

2009 compared with 2008

Operating loss before tax

Operating loss before tax for the year was £2,595 million compared with a loss of £40,836 million in 2008. The reduction in the loss is primarily a result of a substantial increase in non-interest income and a substantial fall in the write-down of goodwill and other intangible assets partially offset by a significant increase in impairment losses and lower net interest income.

After tax, minority interests and preference share and other dividends, the loss attributable to ordinary and B shareholders was £3,607 million, compared with an attributable loss of £24,306 million in 2008.

Total income

Total income increased 50% to £38,690 million in 2009 primarily reflecting a significant reduction in credit and other market losses and a gain on redemption of own debt. Increased market volatility and strong customer demand in a positive trading environment also contributed to this improvement. While income was down marginally in UK Corporate and held steady in Retail & Commercial Banking and RBS Insurance, a significant improvement occurred in Global Banking & Markets, reflecting the reduced credit and other market losses and a more buoyant trading market during the year compared to 2008.

Net interest income

Net interest income fell by 12% to £16,504 million, with average loans and advances to customers stable and average customer deposits down 1%. Group net interest margin fell from 2.12% to 1.83% largely reflecting the pressure on liability margins, given rates on many deposit products already at floors in the low interest rate environment, and strong competition, particularly for longer-term deposits and the build up of the Group's liquidity portfolio.

Non-interest income

Non-interest income increased to £22,186 million from £7,193 million in 2008, largely reflecting the sharp improvement in income from trading activities, as improved asset valuations led to lower credit market losses and GBM benefited from the restructuring of its business to focus on core customer franchises. The Group also recorded a gain of £3,790 million on a liability management exercise to redeem a number of Tier 1 and upper Tier 2 securities. However, fees and commissions fell as a result of the withdrawal of the single premium payment protection insurance product and the restructuring of UK current account overdraft fees, offset by higher fees in businesses attributable to RFS Holdings minority interest..

Operating expenses

Total operating expenses decreased from £54,202 million in 2008 to £21,478 million, largely resulting from the substantial decrease in the write-down of goodwill and other intangible assets, down to £363 million compared with £32,581 million in 2008. Staff costs, excluding curtailment gains, were up 13% with most of the movement relating to adverse movements in foreign exchange rates and some salary inflation. Changes in incentive compensation, primarily in Global Banking & Markets, represented most of the remaining change. This was offset by a gain of £2,148 million arising from the curtailment of prospective pension benefits in the defined benefit scheme and certain other subsidiary schemes. The Group cost:income ratio improved to 56%, compared with 210% in 2008.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, increased by 10% to £4,857 million.

Impairment losses

Impairment losses increased to £14,950 million from £8,072 million in 2008, with Core bank impairments rising by £2,182 million, Non-Core by £4,285 million and RFS Holdings minority interest by £411 million. Signs that impairments might be plateauing appear to have been borne out in the latter part of the year, and there are indications that the pace of downwards credit rating migration for corporates is slowing. Nonetheless, the financial circumstances of many consumers and businesses remain fragile, and rising refinancing costs, whether as a result of monetary tightening or of increased regulatory capital requirements, could expose some customers to further difficulty.

Impairments represented 2.0% of gross loans and advances, excluding reverse repos, in 2009 compared with 0.8% in 2008.

Risk elements in lending and potential problem loans at 31 December 2009 represented 5.5% of loans and advances, excluding reverse repos, compared with 2.5% a year earlier. Provision coverage was 44%, compared with 51% at 31 December 2008 as a consequence of the growth in risk elements in lending being concentrated in secured, property-related loans. These loans require relatively lower provisions in view of their collateralised nature.

Taxation

The effective tax rate for 2009 was 14.3% compared with 5.7% in 2008.

Earnings

Basic earnings per ordinary and B share, including discontinued operations, improved from a loss of 146.7p to a loss of 6.4p.

Balance Sheet

Total assets of £1,696.5 billion at 31 December 2009 were down £705.2 billion, 29%, compared with 31 December 2008, principally reflecting substantial repayments of customer loans and advances, as corporate customer demand fell and corporates looked to deleverage their balance sheets. Lending to banks also fell in line with significantly reduced wholesale funding activity. There were also significant falls in the value of derivative assets, with a corresponding reduction in derivative liabilities.

Loans and advances to banks decreased by £46.4 billion, 34%, to £91.8 billion with reverse repurchase agreements and stock borrowing ('reverse repos') down by £23.7 billion, 40% to £35.1 billion and lower bank placings, down £22.7 billion, 29%, to £56.7 billion, largely as a result of reduced wholesale funding activity in Global Banking & Markets.

Loans and advances to customers were down £146.3 billion, 17%, at £728.4 billion. Within this, reverse repos increased by 4%, £1.7 billion to £41.0 billion. Excluding reverse repos, lending decreased by £148.0 billion to £687.4 billion or by £141.8 billion, 17%, before impairment provisions.

Capital

Capital ratios at 31 December 2009 were 11.0% (Core Tier 1), 14.1% (Tier 1) and 16.1% (Total).

2008 compared with 2007**Operating loss before tax**

Operating loss before tax was £40,836 million compared with an operating profit before tax of £9,832 million in 2007. The results have been adversely affected by the write-down of goodwill and other assets, a substantial decline in non-interest income, a number of specific losses such as counterparty failures, and a marked increase in the credit impairment charge, reflecting weakness in financial markets and a deteriorating global economy.

Losses from credit market exposures increased to £7,781 million, compared with £1,410 million in 2007, with the great majority incurred in the first half of the year. Write-down of goodwill and other assets was £32,581 million. Other one-off items amounted to a credit of £1,674 million, 25% higher than in 2007, principally as a result of a £1,232 million increase in the carrying value of own debt carried at fair value.

Loss attributable to ordinary shareholders was £24,306 million, compared with an attributable profit of £7,303 million in 2007.

Total income

Total income declined by 15% to £25,868 million, with a significant deterioration experienced during the second half of the year principally as a result of £5.8 billion of trading asset write-downs, counterparty failure and incremental reserving within GBM and Non-Core. While income increased in 2008 in Global Transaction Services, UK Corporate, Ulster Bank and US Retail & Commercial, a significant reduction occurred in UK Retail, and in Global Banking & Markets and Non-Core, where a strong performance in rates, currencies and commodities was offset by marked deterioration in credit markets and equities.

Net interest income

Net interest income was increased by 55% to £18,675 million, with average loans and advances to customers up 61% and average customer deposits up 53%. Group net interest margin fell from 2.32% to 2.12% largely reflecting tightened margins within UK Retail as market interest rates fell, with deposit markets remaining competitive and price adjustments on lending taking some time to feed through to the back book.

Non-interest income

Non-interest income was severely affected by the weakness in financial markets experienced over the course of the year, particularly in the fourth quarter. Non-interest income decreased to £7,193 million principally due to the credit market write-downs of £7,781 million offset by a movement in the fair value of own debt of £1,232 million. While the decline was particularly marked in GBM and Non-Core credit markets and equities businesses, with reduced business volumes and mounting mark-to-market trading losses, UK Retail also saw non-interest income fall in the latter part of the year as declining consumer confidence led to lower demand for credit and other financial products.

Operating expenses

Total operating expenses rose to £54,202 million, with cost growth in the Group's core retail and commercial banking franchises offset by efficiency programmes. Integration and restructuring costs were £1,357 million compared with £108 million in 2007. Write-down of goodwill and other assets was £32,581 million.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, decreased by 4% to £4,430 million, reflecting improved risk selection, better claims management and the non-recurrence of the severe floods experienced in 2007 and as a result of movements in financial market values.

Impairment losses

Impairment losses increased to £8,072 million in 2008, compared with £1,968 million in 2007. The Group experienced a pronounced deterioration in impairments in the second half of the year, as financial stress spread to a broad range of customers. The greatest increase in impairments occurred in GBM and Non-Core, where fourth quarter impairments included a loss of approximately £900 million on the Group's exposure to LyondellBasell. However businesses in all geographies also experienced a noticeable increase in impairments in the second half, particularly in the UK and Irish corporate and US personal segments.

Impairments represented 0.44% of gross loans and advances, excluding reverse repos, in the first half but reached 1.27% in the second half. For 2008 as a whole, impairments amounted to 0.82% of loans and advances, excluding reverse repos, compared with 0.28% in 2007. Risk elements in lending and potential problem loans at 31 December 2008 represented 2.52% of gross loans and advances to customers, excluding reverse repos, compared with 1.64% a year earlier. Provision coverage was 51%, compared with 57% at 31 December 2007 reflecting the higher proportion of secured loans included in risk elements in lending and potential problem loans.

Credit market losses

Losses for 2008 relating to the Group's previously identified credit market exposures totalled £7,781 million, net of hedging gains of £1,642 million. This includes impairment losses of £466 million incurred on credit market assets reclassified out of the 'held-for-trading' category in line with the amendments to IAS 39 'Financial Instruments: Recognition and Measurement' issued in October 2008. While the majority of these write-downs were incurred in the first half of 2008, the severity of the financial market dislocation intensified in the fourth quarter, resulting in further losses in particular on the Group's structured credit portfolios.

Write-down of goodwill and other intangible assets

After reviewing the carrying value of goodwill and other purchased intangible assets, the Group recorded an impairment charge of £32,581 million. Of this charge, £23,348 million relates to part of the goodwill in respect of the acquisition of ABN AMRO, while other significant impairments have been recorded on part of the Citizens/Charter One goodwill of £4,382 million, part of the NatWest goodwill (principally allocated to Global Banking & Markets) of £2,742 million and other goodwill of £720 million. Other intangible asset impairments of £1,389 million principally relate to the write down in the value of customer relationships recognised on the acquisition of ABN AMRO.

These impairments have no cash impact, and minimal impact on the Group's capital ratios.

Other non-operating items

Integration and restructuring costs totalled £1,357 million, primarily reflecting the integration of ABN AMRO into the Group, while the amortisation of purchased intangibles increased to £582 million from £124 million.

Taxation

The Group recorded a tax credit of £2,323 million in 2008, compared with a tax charge of £2,044 million in 2007. The effective tax rate for 2008 was 5.7% compared with 20.8% in 2007.

Earnings

Basic earnings per ordinary share, including discontinued operations, decreased from 64.0p to (146.7p).

The number of shares in issue increased to 39,456 million at 31 December 2008, compared with 10,006 million in issue at 31 December 2007, reflecting the Group's capital raisings in June and December and the capitalisation issue in lieu of the interim dividend for 2008.