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## Update No. 17

### Year End Results

RBS recently reported its 2009 financial results. They reported a net loss of £3.6 billion which is better than the prior year, but impairments rose substantially. The Chief Executive, Stephen Hester, forecast another loss in 2010, but a profit in 2011. To quote him: *"There are likely to be precious few really splashy indicators of our success in 2010, as we lay the foundations, but they are being laid and I believe successfully so"*. It seems there is unlikely to be any return to the payment of dividends therefore for some years.

The company has re-organised into "core" and "non-core" divisions, and the loss making parts and questionable assets have been dumped into the latter. One can therefore see more clearly that if the latter are disposed of or wound up in due course, the core division will be reasonably profitable. But that will take some time and meanwhile there are substantial threats on the horizon to the profitability of even the core division. For example, the comment was made by Mr Hester that the profitability of the core division may reduce because GBM earnings may "normalise" faster than the recovery in the Retail and Commercial operations will offset them.

The fund raising via the APS scheme and shrinkage of the balance sheet now means that the core tier one capital ratio is now 11 per cent, up from only 5.9 per cent a year ago. The share price perked up slightly on the day of the announcement but has not improved substantially since. Most analysts still have a jaundiced view of the company's prospects, and their comments are well summarised in this one in the Investor's Chronicle: *"The shares are unlikely to collapse, but there is little to attract new investors"*. Analysts and investors tend not to look further ahead than a couple of years, and forecasting the results that far ahead for RBS is particularly problematic. What might happen thereafter is very difficult for anyone to predict as it is so dependent on many factors beyond the company's control such as the general state of the economy and regulatory changes.

### Staff Bonuses

Chief Executive Stephen Hester has waived his bonus for 2009 (probably worth over £1million). However RBS will be paying out a total of about £1.3 billion in bonuses to other senior staff and over 100 staff will receive over £1 million in deferred share bonuses. The bonus scheme was of course approved by UKFI (who hold the Government's stake in the company) and it is believed to be less generous than other banks not under Government control, and less than the company wished to award. Stephen Hester claimed that 1000 top bankers quit last year for better pay elsewhere and that there will be more losses this year. As RBS is very dependent on profits from investment banking (as opposed to the retail arm), this may be of some concern.

Philip Aldrick in the Daily Telegraph noted though that the profits of the investment banking arm of RBS had been flattered by moving the loss making assets into a "non-core" division. The figures for the latter division were reported separately. He suggests therefore that RBS paid £1.3bn in bonuses on profits that in reality were only £1bn.

### **Staff Pensions**

An article in the Herald Scotland warned that a prospective revaluation of the RBS pension scheme would require RBS to increase its funding of the scheme substantially. Consultants Hymans Robertson had studied the pension deficits on the schemes of several banks and concluded that RBS was one of the worst. Its deficit could be more than 20% of the existing market capitalisation and that RBS was still heavily exposed to equities.

### **Other News**

RBS did manage to dispose of a major proportion of the RBS Sempra Commodities division to J.P. Morgan for \$0.8bn. However they have been forced to take control of £1.8bn of German properties on which they had lent money.

### **Audit Office Report**

A report on "Maintaining financial stability across the UK's banking system" was recently published by the National Audit Office. It covers the events in the banking crisis and how the Government responded. It is well worth a read for those who want to understand what happened and why. See [www.nao.org.uk/publications/0910/uk\\_banking\\_system.aspx](http://www.nao.org.uk/publications/0910/uk_banking_system.aspx) for the full report. It highlights how rapidly the crisis arose, and the fact that the Treasury had insufficient staff to deal with it. It explains how the Government had to step in to support RBS covertly via the Bank of England in October 2008, and this was not even reported to Parliament as was the normal practice. The sums guaranteed to RBS and HBOS at that time are truly staggering. They have not attempted to evaluate whether the measures taken by the Government were cost effective as it is clearly too early to judge.

### **Legal Action Status**

Work is continuing on preparation of the claim, and we will report further on this as soon as possible.

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