requires disclosures about fair value measurements.

Notes

2. Accounting policies (continued)

'Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)' amended IFRS 7 to require disclosures about the effects and potential effects on an entity's financial position of offsetting financial assets and financial liabilities and related arrangements.

Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' require items that will never be recognised in profit or loss to be presented separately in other comprehensive income from those items that are subject to subsequent reclassification.

'Annual Improvements 2009-2011 Cycle' also made a number of minor changes to IFRSs.

Implementation of the standards above has not had a material effect on the Group's results.

IAS 19 'Employee Benefits' (revised) requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £21 million for the quarter ended 31 December 2012, £84 million for the year ended 31 December 2012 and other comprehensive income after tax higher by the same amounts. This also resulted in an increase in the loss per ordinary and B share of 0.2p for the quarter ended 31 December 2012 and 0.8p for the year ended 31 December 2012. Prior periods have been restated.

IFRS 10 'Consolidated Financial Statements' replaces SIC-12 'Consolidation - Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity so as to vary returns for the reporting entity. IFRS 10 requires retrospective application. Following implementation of IFRS 10, certain entities that have trust preferred securities in issue are no longer consolidated by the Group. As a result there was a reduction in Non-controlling interests of £0.5 billion with a corresponding increase in Owners' equity (Paid-in equity) as at 31 December 2012. This resulted in an increase in the loss attributable to non-controlling interests of £1 million for the quarter ended 31 December 2012 and £13 million for the year ended 31 December 2012, with a corresponding increase in the profit attributable to paid-in equity holders. There was no impact on the loss attributable to ordinary and B shareholders. Prior periods have been restated accordingly.

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The judgements and assumptions that are considered to be the most important to the portrayal of the Group's financial condition are those relating to pensions; goodwill; provisions for liabilities; deferred tax; loan impairment provisions and financial instrument fair values. These critical accounting policies and judgments are described on pages 328 to 331 of the Group's 2012 20-F.

Notes

2. Accounting policies (continued)

Recent developments in IFRS

The IASB published:

- in May 2013, IFRIC 21 'Levies'. This interpretation provides guidance on accounting for the liability to pay a government imposed levy. IFRIC 21 is effective for annual periods beginning on or after 1 January 2014.

- in May 2013, 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)'. These amendments align IAS 36's disclosure requirements about recoverable amounts with IASB's original intentions. They are effective for annual periods beginning on or after 1 January 2014.

- in June 2013, 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)'. These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. They are effective for annual periods beginning on or after 1 January 2014.
- in November 2013, 'Defined Benefit Plans: Employee Contributions'. This amendment distinguishes the accounting for employee contributions that are related to service from those that are independent of service. It is effective for annual periods beginning on or after 1 July 2014.

- in November 2013, IFRS 9 'Financial Instruments' (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) which sets out new requirements for hedge accounting and in respect of IFRS 9 transition.
- in December 2013, Annual Improvements to IFRS 2010 - 2012 and 2011 - 2013 cycles. There are a number of minor changes to IFRS that will not have a material effect on the Group's financial statements. All amendments are effective for annual periods beginning on or after 1 July 2014.

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

Notes

3. Analysis of income, expenses and impairment losses					
	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
Loans and advances to customers	**15,125**	16,188	**3,656**	3,829	3,940
Loans and advances to banks	**430**	493	**102**	106	114
Debt securities	**1,185**	1,849	**215**	272	385
Interest receivable	**16,740**	18,530	**3,973**	4,207	4,439
Customer accounts	**2,831**	3,491	**562**	692	849
Deposits by banks	**406**	600	**88**	95	122
Debt securities in issue	**1,307**	2,023	**294**	315	404
Subordinated liabilities	**886**	815	**216**	223	201
Internal funding of trading businesses	**329**	199	**49**	102	90
Interest payable	**5,759**	7,128	**1,209**	1,427	1,666
Net interest income	**10,981**	11,402	**2,764**	2,780	2,773
Fees and commissions receivable					
- payment services	**1,432**	1,368	**368**	375	317
- credit and debit card fees	**1,078**	1,088	**265**	284	280
- lending (credit facilities)	**1,377**	1,480	**344**	335	368
- brokerage	**479**	548	**110**	117	122
- trade finance	**300**	314	**74**	73	64
- investment management	**450**	471	**131**	109	106
- other	**344**	440	**78**	89	117
	5,460	5,709	**1,370**	1,382	1,374
	(942)	(834)	**(244)**	(238)	(245)

Fees and commissions payable - banking					
Net fees and commissions	**4,518**	4,875	**1,126**	1,144	1,129
Foreign exchange	**854**	654	**206**	198	86
Interest rate	**596**	1,932	**(54)**	248	456
Credit	**998**	737	**2**	116	118
Own credit adjustments	**35**	(1,813)	**15**	(155)	(98)
Other	**202**	165	**8**	37	(88)
Income from trading activities	**2,685**	1,675	**177**	444	474
Gain/(loss) on redemption of own debt	**175**	454	**(29)**	13	-
Operating lease and other rental income	**484**	876	**103**	125	152
Own credit adjustments	**(155)**	(2,836)	**(15)**	(341)	(122)
Changes in the fair value of:					
- securities and other financial assets and liabilities	**(26)**	146	**(91)**	36	19
- investment properties	**(281)**	(153)	**(258)**	(7)	(77)
Profit on sale of securities	**830**	1,146	**91**	167	237
Profit/(loss) on sale of:					
- property, plant and equipment	**44**	34	**11**	10	(1)
- subsidiaries and associates	**168**	95	**171**	(21)	(21)
Dividend income	**87**	59	**46**	6	16
Share of profits less losses of associates	**320**	29	**43**	73	21
Other income	**(73)**	139	**(70)**	(13)	3
Other operating income	**1,398**	(465)	**31**	35	227

* Restated - see page 92.

Notes

3. Analysis of income, expenses and impairment losses (continued)						
	Year ended			Quarter ended		
	31 December	31 December		31 December	30 September	31 December
	2013	2012*		2013	2013	2012*
	£m	£m		£m	£m	£m
Total non-interest income	**8,776**	6,539		**1,305**	1,636	1,830
Total income	**19,757**	17,941		**4,069**	4,416	4,603
Staff costs	**7,163**	8,188		**1,541**	1,895	1,656
Premises and equipment	**2,348**	2,232		**700**	544	592
Other (1)	**7,244**	5,593		**3,960**	1,103	2,506
Administrative expenses	**16,755**	16,013		**6,201**	3,542	4,754
Depreciation and amortisation	**1,410**	1,802		**336**	338	498
Write down of goodwill (2)	**1,059**	18		**1,059**	-	18
Write down of other intangible assets	**344**	106		**344**	-	106
Operating expenses	**19,568**	17,939		**7,940**	3,880	5,376
Loan impairment losses	**8,412**	5,315		**5,131**	1,120	1,402
Securities	**20**	(36)		**(19)**	50	52
Impairment losses	**8,432**	5,279		**5,112**	1,170	1,454

* Restated - see page 92.

Notes:

(1) Includes bank levy of £200 million (2012 - £175 million), Payment Protection Insurance costs of £900 million (2012 - £1,110 million), Interest Rate Hedging Products redress and related costs of £550 million (2012 - £700 million) and regulatory and legal actions of £2,394 million (2012 - £381 million).
(2) Excludes goodwill of £394 million written-off in Q4 2012 in respect of Direct Line Group.

Payment Protection Insurance (PPI)

The Group increased its provision for PPI in Q4 2013 by £465 million, bringing the total charge for the year to £900 million. The cumulative charge in respect of PPI is £3.1 billion, of which £2.2 billion (70%) in redress and expenses had been utilised by 31 December 2013. Of the £3.1 billion cumulative charge, £2.8 billion relates to redress and £0.3 billion to administrative expenses.

	Year ended		Quarter ended		
	31 December 2013	31 December 2012	**31 December 2013**	30 September 2013	31 December 2012
	£m	£m	**£m**	£m	£m
At beginning of period	**895**	745	**737**	704	684
Charge to income statement	**900**	1,110	**465**	250	450
Utilisations	**(869)**	(960)	**(276)**	(217)	(239)
At end of period	**926**	895	**926**	737	895

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

Notes

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

Payment Protection Insurance (PPI) (continued)

The principal assumptions underlying the Group's provision in respect of PPI sales relate to: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in the FSA policy statements and expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience, the calculation rules in the FSA statement and the expected mix of claims.

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

			Sensitivity	
Assumption	Actual to date	Current assumption	Change in assumption %	Consequential change in provision £m
Past business review take up rate	36%	38%	+/-5	+/-45
Uphold rate	84%	83%	+/-5	+/-30
Average redress	£1,733	£1,646	+/-5	+/-26

Note:

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

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

Interest Rate Hedging Products (IRHP) redress and related costs

Following an industry-wide review conducted in conjunction with the Financial Services Authority (now being dealt with by the Financial Conduct Authority (FCA)), a charge of £700 million was booked in Q4 2012 for redress in relation to certain interest rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. £575 million was earmarked for client redress and £125 million for administrative expenses. The estimate for administrative costs was increased by £50 million in Q1 2013 following development of the plan for administering this process in accordance with FSA guidelines. The provision was further increased in Q4 2013 by £500 million, reflecting both higher volumes and anticipated redress payments, recalibration of our methodology based on experience during Q4 2013 and additional administration charges. The cumulative charge for IRHP is £1.3 billion, of which £1.0 billion relates to redress and £0.3 billion relates to administrative expenses. Customers may also be entitled to be compensated for any consequential losses they may have suffered. The Group is not able to measure reliably any liability it may have and has accordingly not made any provision.

Notes

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

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

The Group expects to complete its review of sales of IRHP and provide basic redress to all customers who are entitled to it by the end of 2014. On 23 October 2013, the Group announced that it would split redress payments for all customers who may have been mis-sold IRHP. Customers will receive redress monies without having to wait for the assessment of any additional consequential loss claims which are outside the allowance for such claims included in the 8% interest on redress due.

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

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012	**2013**	2013	2012
	£m	£m	**£m**	£m	£m
At beginning of period	**676**	-	**631**	670	-
Charge to income statement	**550**	700	**500**	-	700
Utilisations	**(149)**	(24)	**(54)**	(39)	(24)
At end of period	**1,077**	676	**1,077**	631	676

Regulatory and legal actions

The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. An additional charge of £2,394 million was booked in 2013 (FY 2012 - £381 million; Q4 2013 £1,910 million; Q3 2013 - £99 million; Q4 2012 - £381 million), primarily in respect of matters related to mortgage-backed securities and securities related litigation following recent third party litigation settlements and regulatory decisions.

Staff expenses

Staff expenses comprise	**2013** **£m**	2012* £m	Change %
Salaries	**4,429**	4,748	(7)
Variable compensation	**588**	716	(18)
Temporary and contract costs	**650**	699	(7)
Social security costs	**486**	562	(14)
Share based compensation	**49**	126	(61)
Pension costs			
- defined benefit schemes	**517**	528	(2)
- curtailment and settlement gains	**(7)**	(41)	(83)
- defined contribution schemes	**76**	29	162
Severance	**69**	426	(84)
Other	**306**	395	(23)
Staff expenses	**7,163**	8,188	(13)

* Restated - see page 92.

97

Notes

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

Variable compensation awards

The following tables analyse Group and Markets variable compensation awards for 2013[1].

	Group				Markets		
	2013	2012	Change		**2013**	2012	Change
	£m	£m	%		**£m**	£m	%
Non-deferred cash awards (2)	**67**	73	(8)		**9**	10	(10)
Non-deferred share awards	**-**	27	(100)		**-**	17	(100)
Total non-deferred variable compensation	**67**	100	(33)		**9**	27	(67)
Deferred bond awards	**188**	497	(62)		**43**	212	(80)
Deferred share awards	**321**	82	291		**185**	48	285
Total deferred variable compensation	**509**	579	(12)		**228**	260	(12)
Total variable compensation (3)	**576**	679	(15)		**237**	287	(17)
Variable compensation as a % of operating profit (4)	**19%**	19%			**27%**	16%	
Proportion of variable compensation that is deferred	**88%**	85%			**96%**	91%	
- Of which deferred bond awards	**37%**	86%			**19%**	82%	
- Of which deferred share awards	**63%**	14%			**81%**	18%	

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

Variable compensation decreased by 15% to £576 million for the Group and by 17% to £237 million for Markets. Total Group variable compensation as a percentage of operating profit(4) has remained flat at 19%. The proportion of variable compensation that is deferred has increased to 88% for the Group and 96% for Markets. The proportion of deferred variable compensation delivered to employees in shares has increased significantly as it is capital efficient and better aligns employees' interests with those of the shareholders. 63% of Group deferred variable compensation awards were awarded in shares in 2013 compared with 14% in 2012. For Markets 81% of deferred variable compensation awards were awarded in shares in 2013 compared with 18% in 2012.

Reconciliation of variable compensation awards to income statement charge	**2013** **£m**	2012 £m
Variable compensation awarded	**576**	679
Less: deferral of charge for amounts awarded for current year	**(245)**	(262)
Income statement charge for amounts awarded in current year	**331**	417
Add: current year charge for amounts deferred from prior years	**294**	355
Less: forfeiture of amounts deferred from prior years	**(37)**	(56)
Income statement charge for amounts deferred from prior year	**257**	299
Income statement charge for variable compensation (3)	**588**	716

Notes

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

Year in which income statement charge is expected to be taken for deferred variable compensation	Actual		Expected	
	2012	**2013**	2014	2015 and beyond
	£m	**£m**	£m	£m
Variable compensation deferred from 2011 and earlier	414	**105**	5	-
Variable compensation deferred from 2012	-	**199**	39	24
Clawback of variable compensation	(59)	**(10)**	(3)	-
Less: Forfeiture of amounts deferred from prior years	(56)	**(37)**	-	-
Variable compensation for 2013 deferred	-	**-**	170	76
	299	**257**	211	100

Notes:

(1) The tables above relate to continuing businesses only. There are no amounts relating to discontinued businesses in 2013 (2012 - £24 million).
(2) Cash payments to all employees are limited to £2,000.
(3) Excludes other performance related compensation.
(4) Reported operating profit excluding the impact of RCR and before variable compensation expense and one-off and other items.

4. Pensions

Pension costs	**2013**	2012*
	£m	£m
Defined benefit schemes	**510**	487
Defined contribution schemes	**76**	29
Pension costs - continuing operations	**586**	516

Net pension deficit	2013 £m	2012* £m
At 1 January	**3,740**	2,051
Currency translation and other adjustments	**13**	(12)
Income statement		
Pension costs		
- continuing operations	**510**	487
- discontinued operations	**-**	30
Net actuarial (gains)/losses	**(446)**	2,158
Contributions by employer	**(821)**	(977)
Transfer to disposal groups	**-**	3
At 31 December	**2,996**	3,740
Net assets of schemes in surplus	**(214)**	(144)
Net liabilities of schemes in deficit	**3,210**	3,884

* Restated - see page 92.

The Group and the Trustees of The Royal Bank of Scotland Group Pension Fund agreed the funding valuation as at 31 March 2010 during 2011. It showed that the value of liabilities exceeded the value of assets by £3.5 billion as at 31 March 2010, a ratio of assets to liabilities of 84%. In order to eliminate this deficit, the Group agreed to pay additional contributions each year over the period 2011 to 2018. Contributions started at £375 million per annum in 2011, increasing to £400 million per annum in 2013 and from 2016 onwards will be further increased in line with price inflation. These contributions are in addition to the regular annual contributions of around £250 million for future accrual benefits.

A funding valuation as at 31 March 2013 is currently in progress and is expected to be concluded by 30 June 2014.

Notes

5. Loan impairment provisions

Operating loss is stated after charging loan impairment losses of £8,412 million (year ended 31 December 2012 - £5,315 million). The balance sheet loan impairment provisions increased in the year ended 31 December 2013 from £21,250 million to £25,216 million and the movements thereon were:

	Year ended							
	31 December 2013				31 December 2012			
		Non-				Non-	RFS	
	Core	**Core**	**Total**		Core	Core	MI	Total
	£m	**£m**	**£m**		£m	£m	£m	£m
At beginning of period	**10,062**	**11,188**	**21,250**		8,414	11,469	-	19,883
Transfers (to)/from disposal groups	**(9)**	**-**	**(9)**		764	-	-	764
Currency translation and other adjustments	**81**	**40**	**121**		53	(363)	-	(310)
Disposals	**-**	**(77)**	**(77)**		-	(1)	(4)	(5)
Amounts written-off	**(2,490)**	**(1,856)**	**(4,346)**		(2,145)	(2,121)	-	(4,266)
Recoveries of amounts previously written-off	**168**	**88**	**256**		211	130	-	341
Charge to income statement								
- continuing operations	**3,766**	**4,646**	**8,412**		2,995	2,320	-	5,315
- discontinued operations	**-**	**-**	**-**		-	-	4	4
Unwind of discount (recognised in interest income)	**(201)**	**(190)**	**(391)**		(230)	(246)	-	(476)
At end of period	**11,377**	**13,839**	**25,216**		10,062	11,188	-	21,250

	Quarter ended												
	31 December 2013				30 September 2013				31 December 2012				
		Non-				Non-				Non-	RFS		
	Core	**Core**	**Total**		Core	Core	Total		Core	Core	MI	Total	
	£m	**£m**	**£m**		£m	£m	£m		£m	£m	£m	£m	
At beginning of period	**10,101**	**11,320**	**21,421**		10,358	11,395	21,753		9,203	11,115	-	20,318	
Transfers (to)/from disposal groups	**(9)**	**-**	**(9)**		-	-	-		764	-	-	764	

Currency translation and other adjustments	**(28)**	**(90)**	**(118)**		(98)	(211)	(309)		57	139	-	196
Disposals	**-**	**-**	**-**		-	(77)	(77)		-	(1)	(4)	(5)
Amounts written-off	**(607)**	**(586)**	**(1,193)**		(728)	(302)	(1,030)		(688)	(733)	-	(1,421)
Recoveries of amounts previously written-off	**38**	**27**	**65**		40	30	70		50	46	-	96
Charge to income statement												
- continuing operations	**1,924**	**3,207**	**5,131**		584	536	1,120		729	673	-	1,402
- discontinued operations	**-**	**-**	**-**		-	-	-		-	-	4	4
Unwind of discount												
(recognised in interest income)	**(42)**	**(39)**	**(81)**		(55)	(51)	(106)		(53)	(51)	-	(104)
At end of period	**11,377**	**13,839**	**25,216**		10,101	11,320	21,421		10,062	11,188	-	21,250

Provisions at 31 December 2013 include £63 million in respect of loans and advances to banks (30 September 2013 - £69 million; 31 December 2012 - £114 million).

The tables above exclude impairments relating to securities.

Notes

6. Tax

The actual tax charge differs from the expected tax credit computed by applying the standard UK corporation tax rate of 23.25% (2012 - 24.5%).

	Year ended			Quarter ended		
	31 December	31 December		**31 December**	30 September	31 December
	2013	2012*		**2013**	2013	2012*
	£m	£m		**£m**	£m	£m
Loss before tax	**(8,243)**	(5,277)		**(8,983)**	(634)	(2,227)
Expected tax credit	**1,916**	1,293		**2,088**	147	546
Losses in year where no deferred tax						
asset recognised	**(879)**	(511)		**(688)**	(75)	(129)
Foreign profits taxed at other rates	**(196)**	(383)		**(44)**	(32)	(77)
UK tax rate change impact	**(313)**	(149)		**(116)**	(197)	(14)
Unrecognised timing differences	**(8)**	59		**(6)**	10	42
Non-deductible goodwill impairment	**(247)**	-		**(247)**	-	-
Items not allowed for tax						
- losses on disposals and write-downs	**(20)**	(49)		**(15)**	(5)	(41)
- UK bank levy	**(47)**	(43)		**(6)**	(12)	10
- regulatory and legal actions	**(144)**	(93)		**(54)**	-	(93)
- employee share schemes	**(11)**	(9)		**10**	(7)	35
- other disallowable items	**(202)**	(246)		**(99)**	(21)	(133)
Non-taxable items						
- gain on sale of RBS Aviation Capital	**-**	26		**-**	-	(1)
- gain on sale of Global Merchant Services	**37**	-		**37**	-	-
- other non-taxable items	**171**	104		**56**	29	60
Taxable foreign exchange movements	**(25)**	(1)		**(11)**	(12)	-
Losses brought forward and utilised	**36**	2		**13**	(4)	(10)
Reduction in carrying value of deferred tax asset						
in respect of losses in:						

- UK	**(701)**	-	**(701)**	-	-
- Australia	**-**	(191)	**-**	-	(9)
- Ireland	**-**	(203)	**-**	-	(203)
Adjustments in respect of prior periods	**251**	(47)	**160**	98	(22)
Actual tax (charge)/credit	**(382)**	(441)	**377**	(81)	(39)

* Restated - see page 92.

The tax charge for the year ended 31 December 2013 reflects losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), a reduction in the carrying value of the deferred tax asset in respect of UK losses and the effect of the reduction of 3% in the rate of UK corporation tax enacted in July 2013.

The Group has recognised a deferred tax asset at 31 December 2013 of £3,478 million (30 September 2013 - £3,022 million; 31 December 2012 - £3,443 million) and a deferred tax liability as at 31 December 2013 of £507 million (30 September 2013 - £514 million; 31 December 2012 - £1,141 million). These balances include £2,411 million (30 September 2013 - £2,578 million; 31 December 2012 - £3,072 million) relating to carried forward trading losses in the UK. Under UK tax legislation, these UK losses can be carried forward indefinitely to be utilised against profits arising in the future. The Group has considered the carrying value of this asset as at 31 December 2013 and concluded that it is recoverable based on future profit projections.

Notes

7. Profit/(loss) attributable to non-controlling interests

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
RBS Sempra Commodities JV	**(3)**	3	**(2)**	1	1
RFS Holdings BV Consortium Members	**113**	(30)	**(5)**	5	1
Direct Line Group	**19**	(125)	**-**	-	(125)
Other	**(9)**	16	**4**	-	15
Profit/(loss) attributable to non-controlling interests	**120**	(136)	**(3)**	6	(108)

* Restated - see page 92.

8. Dividends

Dividends paid to preference shareholders and paid-in equity holders are as follows:

	Year ended		Quarter ended		
	31 December	31 December	**31 December**	30 September	31 December
	2013	2012*	**2013**	2013	2012*
	£m	£m	**£m**	£m	£m
Preference shareholders					
Non-cumulative preference shares of US$0.01	**226**	153	**41**	69	43
Non-cumulative preference shares of €0.01	**121**	115	**57**	29	55
	2	5	**1**	-	1

Non-cumulative preference shares of £1						
Paid-in equity holders						
Interest on securities classified as equity, net of tax	**49**	28		**15**	4	16
	398	301		**114**	102	115

* Restated - see page 92.

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

In the context of prior macro-prudential policy discussions, the Board of RBSG decided to partially neutralise any impact on Core Tier 1 capital of coupon and dividend payments in respect of 2013 Group hybrid capital instruments through an equity issuance of c.£300 million. During the year, approximately £255 million was raised through the issue of new ordinary shares and a further £44 million was raised through the sale of surplus shares held by the Group’s Employee Benefit Trust.

For 2014, the Board of RBSG has decided to continue partially neutralising the Core Tier 1 impact of Group hybrid capital instruments. It is expected that £300 million of new equity will be issued during the course of 2014 to achieve this aim.

Notes

9. Earnings per ordinary and equivalent B share

Earnings per ordinary and equivalent B share (1) have been calculated based on the following:

	Year ended		Quarter ended		
	31 December 2013	31 December 2012*	**31 December 2013**	30 September 2013	31 December 2012*
Earnings					
Loss from continuing operations attributable to ordinary and equivalent B shareholders (£m)	**(9,106)**	(5,995)	**(8,706)**	(825)	(2,393)
Profit/(loss) from discontinued operations attributable to ordinary and equivalent B shareholders (£m)	**111**	(60)	**4**	(3)	(225)
Loss attributable to ordinary and equivalent B shareholders (£m)	**(8,995)**	(6,055)	**(8,702)**	(828)	(2,618)
Ordinary shares outstanding during the period (millions)	**6,096**	5,902	**6,156**	6,123	6,003
Equivalent B shares in issue during the period (millions)	**5,100**	5,100	**5,100**	5,100	5,100
Weighted average number of ordinary shares and equivalent B shares outstanding during the period (millions)	**11,196**	11,002	**11,256**	11,223	11,103
Basic (loss)/earnings per ordinary and equivalent B					
	(81.3p)	(54.5p)	**(77.3p)**	(7.4p)	(21.6p)

share from continuing operations							
Basic and diluted loss per ordinary and equivalent B							
share from continuing and discontinuing operations	**(80.3p)**	(55.0p)		**(77.3p)**	(7.4p)	(23.6p)	

* Restated - see page 92.

Notes

10. Segmental analysis

Analysis of divisional operating profit/(loss)

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

The ceding of control which resulted from the partial disposal of the Group's shareholding in Direct Line Group (DLG) has resulted in the Group no longer treating DLG as an operating segment. Comparative data for 2012 have been restated.

Year ended 31 December 2013	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail	**3,979**	**958**	**4,937**	**(2,670)**	**(324)**	**1,943**
UK Corporate	**2,874**	**1,593**	**4,467**	**(2,219)**	**(1,188)**	**1,060**
Wealth	**674**	**419**	**1,093**	**(843)**	**(29)**	**221**
International Banking	**713**	**1,135**	**1,848**	**(1,340)**	**(229)**	**279**
Ulster Bank	**631**	**240**	**871**	**(554)**	**(1,774)**	**(1,457)**
US Retail & Commercial	**1,916**	**1,073**	**2,989**	**(2,186)**	**(156)**	**647**
Markets	**157**	**3,165**	**3,322**	**(2,610)**	**(92)**	**620**
Central items	**147**	**114**	**261**	**(286)**	**(64)**	**(89)**
Core	**11,091**	**8,697**	**19,788**	**(12,708)**	**(3,856)**	**3,224**
Non-Core	**(99)**	**(247)**	**(346)**	**(605)**	**(4,576)**	**(5,527)**
Managed basis	**10,992**	**8,450**	**19,442**	**(13,313)**	**(8,432)**	**(2,303)**
Reconciling items						
Own credit adjustments (1)	**-**	**(120)**	**(120)**	**-**	**-**	**(120)**
Payment Protection Insurance costs	**-**	**-**	**-**	**(900)**	**-**	**(900)**
Interest Rate Hedging Products						

redress and related costs	-	-	-	(550)	-	(550)
Regulatory and legal actions	-	-	-	(2,394)	-	(2,394)
Integration and restructuring costs	-	-	-	(656)	-	(656)
Gain on redemption of own debt	-	175	175	-	-	175
Write-down of goodwill	-	-	-	(1,059)	-	(1,059)
Amortisation of purchased intangible assets	-	-	-	(153)	-	(153)
Strategic disposals	-	161	161	-	-	161
Bank levy	-	-	-	(200)	-	(200)
Write-down of other intangible assets	-	-	-	(344)	-	(344)
RFS Holdings minority interest	(11)	110	99	1	-	100
Statutory basis	10,981	8,776	19,757	(19,568)	(8,432)	(8,243)

Note:

(1) Comprises £35 million gain included in 'Income from trading activities' and £155 million loss included in 'Other operating income' on a statutory basis.

104

Notes

10. Segmental analysis (continued)						
	Net interest income	Non-interest income	Total income	Operating expenses	Impairment losses	Operating profit/(loss)
Year ended 31 December 2012	£m	£m	£m	£m	£m	£m
UK Retail	3,990	979	4,969	(2,549)	(529)	1,891
UK Corporate	2,974	1,749	4,723	(2,089)	(838)	1,796
Wealth	720	450	1,170	(881)	(46)	243
International Banking	913	1,209	2,122	(1,417)	(111)	594
Ulster Bank	649	196	845	(521)	(1,364)	(1,040)
US Retail & Commercial	1,932	1,159	3,091	(2,246)	(91)	754
Markets	111	4,372	4,483	(2,937)	(37)	1,509
Central items	(116)	510	394	(270)	(40)	84
Core	11,173	10,624	21,797	(12,910)	(3,056)	5,831
Non-Core	244	44	288	(944)	(2,223)	(2,879)
Managed basis	11,417	10,668	22,085	(13,854)	(5,279)	2,952
Reconciling items						
Own credit adjustments (1)	-	(4,649)	(4,649)	-	-	(4,649)
Payment Protection Insurance costs	-	-	-	(1,110)	-	(1,110)
Interest Rate Hedging Products redress and						
related costs	-	-	-	(700)	-	(700)
Regulatory and legal actions	-	-	-	(381)	-	(381)
Integration and restructuring costs	-	-	-	(1,415)	-	(1,415)
Gain on redemption of own debt	-	454	454	-	-	454
Write-down of goodwill	-	-	-	(18)	-	(18)
Asset Protection Scheme (2)	-	(44)	(44)	-	-	(44)
Amortisation of purchased intangible assets	-	-	-	(178)	-	(178)
Strategic disposals	-	113	113	-	-	113
Bank levy	-	-	-	(175)	-	(175)
Write-down of other intangible assets	-	-	-	(106)	-	(106)
RFS Holdings minority interest	(15)	(3)	(18)	(2)	-	(20)

Statutory basis	11,402	6,539	17,941	(17,939)	(5,279)	(5,277)

Notes:

(1) Comprises £1,813 million loss included in 'Income from trading activities' and £2,836 million loss included in 'Other operating income' on a statutory basis.
(2) Included in ‘Income from trading activities’ on a statutory basis.

105

Notes

10. Segmental analysis (continued)						
	Net interest income	**Non-interest income**	**Total income**	**Operating expenses**	**Impairment losses**	**Operating profit/(loss)**
Quarter ended 31 December 2013	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
UK Retail	1,014	253	1,267	(722)	(73)	472
UK Corporate	728	401	1,129	(585)	(659)	(115)
Wealth	174	103	277	(207)	(21)	49
International Banking	173	271	444	(337)	(47)	60
Ulster Bank	169	38	207	(136)	(1,067)	(996)
US Retail & Commercial	479	240	719	(531)	(46)	142
Markets	61	565	626	(553)	(34)	39
Central items	7	(143)	(136)	(37)	(1)	(174)
Core	2,805	1,728	4,533	(3,108)	(1,948)	(523)
Non-Core	(38)	(555)	(593)	(139)	(3,164)	(3,896)
Managed basis	2,767	1,173	3,940	(3,247)	(5,112)	(4,419)
Reconciling items						
Payment Protection Insurance costs	-	-	-	(465)	-	(465)
Interest Rate Hedging Products redress and related costs	-	-	-	(500)	-	(500)
Regulatory and legal actions	-	-	-	(1,910)	-	(1,910)
Amortisation of purchased intangible assets	-	-	-	(35)	-	(35)
Integration and restructuring costs	-	-	-	(180)	-	(180)
Gain on redemption of own debt	-	(29)	(29)	-	-	(29)
Write-down of goodwill and other intangible assets	-	-	-	(1,059)	-	(1,059)
Strategic disposals	-	168	168	-	-	168
Bank levy	-	-	-	(200)	-	(200)
Write-down of other intangible assets	-	-	-	(344)	-	(344)
RFS Holdings minority interest	(3)	(7)	(10)	-	-	(10)
Statutory basis	2,764	1,305	4,069	(7,940)	(5,112)	(8,983)

Notes

10. Segmental analysis (continued)						
	Net interest income	Non-interest income	Total income	Operating expenses	Impairment losses	Operating profit/(loss)
Quarter ended 30 September 2013	£m	£m	£m	£m	£m	£m
UK Retail	1,013	254	1,267	(668)	(82)	517
UK Corporate	725	387	1,112	(540)	(150)	422
Wealth	169	102	271	(210)	(1)	60
International Banking	166	288	454	(343)	(28)	83
Ulster Bank	154	60	214	(142)	(204)	(132)
US Retail & Commercial	493	263	756	(555)	(59)	142
Markets	41	793	834	(625)	1	210
Central items	65	40	105	(58)	(66)	(19)
Core	2,826	2,187	5,013	(3,141)	(589)	1,283
Non-Core	(43)	(76)	(119)	(145)	(581)	(845)
Managed basis	2,783	2,111	4,894	(3,286)	(1,170)	438
Reconciling items						
Own credit adjustments (1)	-	(496)	(496)	-	-	(496)
Payment Protection Insurance costs	-	-	-	(250)	-	(250)
Regulatory and legal actions	-	-	-	(99)	-	(99)
Amortisation of purchased intangible assets	-	-	-	(39)	-	(39)
Integration and restructuring costs	-	-	-	(205)	-	(205)
Gain on redemption of own debt	-	13	13	-	-	13
Strategic disposals	-	(7)	(7)	-	-	(7)
RFS Holdings minority interest	(3)	15	12	(1)	-	11
Statutory basis	2,780	1,636	4,416	(3,880)	(1,170)	(634)

Note:

(1)

Comprises £155 million loss included in 'Income from trading activities' and £341 million loss included in 'Other operating income' on a statutory basis.

107

Notes

10. Segmental analysis (continued)						
	Net interest income	Non-interest income	Total income	Operating expenses	Impairment losses	Operating profit/(loss)
Quarter ended 31 December 2012	£m	£m	£m	£m	£m	£m
UK Retail	1,011	219	1,230	(624)	(93)	513
UK Corporate	717	456	1,173	(515)	(234)	424
Wealth	178	107	285	(193)	(16)	76
International Banking	201	283	484	(292)	(37)	155
Ulster Bank	161	51	212	(137)	(318)	(243)
US Retail & Commercial	465	275	740	(517)	(23)	200
Markets	49	592	641	(480)	(22)	139
Central items	(59)	168	109	17	(8)	118
Core	2,723	2,151	4,874	(2,741)	(751)	1,382
Non-Core	53	(85)	(32)	(207)	(703)	(942)
Managed basis	2,776	2,066	4,842	(2,948)	(1,454)	440
Reconciling items						
Own credit adjustments (1)	-	(220)	(220)	-	-	(220)
Payment Protection Insurance costs	-	-	-	(450)	-	(450)
Interest Rate Hedging Products redress and related costs	-	-	-	(700)	-	(700)
Regulatory and legal actions	-	-	-	(381)	-	(381)
Amortisation of purchased intangible assets	-	-	-	(32)	-	(32)
Integration and restructuring costs	-	-	-	(567)	-	(567)
Write-down of goodwill	-	-	-	(18)	-	(18)
Strategic disposals	-	(16)	(16)	-	-	(16)
Bank Levy	-	-	-	(175)	-	(175)
Write-down of other intangible assets	-	-	-	(106)	-	(106)
RFS Holdings minority interest	(3)	-	(3)	1	-	(2)
Statutory basis	2,773	1,830	4,603	(5,376)	(1,454)	(2,227)

Note:

(1) Comprises £98 million loss included in 'Income from trading activities' and £112 million loss included in 'Other operating income' on a statutory basis.

Notes

10. Segmental analysis (continued)			
Total assets by division			
	31 December	30 September	31 December
	2013	2013	2012
Total assets	**£m**	£m	£m
UK Retail	**117,577**	117,020	117,411
UK Corporate	**104,985**	106,995	110,158
Wealth	**21,101**	21,046	21,484
International Banking	**48,526**	53,276	53,091
Ulster Bank	**28,170**	29,395	30,754
US Retail & Commercial	**71,738**	71,911	72,902
Markets	**495,106**	564,457	714,303
Central items	**108,569**	123,345	115,239
Core	**995,772**	1,087,445	1,235,342
Non-Core	**31,197**	41,065	63,418
	1,026,969	1,128,510	1,298,760
Reconciling items			
Direct Line Group	**-**	-	12,697
RFS Holdings minority interest	**909**	926	838
	1,027,878	1,129,436	1,312,295

Notes

11. Financial instruments

Classification

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

	HFT (1)	DFV (2)	HD (3)	AFS (4)	LAR (5)	Other financial instruments (amortised cost)	Finance leases	Non financial assets/ liabilities	Total
31 December 2013	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets									
Cash and balances at central banks	**-**	**-**		**-**	**82,659**				**82,659**
Loans and advances to banks									
- reverse repos	**25,795**	**-**		**-**	**721**				**26,516**
- other	**9,952**	**-**		**-**	**17,603**				**27,555**
Loans and advances to customers									
- reverse repos	**49,897**	**-**		**-**	**-**				**49,897**
- other	**19,170**	**49**		**-**	**364,772**		**6,834**		**390,825**
Debt securities	**56,582**	**122**		**53,107**	**3,788**				**113,599**
Equity shares	**7,199**	**400**		**1,212**	**-**				**8,811**
Settlement balances	**-**	**-**		**-**	**5,591**				**5,591**
Derivatives	**283,508**		**4,531**						**288,039**
Intangible assets								**12,368**	**12,368**

Property, plant and equipment								7,909	7,909
Deferred tax								3,478	3,478
Prepayments, accrued income and									
other assets	-	-		-	-			7,614	7,614
Assets of disposal groups								3,017	3,017
	452,103	571	4,531	54,319	475,134		6,834	34,386	1,027,878
Liabilities									
Deposits by banks									
- repos	23,127	-				5,523			28,650
- other	19,764	-				15,565			35,329
Customer accounts									
- repos	52,300	-				4,184			56,484
- other	10,236	5,862				398,298			414,396
Debt securities in issue	8,560	15,848				43,411			67,819
Settlement balances	-	-				5,313			5,313
Short positions	28,022	-							28,022
Derivatives	281,299		4,227						285,526
Accruals, deferred income and									
other liabilities	-	-				1,764	19	14,234	16,017
Retirement benefit liabilities								3,210	3,210
Deferred tax								507	507
Subordinated liabilities	-	868				23,144			24,012
Liabilities of disposal groups								3,378	3,378
	423,308	22,578	4,227			497,202	19	21,329	968,663
Equity									59,215
									1,027,878

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

Notes

11. Financial instruments: Classification (continued)

31 December 2012	HFT (1) £m	DFV (2) £m	HD (3) £m	AFS (4) £m	LAR (5) £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	-	-		-	79,290				79,290
Loans and advances to banks									
- reverse repos	33,394	-		-	1,389				34,783
- other	13,265	-		-	15,903				29,168
Loans and advances to customers									
- reverse repos	70,025	-		-	22				70,047
- other	24,841	189		-	397,824		7,234		430,088
Debt securities	78,340	873		73,737	4,488				157,438
Equity shares	13,329	533		1,370					15,232
Settlement balances	-	-		-	5,741				5,741
Derivatives	433,264		8,639						441,903
Intangible assets								13,545	13,545
Property, plant and equipment								9,784	9,784
Deferred tax								3,443	3,443
Prepayments, accrued income and other assets	-	-		-	-			7,820	7,820

Assets of disposal groups								14,013	14,013
	666,458	1,595	8,639	75,107	504,657		7,234	48,605	1,312,295
Liabilities									
Deposits by banks									
- repos	36,370	-				7,962			44,332
- other	30,571	-				26,502			57,073
Customer accounts									
- repos	82,224	-				5,816			88,040
- other	12,077	6,323				414,839			433,239
Debt securities in issue	10,879	23,614				60,099			94,592
Settlement balances	-	-				5,878			5,878
Short positions	27,591	-							27,591
Derivatives	428,537		5,796						434,333
Accruals, deferred income and									
other liabilities	-	-				1,684	12	13,105	14,801
Retirement benefit liabilities								3,884	3,884
Deferred tax								1,141	1,141
Subordinated liabilities	-	1,128				25,645			26,773
Liabilities of disposal groups								10,170	10,170
	628,249	31,065	5,796			548,425	12	28,300	1,241,847
Equity									70,448
									1,312,295

Notes:

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

There were no reclassifications in 2013 or 2012.

Notes

11. Financial instruments (continued)

A description of the Group's valuation methodologies is included the Group's 2013 Annual 20-F.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. The valuation framework used to determine the fair value of uncollateralised derivative exposures was refined during the year in line with market developments. The weightings applied to the expected losses and gains in the credit valuation adjustments (CVA) and own credit adjustments (OCA) calculations have been removed. Funding valuation adjustments (FVA) now reflect the counterparty contingent nature of the exposures. FVA is also now considered the primary adjustment applied to liabilities; the extent to which OCA and FVA overlap is eliminated from OCA. The following table shows CVA and other valuation reserves.

Credit valuation adjustments

Credit valuation adjustments represent an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures.

	31 December 2013	30 September 2013	31 December 2012
	£m	£m	£m
Credit valuation adjustments			
- monoline insurers and credit derivative product companies (CDPC)	**99**	199	506
- other counterparties	**1,667**	1,790	2,308
	1,766	1,989	2,814
Other valuation reserves			
- bid-offer	**513**	464	625

- funding valuation adjustment	**424**	355	475
- product and deal specific	**745**	759	763
- other	**8**	26	134
	1,690	1,604	1,997
Valuation reserves	**3,456**	3,593	4,811

The table below analyses CVA relating to other counterparties by rating and sector.	
	31 December
	2013
Ratings:	**£m**
AAA	**104**
AA to AA+	**13**
A to AA-	**168**
BBB- to A-	**446**
Non-investment grade	**936**
	1,667
Sector:	
Banks	**89**
Other financial institutions	**199**
Corporate	**1,126**
Government	**253**
	1,667

Notes

11. Financial instruments: Valuation reserves (continued)

Key points

- Monoline insurers and CDPC: reduced exposures during the year, tighter credit spreads and exchange rate movements contributed to the decrease in CVA.

- Other counterparties: the decrease in CVA during the year was driven by tighter credit spreads, reduction in exposure due to market movements together with realised default losses and reserve releases on certain exposures following restructuring. The net impact of updates to counterparty ratings and recovery rate assumptions also contributed to the decrease. This was partially offset by an increase in CVA due to methodology refinements.

- The decrease in bid-offer reserves during the year reflects risk reduction.

- Reduction in exposure due to market moves together with the impact of methodology refinements contributed to the decrease in FVA. This was partially offset by additional funding related reserves on uncollateralised derivatives in Q4 2013.

Own credit

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

Cumulative OCA (CR)/ DR (1)	Debt securities in issue (2)			Subordinated liabilities			
	HFT	DFV	Total	DFV	Total	Derivatives	Total (3)
	£m	£m	£m	£m	£m	£m	£m
31 December 2013	**(467)**	**(33)**	**(500)**	**256**	**(244)**	**96**	**(148)**
30 September 2013	(548)	(42)	(590)	295	(295)	95	(200)
31 December 2012	(648)	56	(592)	362	(230)	259	29
Carrying values of underlying liabilities	£bn	£bn	£bn	£bn	£bn		

31 December 2013	**8.6**	**15.8**	**24.4**	**0.9**	**25.3**		
30 September 2013	9.4	17.4	26.8	0.9	27.7		
31 December 2012	10.9	23.6	34.5	1.1	35.6		

Notes:

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

Key points

- The cumulative OCA decreased during the year due to tightening of RBS credit spreads.

- Senior issued debt OCA is determined by reference to secondary debt issuance spreads. The five year spread tightened to 92 basis points (30 September 2013 - 83 basis points; 31 December 2012 - 102 basis points). As senior debt classified as DFV includes greater proportion of longer term debt, the impact of spread tightening and discounting is more significant, resulting in a credit balance at 31 December 2013.

- The cumulative OCA relating to derivatives decreased during the year due to tightening of RBS CDS spreads and the net impact of methodology refinements.

Notes

11. Financial instruments (continued)

Financial instruments carried at fair value - valuation hierarchy

Control environment, valuation techniques, inputs to valuation models and discussion on level 3 sensitivities related to all financial instruments measured at fair value on a recurring basis are included in the Group's 2013 20-F. There have been no material changes to valuation or levelling approaches in 2013.

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

					Level 3 sensitivity	
	Level 1	Level 2	Level 3	Total	Favourable	Unfavourable
31 December 2013	£bn	£bn	£bn	£bn	£m	£m
Assets						
Loans and advances to banks	-	35.5	0.3	35.8	30	(10)
Loans and advances to customers	-	68.9	0.2	69.1	20	(30)
Debt securities	58.0	49.7	2.1	109.8	160	(100)
Equity shares	7.0	1.1	0.7	8.8	120	(110)
Derivatives	0.1	284.4	3.5	288.0	390	(250)
	65.1	439.6	6.8	511.5	720	(500)
Proportion	12.7%	86.0%	1.3%	100.0%		
Of which						
Core	64.9	436.2	4.9	506.0		
Non-Core	0.2	3.4	1.9	5.5		
	65.1	439.6	6.8	511.5		

31 December 2012							
Assets							
Loans and advances to banks	-	46.3	0.4	46.7		50	(30)
Loans and advances to customers	-	94.4	0.6	95.0		90	(40)
Debt securities	83.6	64.6	4.8	153.0		370	(190)
Equity shares	13.1	1.3	0.8	15.2		60	(100)
Derivatives	0.1	438.0	3.8	441.9		430	(350)
	96.8	644.6	10.4	751.8		1,000	(710)
Proportion	12.9%	85.7%	1.4%	100.0%			
Of which							
Core	96.4	637.3	5.6	739.3			
Non-Core	0.4	7.3	4.8	12.5			
	96.8	644.6	10.4	751.8			

Notes

11. Financial instruments: Valuation hierarchy (continued)						
					Level 3 sensitivity	
	Level 1	Level 2	Level 3	Total	Favourable	Unfavourable
31 December 2013	£bn	£bn	£bn	£bn	£m	£m
Liabilities						