Re-Strike Deferred Purchase Agreements

Recommended • Series 1

Investment Grade • Series 2

Important Dates

Open / Close Date		23 April 2010 / 23 June 2010
Commencement Date		10 June 2010
Coupon Determination Dates		Annually on 10 July, commencing 10 July 2011
Maturity Averaging Dates		12, 9, 6, 3 months prior to the Maturity Date and the Maturity Date.
Maturity Date	**Series 1**	10 July 2017 (7 years)
	Series 2	10 January 2017 (6.5 years)

Key Information

Investment Type		Units are deferred purchase agreements between the Issuer and investor. The PDS states the Units are "warrants" and "securities" under the Corporations Act.
Issuer & Custodian		RBS Group (Australia) Pty Limited.
Capital Protection Provider		National Australia Bank Limited.
Reference Index	**Series 1**	Risk Stabilised SPI 200 Index Future Strategy Index.
	Series 2	Risk Stabilised Aquantum Pegasus EL1 Strategy Index.
Index Sponsor		The Royal Bank of Scotland plc.
Fixed Coupon Payments	**Series 1**	2.86% p.a. ($0.0286 per Unit).
	Series 2	3.08% p.a. ($0.0308 per Unit).
Variable Coupon Payments		40% of the growth in the Reference Index in excess of the High Water Mark and the Hurdle Rate on a Coupon Determination Date.
High Water Mark		The highest level of the Reference Index on any of the previous Coupon Determination Dates. On the first Coupon Determination Date the High Water Mark is $1.00.
Hurdle Rate		5% or $0.05 per Unit. Fixed for each Coupon Determination Date.
Final Hurdle	**Series 1**	14.0%
	Series 2	6.5%
Issue Price		$1.00 per Unit. Investors must pay $0.80 by the Close Date. Remaining $0.20 is paid by investors via re-investment of Fixed Coupons.
Capital Protection		Units will have a Final Value at Maturity of at least $1.00 per Unit.
Delivery Asset		An equally weighted basket of 5 ASX listed shares.
Liquidity		Monthly on last business day of each month, commencing September 2010.
Currency Hedging		The Reference Index in Series 2 is expressed in USD. However, in calculating the returns on the Units, currency is ignored.

Fees & Commissions

Underlying Index Fee	**Series 1**	Nil
	Series 2	Fees of up to a maximum of 3.65% p.a. are incorporated into the calculation of the Underlying Index. In addition, a 15% performance fee is applied to any outperformance of the Underlying Index over the previous high water mark each year.

What this Rating Means

For Series 1, the **Recommended** rating indicates that Lonsec has conviction that the fund or product can achieve its objectives and, if applicable, outperform peers over an appropriate investment timeframe. The manager or product has a number of competitive advantages in people, process and product design. The investment is a recommended entry point to access this asset class or strategy.

For Series 2, the **Investment Grade** rating indicates that Lonsec believes that the fund or product can achieve its objectives and, if applicable, outperform some of its peers over an appropriate investment timeframe. However, compared to higher rated managers / funds, this manager has fewer competitive advantages in people, process or product design. If available, higher rated funds or products giving access to this asset class or strategy are expected to provide better long term investment outcomes.

Using this Product

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Lonsec views Series 1 as Australian equities exposure best suited to some balanced and growth investors. Maximum percentage allocations to each asset class are outlined in Lonsec's Risk Profile Review. Series 2 provides the ability to gain leveraged exposure to the price growth potential of a long / short commodities index. Lonsec considers Series 2 to be part of the Alternative Assets – Aggressive sector and most suited to Growth and High Growth investors. Maximum percentage asset class allocations for all risk profiles are outlined in Lonsec's Risk Profile Review.

- The Units may appeal to investors who are currently invested in "cash-locked" products, where an early termination of their investment would involve break costs. The Issue Price of $0.80 per Unit means these investors may be able to terminate their existing investment and re-invest the proceeds (less break costs) and gain exposure to the growth potential of Series 1 and / or 2. However, investors should consider individual circumstances and taxation implications before making any decision in relation to the Units.

- The Units provide exposure based on the volatility of price movements in the Underlying Index. As such, investors should believe the historically high levels of volatility since the start of the global financial crisis will subside to long term averages or below average levels and have a positive view on the Reference Index in the medium term.

Product Risk Characteristics

	Low	Moderate	High
Leverage		▲	
Liquidity		▲	
Counterparty	▲		
Concentration		▲	
Volatility – Series 1			▲
Volatility – Series 2		▲	

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.

Lonsec Opinion of this Product

- The Units provide investors with a potentially leveraged exposure to the performance of 2 different Reference Indices. The Units aim to provide both capital growth and income over the investment term with the benefit of capital protection at maturity.

- An investor's exposure to the Underlying Index varies between 0% and 150% for Series 1 and 0% and 145% for Series 2 and is determined by the volatility of the Underlying Index. The basic principle is to reduce exposure to the Underlying Index when volatility rises above a Target Level and increase exposure when volatility falls below the Target Level in order to maintain a constant level of volatility. Therefore Unit returns are greatest when the prices of the Underlying Index trend upwards with low volatility. The Units will also act to reduce exposure to any sharp fall in the Underlying Index provided the fall is accompanied by heightened volatility. Generally speaking, this was the case during 2007 and 2008 when equity and other markets recorded significant falls, although during 2009 while many markets recovered, volatility remained at heightened levels.

- To the extent that exposure to the Underlying Index is greater than 100%, an investment in the Units represents a leveraged investment. Leverage has the effect of magnifying movements (both positive and negative) in the Underlying Index.

- Lonsec considers the Issuer and its parent to be a very experienced issuer of investment products. The Group is extremely well resourced both globally and in Australia.

- Series 1 provides a risk controlled exposure to the rolling futures strategy tracking the S&P/ASX 200 Index. The Series 1 Reference Index does not have any live performance history and references to historical performance in the PDS are based on simulated data. Advisers should note that simulated performance is not a reliable indicator of future performance. Due to the rolling futures strategy and risk control overlay, the performance of the Reference Index should not be expected to perfectly match the S&P/ASX 200 Index.

- Series 2 provides exposure to a commodities index, representing a combined effort between the RBS Group and the skills of a well respected commodities trader. The Reference Index is rules-based and tracks the price movements of 24 commodities (as at the date of the PDS). The Reference Index incorporates a performance fee (when the Underlying Index is above a high water mark). In Lonsec's opinion performance fees are not standard for rules-based indices. Furthermore, Lonsec prefers to see performance fees subject to a hurdle to better align interests with investors. Simulated data is included in Section 4 of the PDS and is net of the above mentioned fees. The Reference Index has been live since 9 November 2009. Advisers should note that simulated performance is not a reliable indicator of future performance.

- The mechanism which adjusts an investor's exposure to the Underlying Index on a daily basis has some positive features, however this also means investor returns at maturity (Final Value at Maturity) are path dependent and will vary significantly under different return and volatility scenarios. Some scenario analysis is outlined on page 6. Investors should note that these are only a guide. Generally speaking, Units could be expected to outperform a direct investment in the Underlying Index during periods of strong returns accompanied by average or below average volatility due to the leveraged exposure the Units can achieve. In periods of significant price weakness in the Underlying Index the capital protection features provide investors with downside protection at maturity. It is less certain in sideways trending or very volatile market conditions whether the Units or a direct investment would provide superior returns; however the higher fees associated with the Series 2 Units have the potential to be a drag on performance.

- Investors receive a minimum Final Value $1.00 per Unit for an initial investment of $0.80 per Unit and pay no management fees during the investment term. The cost investors pay for capital protection and exposure to the Reference Indices is obfuscated in various features of the Product, some of which the Issuer determines in its discretion. As is often the case with structured product pricing generally, these prices will not be transparent to the investor.

Relevant Parties

The Issuer of the Units RBS Group (Australia) Pty Limited (RBS), a wholly owned subsidiary of the Royal Bank of Scotland Group. The Royal Bank of Scotland Group was founded in 1727 and its operations span retail banking, corporate and commercial banking, financial markets activities, wealth management and insurance. In Asia Pacific, RBS serves corporate, institutional and public sector clients in 11 countries.

RBS and its subsidiaries have had a local presence since 1974 and work on some of the local market's largest and most complex transactions and projects for corporate, institutional and public sector clients.

The Royal Bank of Scotland plc has significant experience in structuring investment products globally.

Following the announcement of significant losses following the global financial crisis, the UK Government is now the largest shareholder in the Royal Bank of Scotland plc.

Reference Indices

Series 1

The **Reference Index** is the Risk Stabilised SPI 200 Index Future Strategy Index, which aims to track a notional strategy that applies a volatility stabilisation overlay to the Underlying Index. The purpose of the volatility stabilisation overlay is to actively adjust exposure to the Underlying Index so that the Reference Index volatility is maintained at the Target Volatility, **in this case 14%.**

The Royal Bank of Scotland plc is the sponsor of the Reference Index and also the Calculation Agent.

The **Underlying Index** is the ASX 200 Excess Return Rolling Futures Index which aims to provide an exposure to the Australian sharemarket by a continual investment in the SFE SPI 200 futures contract. The Underlying Index is intended to reflect the excess return performance of a quarterly investment in the rolling futures contract (being the SFE SPI 200 futures contract whose expiration is closest to the current date).

Investors should note the Underlying Index has no actual historical performance and the performance information provided in the PDS is based on simulations.

Series 2

The **Reference Index** is the Risk Stabilised Aquantum Pegasus EL1 Strategy Index (USD) is calculated and maintained by Future Value Consultants Limited (Reference Index Calculation Agent) based on a methodology developed by The Royal Bank of Scotland plc (Reference Index Sponsor). The Reference Index aims to track a notional strategy that applies a risk stabilisation overlay to the Underlying Index. The purpose of the volatility stabilisation overlay is to actively adjust exposure to the Underlying Index so that the Reference Index volatility is maintained at the Target Volatility, **in this case 6%.**

The formulae and calculations for the Reference Index and volatility are detailed in Section 13 of the PDS.

In calculating the Reference Index, fees up to a maximum of 3.65% (excluding the Performance Fee) are incorporated:

- Access Cost of 1.20% p.a. charged by RBS plc to implement the Reference Index. This fee can vary from 1.00% to 1.75% p.a.
- Licensee Management Fee of 1.15% p.a. charged by RBS plc to maintain the Reference Index. This fee can vary from 1.00% to 1.40% p.a.
- Licensor Management Fee of 0.35% p.a. charged by Aquantum Algorithmic Ltd. This fee can vary from 0.30% to 0.50% p.a.
- Performance Fee of 15% (subject to a high water mark) charged by RBS plc. For example, if outperformance above the previous high water mark is 10%, the performance fee charged will be 1.5% (i.e. 10% x 15%).

The **Underlying Index** is the Aquantum Pegasus EL Excess Return Index (USD), a commodity index which references a diversified portfolio of exchange traded commodity from various sectors including energy, metals, agriculture and livestock. As at the date of the PDS, the index included 24 exchange traded commodity contracts.

The Underlying Index is a market-neutral strategy which means that its performance should not depend on the direction of the exchange traded commodities to which the index is linked.

The weights in individual commodities are restricted to ensure diversification, with any individual commodity restricted to a 15% maximum. The weights are rebalanced monthly to ensure that diversification remains intact.

Simultaneous long and short positions are established in certain exchange traded commodities contracts with different expiry dates with the aim of generating positive returns. The Underlying Index aims to deliver absolute returns with a low level of volatility.

The Underlying Index is leveraged, for every 1 USD invested, the index will reference short positions and long positions with a total notional value of 3.5 USD each position.

How does the Product Work?

Investors enter into a deferred purchase agreement with the Issuer, under which investors agree to buy Delivery Assets at the Maturity Date equal to the Final Value at Maturity. RBS, as Custodian, holds each Unit on separate trust for each investor subject to a fixed charge.

Unit Value

The Unit Value for each Series is calculated daily by determining the level of exposure to the relevant Underlying Index. The level of exposure is determined each business day based on the volatility of the Underlying Index over the previous 20 business days. The basic principle is to reduce exposure to the Underlying Index when volatility rises and increase exposure when volatility falls in order to maintain a fixed level of volatility. The Target Volatility differs for each Series. This requires investors to pay $0.80 by the Close Date. The remaining $0.20 is paid by investors through the re-investment of the Fixed Coupons received over the investment term.

Exposure to the Reference Index varies between a minimum of 0% and maximum of 150% for Series 1 and between 0% and 145% for Series 2. An outline appears below:

Series 1

Volatility between -	Exposure*
0.00% to 9.00%	150.00%
9.00% to 14.00%	**100.00%**
14.00% to19.00%	73.68%
19.00% to 24.00%	58.33%
24.00% to 29.00%	48.28%
29.00% to 34.00%	41.18%
34.00% to 44.00%	31.82%
44.00% to 54.00%	25.93%
>54.00%	0.00%

Series 2

Volatility between -	Exposure*
0.00% to 4.00%	145.00%
4.00% to 5.00%	120.00%
5.00% to 6.00%	**100.00%**
6.00% to 7.50%	80.00%
7.50% to 10.00%	60.00%
10.00% to 15.00%	40.00%
15.00% to 20.00%	30.00%
20.00% to 30.00%	20.00%
30.00% to 40.00%	10.00%
>40.00%	0.00%

* *Exposure levels are indicative only. The actual levels of volatility could be lower or higher than those provided in the table below, and will be confirmed on or around the Commencement Date and published at www.rbs.com.au/structuredproducts.*

Investors should note that the Target Volatility for Series 1 is below the long term volatility for the Underlying Index. This means that if the Underlying Index has volatility levels in line with its historical average then investors will not be exposed to the full movements in the index i.e. if volatility is 20% then investors will be approximately 70% exposed to movements in the index (both positive and negative).

The Issuer intends to publish the exposure and the actual volatility (for each previous 20 Business Days) weekly (or more frequently) on its website at www.rbs.com.au.

Generally speaking, Unit returns should be greatest when the prices of the Reference Index trend upwards with volatility lower than the Target Volatility.

Fixed Coupons

Investors receive Fixed Coupons of 2.86% p.a. for Series 1 and 3.08% p.a. for Series 2. However, this will not be received as cash and must be reinvested as a further capital contribution. These amounts are capital protected at maturity.

Variable Coupons

Investors may receive Variable Coupons. These are calculated as the greater of:

- 0%; and
- 40% of the annual growth of the Reference Index **above a High Water Mark and Hurdle Rate**.

The Unit Value is adjusted to reflect any coupons paid.

Final Value at Maturity

The Final Value at Maturity is determined on the Maturity Date as follows:

Minimum Final Value + Issue Price x [Max (0, (Final Reference Index Value / Initial Reference Index Value – 1) – Aggregate Variable Coupons – Final Hurdle)]

Averaging is applied to the Reference Index in the final year (Final Reference Index Value). Averaging has the effect of reducing returns to investors where the Reference Index increases strongly over the final year. Conversely, averaging has the effect of increasing returns where the Reference Index falls over the final year.

This means that for investors to receive a Final Value at Maturity in excess of their investment amount ($1.00 per Unit) the growth of the Reference Index (after adjusting for different exposure levels and averaging described above) must be greater than the total Variable Coupons paid and the Final Hurdle.

Worked examples are provided in Section 6 of the PDS.

Scenario Analysis

It is very difficult to provide any certainty of investor returns during the investment term and at maturity as the varying exposure levels during the investment term mean returns are path dependent. This means Unit returns are not only dependent upon the volatility of the Reference Index, but the timing of any movements as this impacts the level of leverage.

Appendix A of this review illustrates four scenarios for each Series that Lonsec has prepared.

What Happens at Maturity?

Investors choose one of two options:

- Accept physical delivery of the Delivery Asset; or
- Instruct the Issuer to sell the Delivery Asset on their behalf under Agency Sale Option and forward the cash proceeds.

The value of the Delivery Asset received equates to the Final Value at Maturity.

Liquidity

Units will not be listed on the Australian Securities Exchange or any other exchange. Due to the nature of the Reference Indices, investors should have the intention of holding Units to maturity.

Redemption requests can be made on a monthly basis provided the Issuer receives the request at least 10 business days before the relevant Buy-Back Date. The Issuer has the discretion to accept, reject or defer any redemption request.

Investors should be aware that any early redemption will involve the unwinding of transactions that involve crossing bid/offer spreads and termination of hedge contracts. As a result redemption proceeds prior to maturity may be less than the investment amount and will not be capital protected.

Risks

An investment in the Units carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in Section 7 of the PDS and should be read in full and understood by investors. Lonsec considers the major risks to be:

Performance Risk – The Unit Value is dependent on the price performance of the relevant Reference Index and the level of notional exposure to the Underlying Index which varies according to volatility levels. These can be influenced by many different factors including but not limited to interest rates, economic policies, political events, war and natural events. There is no guarantee the price movements of the Reference Index will lead to an increase in the Unit Value over the investment term.

Exposure and Volatility Risk – The volatility feature may act to increase or decrease an investor's exposure to movements in the Reference Index. Where exposure exceeds 100% the effect of any decrease in the Underlying Index will be magnified and when exposure is below 100% investors will not realise the full benefit of any increase in the Reference Index.

Early Maturity Risk – The Issuer may nominate early or late maturity date if there is an Adjustment Event or Market Disruption Event. These include but are not limited to events such as trading suspensions of the Reference Index or a material change to the way they are calculated. This also includes where the Issuer is unable to hedge its obligations under the Terms of the deferred purchase agreement. **Capital protection does not apply in the event of an early maturity.**

Leverage Risk – Investors may have a leveraged exposure to the Underlying Index of up to $1.50 per $1.00 invested for Series 1 and $1.45 per $1.00 invested for Series 2. The use of leverage can magnify the gains and losses of an investor's exposure to the Reference Index during the investment term.

Counterparty Risk – Investors are exposed to the creditworthiness of the Issuer, as returns are dependent on the Issuer performing its obligations as they fall due. These obligations rank equally with other unsecured debt liabilities of the Issuer. The Minimum Final Value of $1.00 per Unit and the Fixed Coupons are provided by the Capital Protection Provider. The Issuer (and hence investors) are reliant on the Capital Protection Provider in this respect.

Taxation

Lonsec advises investors to consult a taxation specialist before making a decision to invest (or not to invest) based upon these taxation considerations. Investors should refer to Section 9 of the PDS.

Further Information

Further information can be obtained at:

www.rbs.com.au/structuredproducts

Appendix A – Scenario Analysis

The following scenario analysis has been prepared by Lonsec using the assumptions below and the formulae and calculations in Section 13 of the PDS. Lonsec does not represent that the results nor stated returns and volatilities for the Underlying Indices represent the full range of possible outcomes. Given the active nature of the volatility stabilisation process, actual returns may not mirror those displayed below for any combination of expected return and forecast volatility. In each scenario, 10,000 trials were run to determine the simulated results.

Assumptions

1. Investment term is 7 years;
2. Units are held to maturity, therefore capital protection applies so Final Value is at least $1.00; and
3. Expected return series are normally distributed, i.e. returns do not exhibit skewness nor kurtosis (fat tails).

Underlying Index		Simulated Results					
Expected Return (% p.a.)	Forecast Volatility (% p.a.)	Average Aggregate Variable Coupons ($ per Unit)	Average Final Value at Maturity ($ per Unit)	In 50% of simulations, Aggregate Variable Coupons exceed ... ($ per Unit)	Percentage of simulations when Aggregate Variable Coupons exceeds $0.00 per Unit	In 50% of simulations, Final Value at Maturity exceeds ... ($ per Unit)	Percentage of simulations when Final Value at Maturity exceeds $1.00 per Unit
Series 1							
-5%	17%	$0.02	$1.01	59% don't exceed $0.00	41%	93% don't exceed $1.00	7%
+5%	17%	$0.09	$1.13	$0.07	81%	$1.00	50%
+10%	17%	$0.18	$1.31	$0.15	93%	$1.25	88%
20% decline in Year 1 then +5% p.a	17%	$0.04	$1.06	$0.01	52%	69% don't exceed $1.00	31%
Series 2							
-5%	6%	$0.00	$1.00	99% don't exceed $0.00	1%	100% don't exceed $1.00	0%
+5%	6%	$0.02	$1.07	$0.01	66%	$1.04	60%
+10%	6%	$0.08	$1.30	$0.07	99%	$1.30	99%
20% decline in Year 1 then +5% p.a	6%	$0.00	$1.01	89% don't exceed $0.00	11%	90% don't exceed $1.00	10%

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Date Prepared: May 2010
Analyst: Stewart Gault
Release Authorised by: Michael Elsworth

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