



RBS UK Balanced Sector Index

An Index which aims to provide balanced exposure to the UK economy

The RBS UK Balanced Sector Index is one of a range of exclusive rules-based indices created by RBS plc and designed to provide access to a variety of investment themes.

What is an index?

An index is a tool for measuring the performance of a collection of financial assets. It may, for example, be composed of shares in companies from a specific industry sector or a particular country or it may contain a range of commodities such as oil, gold or wheat. An index is therefore often useful as a benchmark which can be used to represent the performance of a particular market sector. For example, the FTSE 100 Index is a measure of the share price performance of the largest 100 companies that are based in the UK and listed on the London Stock Exchange.

In order to determine which shares the index will measure, it uses a set of pre-defined rules. By utilising a clearly defined, rules-based measure of the market sector (e.g. in the case of the FTSE 100 Index, UK shares), financial institutions, such as banks, can create products linked to the performance of these indices.

Why use an index?

An index can offer a number of potential benefits:

- **Diversification** – investing in a wide range of financial assets, such as a collection of UK shares rather than just one individual UK share, reduces exposure to the specific risks associated with a particular company. Instead, exposure is to the performance of the market sector generally. A more diverse exposure to the market sector can help create more consistent returns over the medium to long-term.
- **Exposure to new market sectors or investment themes** – an index can provide exposure to market sectors or investment themes that may otherwise be too expensive or difficult to access.
- **Simplicity** – an index will use clearly defined rules to help determine which financial assets to track and when.
- **Low cost** – gaining exposure to entire market sectors or investment themes without having to buy each individual constituent of an index can save significant transaction costs.

The Royal Bank of Scotland plc ('RBS plc') has created its own range of custom indices which use rules-based techniques similar to traditional benchmark indices, yet aim to offer exposure to specific market sectors or investment themes that you may otherwise be unable to access. The RBS UK Balanced Sector Index is one such custom index.

Introducing the RBS UK Balanced Sector Index

The RBS UK Balanced Sector Index (the 'Index') is designed to represent a balanced measure of the largest companies in the UK shares market.

Each of the individual companies and industry sectors within the Index are assigned an equal weighting. This aims to provide a more balanced exposure to the performance of UK companies than would be achieved by investing in traditional benchmark indices such as the FTSE 100 Index which includes similar companies but weights them by their size.

Additionally, the Index has an automatic feature, called a 'Volatility Control Overlay' (sometimes referred to as 'Dynamic Risk Management'), which is designed to protect against some of the inherent volatility exhibited by shares and cushion the effect of sudden market movements.

Official Index name

The official name of the Index is the RBS UK Balanced Sector Index (GBP) PR 12.65%.

The significance of the terms used in the Index name will be explained throughout this guide.



Traditional indices and how they are constructed

There are a number of well-known benchmark indices which measure the share price performance of the largest companies in particular countries. For the UK, the benchmark index is the FTSE 100 Index. This index is designed to measure the share price performance of the 100 largest companies in the UK shares market.

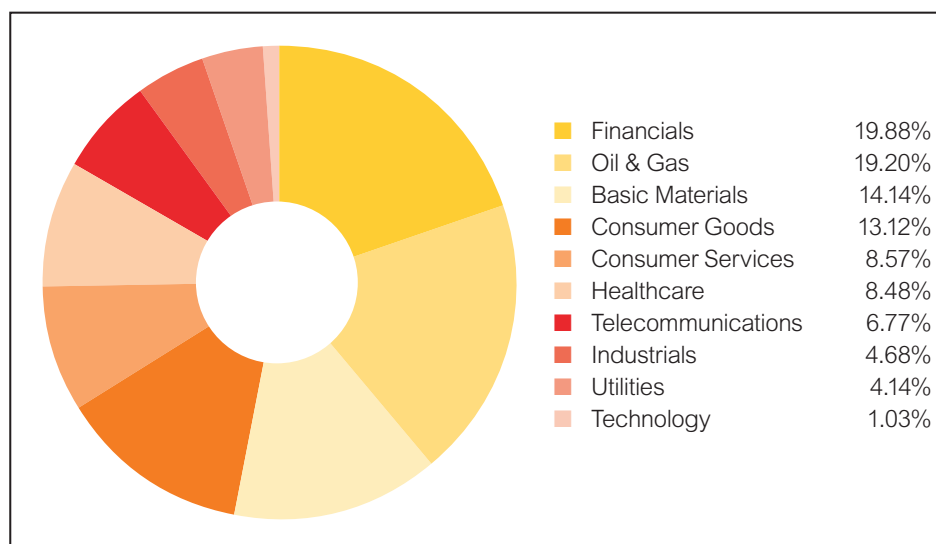
The companies within the FTSE 100 Index are weighted according to their market capitalisation. Market capitalisation is a measure of the size of a company and is calculated by multiplying the number of shares in that company by the current share price. This leads to larger companies being assigned a much higher weighting in the FTSE 100 Index than the smaller companies. Consequently, traditional indices such as the FTSE 100 Index tend to have large exposures to certain individual companies as well as individual industry sectors.

For example, the top 10 companies currently represent 45.65% of the performance of the FTSE 100 Index, while the bottom 50 companies only account for 11.53%¹. This means that the performance of the FTSE 100 Index is disproportionately influenced by the largest companies and the smaller companies have a much smaller influence.

Furthermore, the largest companies in the UK tend to be large financial institutions and oil/gas producers meaning that the FTSE 100 Index is also heavily weighted to certain industry sectors. These two industry sectors together currently represent 39.08%¹ of the total FTSE 100 Index.

By having this level of exposure to a smaller number of large companies and particular industry sectors, the FTSE 100 Index does not necessarily provide a well diversified measure of the performance of the broad UK shares market as a whole. It may be more influenced by movements caused by individual industry sector or company events that do not reflect the wider market.

FTSE 100 Index industry sector breakdown²



¹ Source: Bloomberg, 8 June 2011.

² Source: Bloomberg, 8 June 2011.

The RBS UK Balanced Sector Index

Diversification can be important when trying to create consistent, long-term gains from an investment. The RBS UK Balanced Sector Index has been created in order to help provide this diversification by aiming to ensure the Index is not over-exposed to particular companies and industry sectors.

The RBS UK Balanced Sector Index is linked to the performance of up to 90 of the largest companies in the UK shares market. The 90 companies are split across 9 industry sectors with each industry sector holding up to 10 individual companies.

Rather than weighting those companies by their market capitalisation as traditional benchmark indices such as the FTSE 100 Index do, the RBS UK Balanced Sector Index splits the companies up into their respective industry sectors. Each industry sector, and each company within those industry sectors, is then given an equal weighting within the RBS UK Balanced Sector Index.

The weighting of each company and/or each industry sector within the Index will change as the prices of the underlying company shares change. As a result, twice a year on the semi-annual re-balance date, the Index will re-set the weightings to the companies and industry sectors so that they are equally weighted again, this is known as re-weighting.

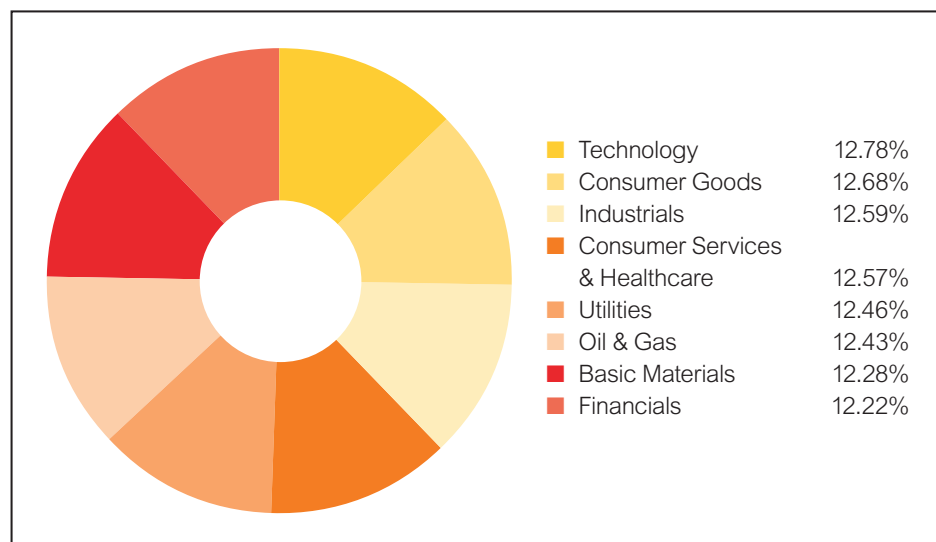
Therefore, while the largest companies based in the UK shares market have the greatest influence on the FTSE 100 Index, the RBS UK Balanced Sector Index provides a broader exposure to the full range of large UK company shares and so is designed to be more representative of the broad UK economy. It also avoids over-exposure to any individual companies or individual industry sectors.

What are the industry sectors?

The RBS UK Balanced Sector Index provides an equal weighting (on each re-weighting date) to the following industry sectors: Basic Materials, Consumer Goods, Consumer Services, Financials, Healthcare, Industrials, Oil & Gas, Technology and Utilities.

Note: Healthcare is currently grouped with Consumer Services until the next re-weighting date only (on 1 December 2011). This is a result of the Healthcare industry sector currently being too small to make up its own industry sector.

Industry sector breakdown



Source: RBS plc Global Banking and Markets, 6 June 2011.

How are the companies in the RBS UK Balanced Sector Index weighted?

- Each industry sector holds an equal weighting in the Index.
- Each industry sector has a minimum of 6 and maximum of 10 of the largest companies within that industry sector (by market capitalisation).
- Each company within each industry sector is equally weighted.
- To be eligible for inclusion on the Index, each company must have at least GBP 1 billion market capitalisation and be incorporated/headquartered in the UK.
- Re-weighting of the underlying company shares within the Index occurs semi-annually.

Volatility Control Overlay

On a short term basis, markets can behave unexpectedly and can experience large movements in their price.

Volatility is one measure of these price movements and is the amount by which the price level of a financial asset moves from its average price over a set period of time. As such, volatility is often used to describe the uncertainty in share price movements and so is often used as a measure of risk.

Historical trends have shown that generally, volatility and performance have an inverse relationship: market rises tend to be steady (i.e. with low volatility) while market falls tend to be short and sharp (i.e. with high volatility). The RBS UK Balanced Sector Index has an automatic feature known as the Volatility Control Overlay that aims to provide some protection against volatility.



How does the Volatility Control Overlay work?

To determine how volatile the underlying company shares are, the RBS UK Balanced Sector Index compares the daily level of the underlying company shares to the average level over the last 20 trading days. The amount of movement from this average level gives a specific volatility level.

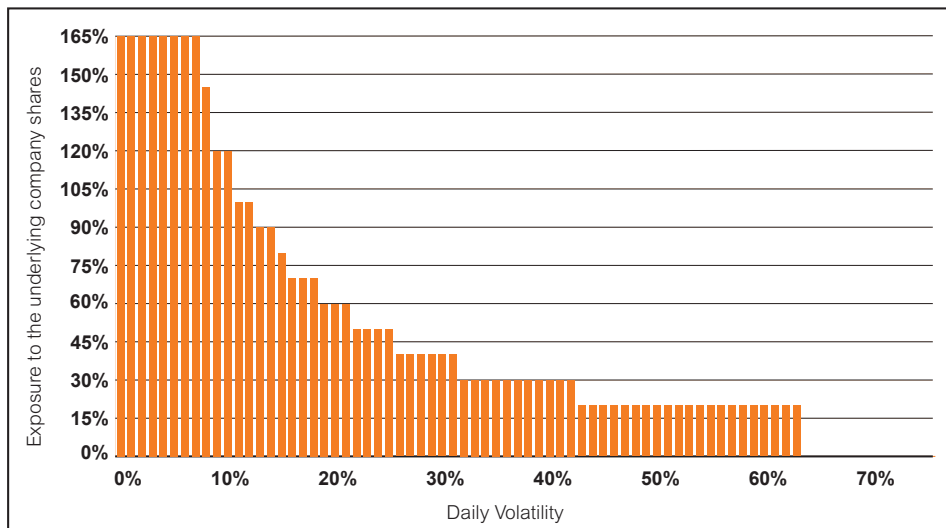
If the volatility of the underlying company shares on a particular day is at or above a pre-determined level (in this case 12.65%), the RBS UK Balanced Sector Index will proportionally reduce exposure to the underlying company shares, down to a minimum exposure of 0%. In this case, the Index will not be exposed to the underlying company shares and so the Index will not grow in value.

If the volatility of the underlying company shares on a particular day is below the pre-determined level, the RBS UK Balanced Sector Index will increase exposure to the underlying company shares, up to a maximum exposure of 165% of the performance of the underlying company shares. This means that when the underlying company shares rise (or fall) in value by 1%, the RBS UK Balanced Sector Index will rise (or fall) in value by 1.65%. This has the ability to magnify both gains and losses.

By reducing the exposure to the underlying company shares during periods of higher volatility and increasing exposure during periods of lower volatility, when markets are more stable, the RBS UK Balanced Sector Index seeks to make the most of market rises and reduce exposure to market falls. Obviously though, if markets rise in a volatile manner then the Volatility Control Overlay may limit the effect of this rise on the Index.

The Volatility Control Overlay is based on the historical relationship between volatility and performance and this relationship may not continue in the future.

Application of the Volatility Control Overlay

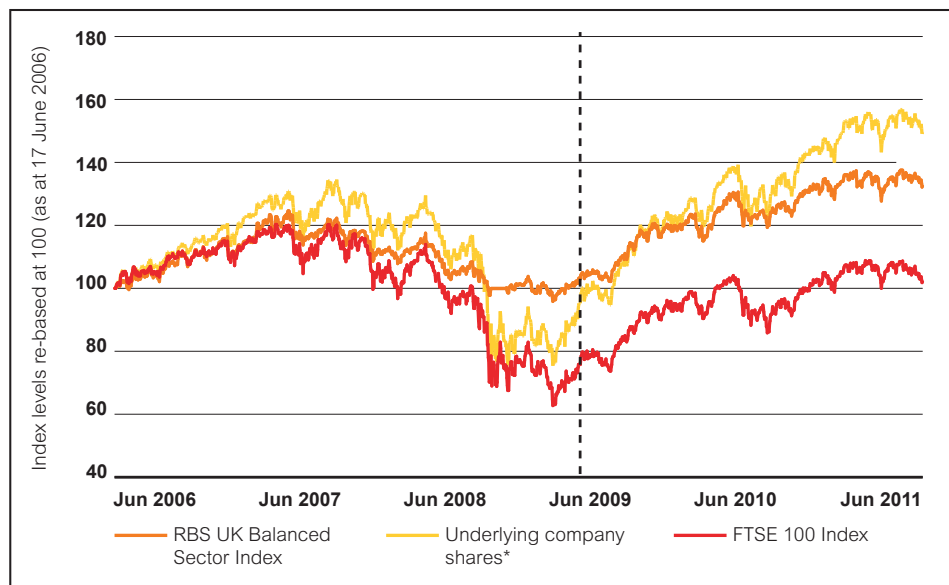


Source: RBS plc Global Banking and Markets, June 2011.

What has this meant for performance?

The below graph demonstrates the results of the RBS UK Balanced Sector Index's balanced exposure to the underlying company shares.

Simulated and historical performance over the last five years



Source: Bloomberg, 17 June 2011.

*This illustrates how the underlying company shares that make up the RBS UK Balanced Sector Index have performed without the application of the Volatility Control Overlay. The performance of the underlying company shares does not include any dividends.

Please note: This information refers to simulated past performance and past performance, both of which should not be used as an indicator of future performance. The above performance is net of all costs, adjustments and fees. Live performance of the RBS UK Balanced Sectors Index is since 11 May 2009. The Royal Bank of Scotland plc has retrospectively calculated the Index levels based on the Index rules and historical data from sources the Index sponsor deems reliable.

Treatment of dividends

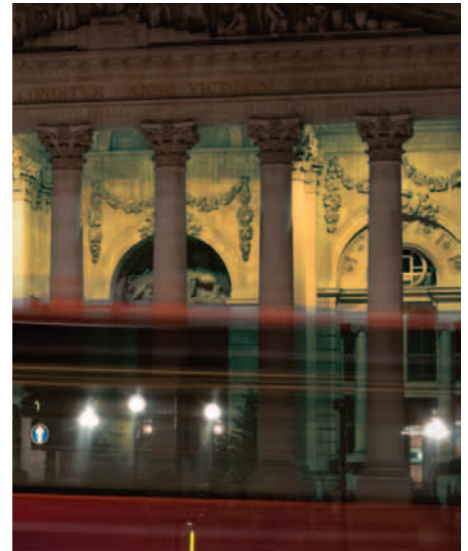
The RBS UK Balanced Sector Index will reinvest any dividends paid by the constituent companies in the Index. These dividend payments will be reflected in the level of the Index. It is important to note, however, that the RBS UK Balanced Sector Index applies a dividend adjustment on the performance of the underlying company shares. It does this by deducting, on a daily basis, a rate of 3% per year from the level of the Index. The dividend adjustment represents the cost incurred by RBS plc to gain exposure to the Index. Prospective investors should understand that the dividend adjustment will have a material effect on the level of the Index. Such adjustments are not passed on to investors as a fee but will be deducted from the Index level. If actual dividends paid by the underlying company shares in the Index are greater than 3% per year, the re-invested dividends will be greater than the dividend adjustment and this will have a positive effect on the level of the Index. If actual dividends paid are less than 3% per year, the re-invested dividends will be less than the dividend adjustment and this will have a negative effect on the level of the Index.

Calculating the Index

The Index is the exclusive property of The Royal Bank of Scotland plc. Standard & Poor's maintains and calculates the level of the Index. Standard & Poor's shall have no liability for any errors or omissions in calculating the Index. Standard & Poor's is a trademark of The McGraw-Hill Companies, Inc.

Summary

The RBS UK Balanced Sector Index has been designed by RBS plc to provide balanced exposure across UK companies and industry sectors as well as seeking to cushion the level of the Index from the effect of sudden market movements.



Key considerations

You cannot invest in the RBS UK Balanced Sector Index directly but can gain exposure to the Index through products that are linked to the performance of the Index. If such products are issued by RBS plc, you could lose some or all of your investment if RBS plc defaults or goes bankrupt.

Exposure to the underlying company shares that make up the Index may be up to 165%. This means that when the underlying company shares rise (or fall) in value by 1%, the RBS UK Balanced Sector Index will rise (or fall) in value by 1.65%. This has the ability to magnify both gains and losses.

Any product linked to the RBS UK Balanced Sector Index will have its own risks. You will need to read all the relevant documentation before investing.

The Index is exposed to equity markets and investments in products relating to equity markets may be negatively affected by global economic, financial and political developments.

The Index operates on the basis of pre determined rules set by RBS plc. No assurance can be given that the rules and therefore the Index will be successful, generate positive returns or perform better than any benchmark or other indices.



Further considerations

The Index does not invest directly in the underlying company shares that make up the Index. This means that you have no rights to these underlying company shares or any associated dividends.

RBS plc and/or Standard & Poor's ('S&P') have discretion in making certain decisions, calculations and corrections which may apply retrospectively or from the relevant date forward. The exercise of this discretion may adversely affect the performance of the Index though RBS plc must always act in good faith when making any decisions, calculations or corrections.

RBS plc is a multi-service financial institution, and occasions can arise where RBS plc, any of its respective affiliates or subsidiaries or their respective directors, officers, employees, representatives delegates or agents may have some form of conflict of interest in relation to the structure and operation of the Index. RBS plc maintains a Conflicts of Interest policy as required by the Financial Services Authority to manage any such conflict.

The Index rules may be amended by RBS plc and/or S&P acting in a commercially reasonable manner. Any such amendment may be made without the consent of or notice to investors in products linked to the Index and may have an adverse effect on the level of the Index.

There is a risk that the level of the Index may be postponed or terminated if the prices of the underlying company shares are not published, for example if the relevant stock exchanges fail to open or suspend or stop trading.

The level of the Index may not be published or in the event that it is not possible or practicable to continue, the Index may be terminated by RBS plc. Should the Index cease to exist, any product linked to this Index may be restructured or may terminate early. This may have a negative impact on the return on any investment in such a product.

This document is an advertisement and is not a prospectus for the purposes of EU Directive 2003/71/EC (the "Directive") and/or Part VI of the Financial Services and Markets Act 2000.

Investors should not subscribe for any securities or place any deposit referencing the RBS UK Balanced Sector Index ("Index") without first having read and understood (i) the methodology and rules used to construct, calculate and maintain the Index ("Index Rules") and (ii) information contained in the prospectus relating to such securities or the terms and conditions of such deposit. Investors may obtain copies of (i) the Index Rules from RBS plc, (ii) the prospectus on the website of the London Stock Exchange and in hard copy at the offices of the issuer (in the case of securities) and (iii) the terms and conditions of the deposit at the offices of the deposit taker (in the case of deposits).

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