

RBS Group Pension Fund

> Members' Newsletter 2014

A message from the Chairman

I am pleased to present the Annual Newsletter for The Royal Bank of Scotland Group Pension Fund ('the Fund') for the year ended 31 March 2014.

The Fund is one of the largest pension schemes in the UK and the Trustee keeps the financial health of the Fund under regular review. I am pleased to report that the value of the net assets increased during the year by £0.5 billion, to £26.2 billion at 31 March 2014.

Valuation

In last year's newsletter, I explained that the Trustee was working on the actuarial valuation of the Fund as at 31 March 2013. The valuation is normally undertaken every three years and its purpose is to compare the assets of the Fund with the amount required to pay all benefits in the future, and to agree the level of contributions that the Bank should pay into the Fund. I'm pleased to tell you that the Trustee and the Bank recently agreed the valuation outcome and full details are included in the supplement to this newsletter. You may have noticed that you have received the newsletter slightly later this year. This is in order to provide you with the results of the finalised valuation.

Following the merger of the defined benefit section of the RBS AA Pension Scheme with the Fund on 31 March 2012 a new section was created within the Fund known as the 'RBS AA Section'. This section is financially separate from the rest of the Fund, known as the Main Fund Section, and an actuarial valuation is therefore undertaken separately for each section.

The Main Fund Section showed a funding level of 81% at 31 March 2013 and the corresponding shortfall of assets relative to the liabilities was £5,652 million. The Bank has agreed to make up this shortfall over the period to 2023 and will initially pay £650 million towards this in 2014, 2015 and 2016 and £450 million per annum thereafter (increasing in line with inflation). These contributions are in addition to the ongoing cost of the Fund which is also met by the Bank.

The RBS AA Section showed a funding level of 98% at 31 March 2013 and the corresponding shortfall of assets relative to the liabilities was £15.4 million. The Bank has agreed to pay £5.2 million per annum until March 2016 which aims to make up this shortfall. These contributions

are in addition to the ongoing cost of the Fund, and the contributions to the Main Fund Section which are also met by the Bank.

For both sections the funding level has improved over the period to 31 March 2014. The annual update shows that the funding level for the Main Fund Section was 86% at 31 March 2014 and for the RBS AA Section 104%. More information is included in the appendix.

2014 Budget

The 2014 Budget proposed a number of changes for pensions – most of these are designed to increase the flexibility and choice for members of pension schemes. The impact for defined benefit (DB) schemes such as the Fund, is perhaps less than for defined contribution (DC) schemes although it is still significant. More information is included in the 'Pensions News' section on page 5.

In March this year the Bank launched pensions as an 'Anytime' election, meaning there is no longer a limited window in which active members can make pension elections. This means that decisions on your choice of Normal Pension Age, APeCs contributions, related investment choices and opting out of the Fund can all now be made at any point throughout the year. The choices you make will take effect from the first day of the next month. For example, if you change your APeC amount in June it will take effect from 1 July and you will see the change in deduction in your July salary.

Pension Scams

Previously known as Pensions Liberation Fraud, Pension Scams have been a problem in the pensions industry recently. A pension scam is a transfer of a scheme member's pension savings to an arrangement that will allow access to funds before age 55. Converting a pension into cash might sound very attractive, however, pension scams can result in tax charges and penalties of more than half the value of a member's pension savings, and those being targeted are usually not being told about these potential tax implications.

Contents

- > 01 A message from the Chairman
- > 03 Investment report
- > 04 Fund finances
- > 04 Membership statistics
- > 04 News
- > 05 Pension news
- > 07 Useful information
- > 07 Your Pension team

The Fund has taken a number of steps in order to protect its members who request a transfer but we would urge all members to be vigilant as an increasing number of companies are targeting savers by mass text or cold calls. Since 20 March 2014, Her Majesty's Revenue and Customs has been given new powers to refuse to register, or to de-register pensions schemes where it considers the main purpose of that scheme to be to provide unauthorised benefits.

Regulatory Developments

The Trustee has also kept under review relevant legal and regulatory developments affecting the Fund. During the year the Trustee has engaged with The Bank as Principal Employer and Her Majesty's Treasury in respect of the implications for the Fund, and the action required, of the Banking Reform Act and the European Resolution and Recovery Directive.

Board and Committee meetings

The Trustee Board met four times during the period. In addition the Board and the Funding and Monitoring Committee met with representatives of the Bank on a number of occasions to discuss the actuarial valuation as at 31 March 2013 and the funding strategy for the Fund. There were also regular scheduled meetings of the Trustee Board's Administration and Benefits, Funding and Monitoring, Risk and Audit, and Investment Committees, together with a number of additional meetings as required.

Changes to the Trustee Board

During the year the Trustee undertook an exercise to select Member Nominated Directors (MNDs). For the first time, the process was in two stages, where member nominations were followed by a selection procedure and then an election where all members were eligible to vote.

It was also agreed that MNDs will serve either a four or six year term of office to provide continuity on the Trustee Board. Following the conclusion of the ballot Malcolm Groves, Stephen Fallowell, Marie Kiernan and Ian Purves were appointed to the Board on 25 March 2014.

Fiona Davis stepped down from the Board on 27 June 2014 and our new company nominated director, Laura Barlow was appointed on 21 July 2014 in her place.

The MND exercise resulted as the term of our previous MNDs had come to a close and as a result Peter Easton, Graham Halstead and Colin Wilson all stood down at the same date. I would like to thank Peter, Graham and Colin for their contribution to the Board.

We noted with sadness the death of Peter Boyd in October 2013 following a lengthy illness. Peter was a valued member of the Trustee Board and made a substantial and valued contribution to the successful running of the Fund. We will miss Peter's knowledge, warmth and good humour and our condolences go to his family and friends.

Finally, I would like to thank our exiting Trustee Directors for their contributions to the running of the Fund and to welcome our new Trustee Directors to the Board. I would also like to thank all of the continuing Trustee Directors and our internal and external advisors for their commitment and support throughout the year.

Miller McLean

Chairman of the Trustee Board

August 2014

> Investment report

The Fund's investment programme is overseen by the Investment Committee ('the Committee') and supported by RBS Investment Executive Limited ('RIEL'). The investment programme has continued to evolve over the last year with much of the activity having a focus on improving the resilience of the Fund to investment risks. The key activity was as follows:

Increasing diversification	Diversification balances the portfolio and helps the Fund to generate more consistent returns. Over the last year the Fund continued to screen new asset classes and made investments in real estate debt, US term annuities, infrastructure, US residential property, shipping and forestry. The Fund also bought 50% of a Northern Irish gas utility company, Phoenix Natural Gas, for its infrastructure equity portfolio.
Liability hedging	Liability hedging works by offsetting the impact of unexpected movements in interest rates and inflation which change the value of the liabilities. The Fund increased the amount of interest rate risk hedged by its hedging portfolio.
Central clearing and collateral management for derivatives	<p>Derivatives have become an important tool in the management of the Fund, in particular for managing risks, such as currency, interest rate and inflation risk, that would otherwise be difficult to control.</p> <p>A new operational infrastructure for the management of derivatives has been put in place which means that the Fund can now transact derivatives through exchanges thereby benefiting from the reduction in operational risk. The Fund also appointed a specialist collateral manager for its derivatives programme (the term 'collateral' refers to assets which are received from or pledged to the counterparty when a derivative is in profit or in loss).</p> <p>The key benefits of the new approach are 1. Better overall risk management, 2. More efficient collateral management (leading to lower overall trading costs) and 3. Full compliance with new European and US derivatives regulations.</p>
Strategic Benchmark review	A detailed review of investment strategy was recently completed to take account of the 2013 actuarial valuation. The investment strategy uses an integrated approach to ensure compatibility with the funding strategy and the assessment of the employer covenant. The result of the review is that the Strategic Benchmark will be changing between now and March 2015, including an overall reduction in growth assets.

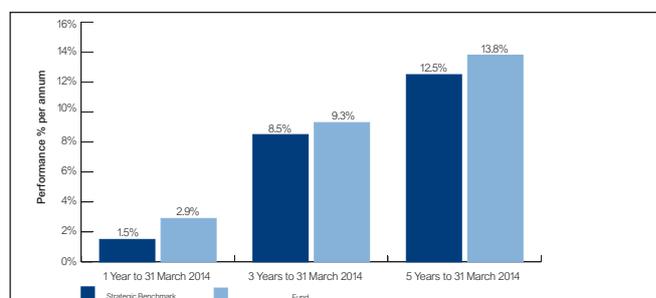
Performance

The backdrop for the last year has been one of an improving economic situation for the UK and for most other developed countries. By contrast, emerging market economies have generally been weaker than in recent years. While performance has been mixed across asset classes, at an overall Fund level the value of the assets increased and the shortfall to the liabilities reduced.

Fund performance

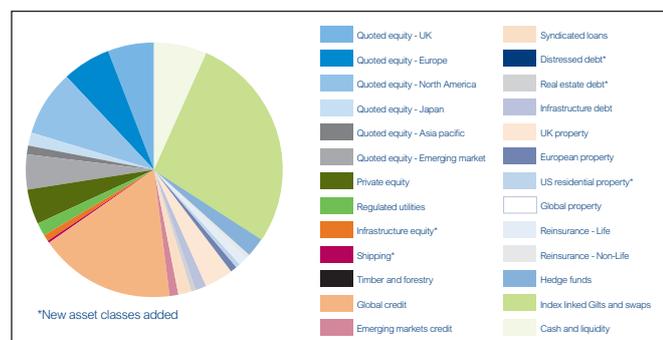
Fund performance is measured against a Strategic Benchmark.

The Fund has performed well against the Strategic Benchmark; in the year to 31 March 2014 the Fund outperformed by £313m and over the three year period to 31 March 2014 the Fund outperformed by £385m.

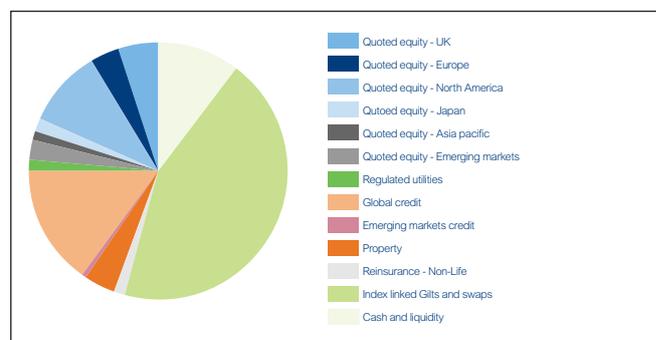


Distribution of assets as at 31 March 2014

Main Fund Section



AA Section



More information

More information, including the Statement of Investment Principles can be found online at <http://www.rbselect.rbspeople.com/uk/4.2.final-salary-pension-plan.php>

> Fund finances

	£m
Fund Value at March 2013	25,717
Income	
– Contributions	648
– Transfers in	1
– Other	
Total Income	649
Expenditure	
– Benefits	(755)
– Transfers	(74)
– Administration expenses	(28)
Total expenditure	(857)
Net returns on investments	694
Net increase in the Fund	486
Fund value at March 2014	26,203

> Membership statistics

	At 31 March 2013	Changes in year	At 31 March 2014
Main Fund Section			
Active members	35,290	(3,005)	32,285
Deferred pensioners	122,116	319	122,435
Pensioner members	62,006	1,327	63,333
	219,412	(1,359)	218,053
AA Section			
Active members	62	(7)	55
Deferred pensioners	2,134	(52)	2,082
Pensioner members	664	33	697
	2,860	(26)	2,834
Total members	222,272	(1,385)	220,887

> News

Making additional pension contributions [APeCs] - a tax efficient way to save for your retirement.

The Fund participates in the RBS Common Investment Fund and a range of funds are available to active members who wish to make additional retirement savings. As a reminder to members the current investment choices are summarised below:

Fund Name	Fund Objective	Active or Passive
UK Equity Fund provided by Lindsell Train, M&G, Majedie, River & Mercantile	This actively managed fund aims to perform ahead of the UK stock market by investing in a selected set of shares in UK companies.	Active
UK Equity Tracker Fund provided by BlackRock	This passively managed fund aims to perform in line with the UK stock market by investing in shares in UK companies in similar weights to the overall stock market.	Passive
International Equity Fund provided by Lazard, M&G, MFS, Veritas	This actively managed fund aims to perform ahead of the international stock market (overseas markets excluding the UK and emerging markets) by investing in a selected set of shares in overseas companies.	Active
International Equity Tracker Fund provided by BlackRock	This passively managed fund aims to perform in line with the international stock market (overseas market excluding the UK and emerging markets) by investing in shares in overseas companies in similar weights to the overall stock market.	Passive
Pre-retirement Fund provided by Legal & General ('LGIM'), Fidelity	This fund invests in a blend of passively managed long-dated government bonds and actively managed long-dated corporate bonds. This approach aims to protect against changes in annuity rates (i.e. the cost of converting your saving into a pension) while providing some additional growth through income.	Active and Passive
Index-Linked Gilt Fund provided by LGIM	This passively managed fund invests in UK government index-linked Gilts that have a maturity period of five years or longer.	Passive

Fund Name	Fund Objective	Active or Passive
Cash Fund provided by LGIM	This actively managed fund aims to provide capital protection with returns in line with wholesale money market short-term interest rates.	Active
Property Fund provided by Standard Life, LGIM	This actively managed fund aims to achieve long-term capital growth through exposure to direct and indirect property investments in the UK and overseas.	Active
Diversified Growth Fund provided by BlackRock, Fidelity, M&G, LGIM, H2O, PIMCO, Newton & Henderson	This fund uses both active and passive management strategies across a blend of asset classes. The fund currently invests in UK equities, overseas equities (including 'emerging markets'), corporate bonds and commercial property. This approach aims to deliver a return over CPI inflation of approximately 3-5% over the long term.	Active
Emerging Markets Equity Tracker Fund provided by LGIM	This passively managed fund aims to perform in line with the index of emerging markets stocks by holding shares in those companies in similar weights to the overall index.	Passive
Over 15 Year Gilt Fund provided by LGIM	This passively managed fund aims to perform in line with the index of Over 15 Year Gilts (UK government bonds).	Passive
Corporate Bond Fund provided by Fidelity	This actively managed fund aims to perform ahead of an index of over 10 year corporate bonds by investing mainly in long dated bonds issued by both UK and overseas companies.	Active

> Pension news

Budget 2014

As part of the Budget announcement in March this year the Government revealed a number of changes for members of DC pension schemes. These changes will have the greatest impact on DC plans but represent a major change in the pensions industry. Some of these changes came into effect immediately and others are scheduled to be introduced in April 2015 (subject to consultation).

The changes that came into effect immediately (from 27 March 2014) are as follows:

- Individuals with DC funds are already able to set up 'capped drawdown' arrangements rather than purchase an annuity. The limit on income that can be taken this way in any 'drawdown year' is 150% of an equivalent annuity (increased from 120%)
- Where a pensioner (or dependant) with DC funds meets certain conditions they can have 'flexible drawdown' with no limit on the amount that can be taken each year. One of these conditions is that the individual will receive an annual pension income (excluding the drawdown income) of a specified amount – this amount was reduced to £12,000 per year (from £20,000)
- A member over age 60 who has a small value of savings overall can take a trivial commutation lump sum (the whole value as cash). The criterion for allowing this to be taken is that the value of the savings cannot exceed £30,000 (increased from £18,000)
- There are other circumstances in which small pots can be paid entirely as cash – in particular where the lump sum payments would be less than £10,000 (raised from £2,000). For DC funds, this limit will apply to up to three small savings pots (increased from two)

The changes currently subject to consultation aim to build on these changes and introduce further flexibility from April 2015.

They are as follows:

- The complete removal of the limits on income drawdown
- Trivial commutation will be allowable from normal minimum pension age – this is currently 55 but will rise to 57 from 2028 and remain a constant 10 years below State Pension Age
- Trustees and providers of DC schemes be required to refer members to the guidance service on retirement choices
- Lump sum payments from DC schemes at retirement of a higher amount than currently payable (i.e. 25% of fund value payable as tax free cash) would only be taxed at the members marginal rate

There was also a statutory consultation on whether transfers from DB plans (like the Fund) to DC plans should be disallowed in future. The Government has confirmed that it does not intend to make any changes to prohibit these transfers. Transferring your benefits to a DC plan is not a decision that should be undertaken lightly, if you are considering this option you should take independent financial advice to ensure it is the best choice for you.

Making your choices Anytime

We would encourage members to think about their pension from the Fund and whether you are on track to get the income that you need in retirement. To help you make decisions about your pension we have launched www.rbspensions.co.uk. Here we provide our simple plan for retirement decisions in 4 steps:

- How Much is Enough?
- What Do You Need to Save?
- Where Should You Invest Your Savings?
- Keeping on Track

Step 1 focuses on 'How Much is Enough?' to help you work out how much income you will need when you retire - the guideline amounts are based on government research, but there is also the facility to tailor the calculator to provide a guide for your individual circumstances.

Once you know how much you need in retirement then Step 2 can help you to work out 'What Do You Need to Save?' Current staff can do this by using the amount of money you have calculated you will need as an input for the retirement planner at www.rbspeople.com/YourRewardOnline to help you target this amount - this planner will take into account your benefits already earned in the Fund. Deferred and Pensioner members can use their annual benefit statement to help them assess their position.

If you are paying APeCs there is a choice of 12 investment funds available – you can find out more information at www.rbspeople.com/rbselect. Step 3, 'Where Should You Invest Your Savings?' will launch in due course and will help you understand your investment choices, so keep an eye out for further information around this.

Finally it is important that you regularly review whether your retirement savings are on track to provide you with the pension you are hoping for; we will cover this in more detail in Step 4 – 'Keeping on Track'. We suggest you take the time to look at your pension in detail at least once a year, and especially if anything changes in your work or personal life.

As a reminder, you can now make decisions about your APeCs, the related investment choices and have the option to opt out of the Fund during any month. Decisions taken in one month will take effect from the first day of the next month.

Changes to tax relief

There is a limit on the amount of pension savings you can make in a year and still receive tax relief, referred to as the Annual Allowance. From April 2014 this amount is £40,000. Please note this is a reduction from previous years. If the increase in the value of your pension is more than this limit then you will have to pay tax at your marginal rate on the excess. In calculating the limit for any year then you may add on any unused allowance from the previous three years (provided you were a member of a pension scheme in those years).

As well as the limit on the amount of tax-advantaged pension saving that you make in a year, there is also a limit on the total amount of pension value you can build up in a lifetime. This changed to £1.25 million from April 2014 (a reduction from £1.5m). Employees will have been informed if the Bank thinks you are likely to be affected by this limit based on your pension savings in RBS plans, but it is your responsibility to check and to allow for other pension arrangements. We would suggest you take independent financial advice if you are in any doubt.

> Useful information

Early retirement due to ill-health

You may retire from active membership at any time with an immediate pension where you are assessed as meeting the Fund's ill health test. There are a range of tests which apply under different membership schedules but, in broad terms, your state of health must be assessed as having the effect that you will be prevented from carrying on your occupation until your normal retirement age. Your pension will normally be based on service up to the date you retire. If you have been absent from work due to ill health for five and a half years, you may be entitled to a higher value pension, which takes into account the service you would have completed had you remained an active member until normal pension age.

Full conditions for payment of an ill-health pension and the amount of pension payable will depend on the particular membership schedule to which you belong. The summary set out above will apply to most members but may not apply to you. If you require details of specific terms on which you may take ill-health pension, you should contact Pension Services using the contact details set out at the end of this Newsletter.

Anti-terrorism

Member data is being screened against the anti-terrorism sanctions list. The Terrorist Asset-Freezing Act 2010 makes it a criminal offence to provide funds or financial services to 'Designated Persons', as determined by HM Treasury. HM Treasury provides an online list of 'Designated Persons' and the Trustee carries out screening of pensioners in receipt of payments against this list to avoid criminal sanction.

> Your Pension team

The Trustee Board is responsible for operating the Fund in line with its formal rules and pensions law. It also has a duty to protect the interests of all the Fund members, including pensioners and those who are no longer employed by the Bank, but who still have benefits in the Fund (deferred members).

Your current Trustee Directors are:

Company Nominated

Miller McLean (Chairman)
Donald Workman (Deputy Chairman)
Laura Barlow
Ronnie Bowie (Independent Director)
Stephen Boyle
George Graham

Member Nominated

Stephen Fallowell
Malcolm Groves
Marie Kiernan
Ian Purves

Changes during the year:

Peter Easton, Graham Halstead and Colin Wilson resigned as Member Nominated Trustee Directors on 25 March 2014 after the conclusion of their terms of office. Peter Boyd, who had also been a Member Nominated Trustee Director died on 17 October 2013. Four new Trustee Directors, Stephen Fallowell, Malcolm Groves, Marie Kiernan and Ian Purves were appointed as Member Nominated Trustee Directors on 25 March 2014. Fiona Davis stepped down on 27 June 2014 and Laura Barlow was appointed on 21 July 2014.

Trustee meetings during the year:

The Trustee Board met four times during the period. In addition the Trustee Board and the Funding and Monitoring Committee met the Bank on a number of occasions to discuss the funding strategy of the Fund.

The Trustee Board sub committees met as follows during the period:

- The Administration and Benefits Committee met four times, with an additional six meetings being held by audio or e-mail
- The Funding and Monitoring Committee met ten times
- The Investment Committee met four times
- The Risk and Audit Committee met five times

Privacy & Data Protection

RBS Pension Trustee Limited (**the Trustee**) is the Data Controller for the purposes of the Data Protection Act 1998. In the course of administering the Fund, the Trustee will collect, store and process your personal information and that of your spouse, partner and dependants.

By being a member of the Fund you are consenting to the Trustee using and sharing personal information for: 1) the administration and effective management of the Fund; 2) processing by third parties who receive information in order to facilitate the administration and effective management of the Fund; and 3) other forms of processing which the Trustee will carry out as part of their legal and regulatory obligations in relation to the management of the Fund, e.g. complying with sanctions screening requirements and anti-money laundering rules.

The third parties to whom the Trustee may disclose your personal information include actuaries, tracing companies, pension-risk companies, occupational health doctors, external advisors (e.g. independent financial advisors, lawyers, consultants), insurance companies, regulators and ombudsmen.

The Trustee will take all reasonable steps to ensure that your information is held securely.

Should you have any questions about the collection, storage, processing of or access to your personal information under the Fund, please contact Pension Services. Their address is shown below.

The Royal Bank of Scotland
Registered in Scotland No. 45551
Registered Office:
36 St. Andrew Square
Edinburgh EH2 2YB

Pension Services
HR People Services
The Royal Bank of Scotland Group
City Link House
4 Addiscombe Road
Croydon CR9 1YB

Find out more

The following documents are available on request from Pension Services:

- > **Latest Actuarial Valuation Report**
Contains details of the Fund's financial position as at 31 March 2013.
- > **Latest Annual Report and Accounts**
Shows the Fund's income and expenditure in the 12 months to 31 March 2014.
- > **Current Schedule of Contributions**
Shows how much money is being paid into the Fund.
- > **Trustee's Statement of Funding Principles**
Explains how we plan to make sure enough money is paid into the Fund to provide the benefits that members have built up.
- > **Trustee's Statement of Investment Principles**
Explains how we invest the money paid into the Fund.
- > **Latest Engagement & Voting Report**

Useful Information, including a copy of this newsletter and the accounts are available under the useful information section of the Group Fund pages of [rbspeople.com/rbselect](http://www.rbspeople.com/rbselect) here http://www.rbselect.rbspeople.com/uk/4.2.final-salary-pension-plan.php?loc=package_information

Contact us

If you have a question, please contact Pension Services:

Employee members
Please contact via HR help on any of the HR pages of Insite.

Deferred members
RBSpensionplans@rbs.co.uk

Pensioner members
RBSpensionplans@rbs.co.uk

Alternative formats

This communication is available in large print, Braille or audio on request from Pension Services.