The Rt Hon George Osborne MP,
Chancellor of the Exchequer,
Her Majesty's Treasury,
1 Horse Guards Road,
London
SW1A 2HQ

ROTHSCHILD

10 June 2015

Dear Chancellor,

The government's shareholding in the Royal Bank of Scotland

You asked us to provide you with an assessment of whether or not it is appropriate and in the interests of taxpayers for the government to start to sell its stake in the Royal Bank of Scotland Group plc (RBS). This document summarises the analysis we have undertaken and sets out our resulting conclusions.

As of today, in the absence of unforeseen circumstances, taxpayers can comfortably expect to secure proceeds from their interventions in the banks that exceed the money put in. This contrasts with expectations at the time such interventions were made: in the 2009 Budget, HM Treasury estimated that the ultimate cost to the taxpayer of the financial sector interventions would be in the order of £20-50 billion. Alongside the United States, the UK will be one of the first countries that is able to demonstrate that it can comfortably expect to record a gain on its bank interventions.

As for RBS, it has made significant progress since the time of the government's interventions. It has removed more than £1 trillion of assets from its balance sheet, significantly improved its capital position and now has a much more robust funding and liquidity structure. It is shrinking RCR, the internal bad bank created after HM Treasury's review in 2013, and looks set to complete the wind-down ahead of schedule. The management team, led by Ross McEwan, has re-evaluated the Group's strategy and the bank is on course to be smaller and simpler, focused on serving its customers in businesses where it has real competitive advantage. While much remains to be done, in particular to improve customer service, reduce costs and shrink the investment bank, the new strategy is consistent with the new direction for the bank that was set out by RBS and HM Treasury at the conclusion of the government's bad bank review.

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The returns on the government's interventions in RBS will be determined by the success of the whole of the selling programme, rather than the terms achieved on the first few disposals. Accordingly, as a precursor to a long-term programme, we believe that it is now in the interest of taxpayers for the government to set in train an initial small disposal of RBS shares for a number of reasons:

1. By starting to sell, the government will increase the free float which should in turn improve the marketability of the remainder of its shareholding. This will enable the government to execute larger sales on better terms than would otherwise have been the case;

2. We believe that sending a strong signal that RBS is on the road to recovery and that its reprivatisation has begun may also bring further benefits to the bank and therefore to the taxpayer as shareholder;

3. Market conditions for financial assets and bank shares are currently good;

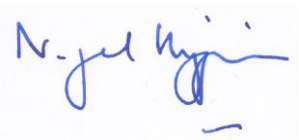
4. We believe that the current price of RBS shares reasonably reflects its future prospects based on its current strategy and the risks associated with this being achieved; and

5. We believe that RBS is ready to be sold and do not believe that there are other reasons that would preclude a share sale in the short term (i.e. in the next 12 months) or render it poor value for money for the taxpayer.

Given the current limited market for RBS shares, any sales in the short term would need to be carefully calibrated by reference to the depth of the market and the current size of RBS's free float and with a clear objective of maintaining an orderly aftermarket following any transaction.

Yours truly,

For and on behalf of Rothschild



Nigel Higgins, Chief Executive