RBS
The Royal Bank of Scotland

Annual Report and Accounts 2011

Annual report and accounts

2	Board of directors and secretary		
3	Financial review		
163	Report of the directors		
167	Statement of directors' responsibilities		
168	Independent auditor's report to the members of The Royal Bank of Scotland plc		
169	Consolidated income statement		
170	Consolidated statement of comprehensive income		
171	Balance sheets		
172	Statements of changes in equity		
174	Cash flow statements		
175	Accounting policies		
187	Notes on the accounts		
	1	Net interest income	187
	2	Non-interest income	188
	3	Operating expenses	189
	4	Pensions	193
	5	Auditor's remuneration	196
	6	Tax	197
	7	Profit attributable to preference shareholders	198
	8	Ordinary dividends	198
	9	Profit/(loss) dealt with in the accounts of the Bank	198
	10	Financial instruments - classification	199
	11	Financial instruments - valuation	209
	12	Financial instruments - maturity analysis	225
	13	Financial assets - impairments	228
	14	Derivatives	231
	15	Debt securities	235
	16	Equity shares	237
	17	Investments in Group undertakings	238
	18	Intangible assets	238
	19	Property, plant and equipment	242
	20	Prepayments, accrued income and other assets	245
	21	Assets and liabilities of disposal groups	245
	22	Short positions	246
	23	Accruals, deferred income and other liabilities	246
	24	Deferred tax	247
	25	Subordinated liabilities	248
	26	Share capital and reserves	254
	27	Leases	255
	28	Securitisations and asset transfers	257
	29	Capital resources	259
	30	Memorandum items	261
	31	Net cash inflow from operating activities	270
	32	Analysis of the net investment in business interests and intangible assets	270
	33	Interest received and paid	271
	34	Analysis of changes in financing during the year	271
	35	Analysis of cash and cash equivalents	271
	36	Segmental analysis	272
	37	Directors' and key management remuneration	277
	38	Transactions with directors and key management	277
	39	Related parties	278
	40	Ultimate holding company	280
	41	Post balance sheet events	280
281	Additional information		

Board of directors and secretary

Chairman
Philip Hampton
Nominations (Chair)

Executive directors
Stephen Hester
Bruce Van Saun

Non-executive directors
Sandy Crombie*
Senior Independent Director
Nominations, Remuneration, Risk

Alison Davis*
Nominations, Remuneration

Tony Di Iorio*
Audit, Nominations, Risk

Penny Hughes*
Remuneration (Chair), Nominations

Joe MacHale*
Nominations, Risk

John McFarlane*
Nominations, Remuneration

Brendan Nelson*
Audit (Chair), Nominations, Risk

Baroness Noakes*
Audit, Nominations

Arthur 'Art' Ryan*
Nominations

Philip Scott*
Risk (Chair) Audit, Nominations

Secretary
Aileen Taylor

Audit	member of the Group Audit Committee
Nominations	member of the Group Nominations Committee
Remuneration	member of the Group Remuneration Committee
Risk	member of the Board Risk Committee
*	independent non-executive director

Auditors
Deloitte LLP
Chartered Accountants and Statutory Auditor
Hill House
1 Little New Street
London EC4A 3TR

Registered office
36 St Andrew Square
Edinburgh EH2 2YB
Telephone: +44 (0)131 556 8555

Head office
PO Box 1000
Gogarburn
Edinburgh EH12 1HQ
Telephone +44 (0)131 626 0000

The Royal Bank of Scotland plc
Registered in Scotland No. 90312

Financial review

Description of business

Introduction

The Royal Bank of Scotland plc ('the Royal Bank', 'RBS plc' or 'the Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc ('RBSG' or 'the holding company'), a large banking and financial services group. The 'Group' comprises the Bank and its subsidiary and associated undertakings. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

Following the placing and open offers in December 2008 and in April 2009, HM Treasury owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HM Treasury. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HM Treasury's holding of ordinary shares of the holding company remained at 70.3% although its economic interest rose to 84.4%.

At 31 December 2011, HM Treasury's holding of ordinary shares in the holding company was 66.9% and its economic interest was 82.2%.

Organisational structure and business overview

The Group's activities are organised on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile. UK Retail remains committed to delivering 'Helpful and Sustainable' banking and to the commitments set out in its Customer Charter - the results of which are externally assessed and published every six months.

UK Corporate is a leading provider of banking, finance and risk management services to the corporate and SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes asset finance through the Lombard brand.

Wealth provides private banking and investment services in the UK through Coutts & Co and Adam & Company, offshore banking through RBS International, NatWest Offshore and Isle of Man Bank, and international private banking through Coutts & Co Ltd.

Global Transaction Services (GTS) ranks among the top tier of global transaction banks, offering payments, cash and liquidity management, trade finance and commercial card products and services. Through the network and extensive partner bank agreements, GTS is able to support and connect customers across 128 countries.

Ulster Bank is the leading retail and business bank in Northern Ireland and the third largest banking group on the island of Ireland. It provides a comprehensive range of financial services. The Retail Markets division, which has a network of 236 branches, operates in the personal and financial planning sectors. The Corporate Markets division provides services to SME business customers, corporates and institutional markets.

US Retail & Commercial provides financial services primarily through the Citizens and Charter One brands. US Retail & Commercial is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states.

The divisions discussed above are collectively referred to as Retail & Commercial.

Global Banking & Markets (GBM) is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. The division is organised along six principal business lines: money markets; rates flow trading; currencies; equities; credit and mortgage markets and portfolio management and origination.

Central Functions comprises Group and corporate functions, such as treasury, funding and finance, risk management, legal, communications and human resources. The Centre manages the Group's capital resources and Group-wide regulatory projects and provides services to the operating divisions.

Non-Core division manages separately assets that the Group intends to run off or dispose of. The division contains a range of businesses and asset portfolios primarily from the GBM division, linked to proprietary trading, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also includes a number of other portfolios and businesses including regional markets businesses that the Group has concluded are no longer strategic.

Business Services supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Business Services drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and is the Group's centre of excellence for managing large-scale and complex change. For reporting purposes, Business Services costs are allocated to the divisions above. It is not deemed a reportable segment.

Description of business continued

Organisational change

In January 2012, the RBS Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes will see the reorganisation of the RBS Group's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities. The changes will ensure the wholesale businesses continue to deliver against the RBS Group's strategy.

The changes will include an exit from cash equities, corporate brokering, equity capital markets and mergers and acquisitions businesses. Significant reductions in balance sheet, funding requirements and cost base in the remaining wholesale businesses will be implemented.

Existing GBM and GTS divisions will be reorganised as follows:

- The 'Markets' business will maintain its focus on fixed income, with strong positions in debt capital raising, securitisation, risk management, foreign exchange and rates. It will serve the corporate and institutional clients of all RBS Group businesses.

- GBM's corporate banking business will combine with the international businesses of our Global Transaction Services arm into a new 'International Banking' unit and provide clients with a 'one-stop shop' access to the RBS Group's debt financing, risk management and payments services. This international corporate business will be self-funded through its stable corporate deposit base.

- The domestic small and mid-size corporates currently served within GTS will be managed within RBS's domestic corporate banking businesses in the UK, Ireland (Ulster Bank) and the US (US Retail & Commercial).

Our wholesale business will be retaining its international footprint to ensure that it can serve our customers' needs globally. We believe, that despite current challenges to the sector, wholesale banking services can play a central role in supporting cross border trade and capital flows, financing requirements and risk management and we remain committed to this business.

Going forward the Group will comprise the following segments:

- Retail and Commercial
  - UK Retail
  - UK Corporate
  - Wealth
  - US Retail & Commercial
  - Ulster Bank
  - International Banking
- Markets
- Group Centre
- Core
- Non-Core

Business divestments

To comply with European Commission (EC) State Aid requirements the RBS Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. This supplements the measures in the Strategic Plan previously announced by the RBS Group. These include divesting RBS Insurance, 80.01% of Global Merchant Services (completed in 2010) and substantially all of Sempra Commodities J.V. business (largely completed in 2010) as well as divesting the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the Direct SME customers across the UK ("UK branch-based businesses").

Recent developments

Liability management: Exchange offer

On 28 February 2012, The Royal Bank of Scotland plc announced an invitation to offer to exchange certain Canadian Dollar, Australian Dollar, US Dollar, Euro and Swiss Franc denominated subordinated notes for new Canadian Dollar, Australian Dollar, US Dollar, Euro and Swiss Franc denominated subordinated notes, due 2022 and callable 2017. The new notes, other than the Australian Dollar denominated new notes, were issued on 16 March 2012, and the Australian Dollar denominated new notes were issued on 19 March 2012, in each case under the £90,000,000,000 Euro Medium Term Note Programme of The Royal Bank of Scotland plc and The Royal Bank of Scotland Group plc.

National Loan Guarantee Scheme

On 20 March 2012, the Group agreed to participate in the National Loan Guarantee Scheme (the "Scheme"), pursuant to which The Commissioners of Her Majesty's Treasury ("HM Treasury") have agreed to unconditionally and irrevocably guarantee the due payment of all sums due and payable by the Group under any senior unsecured notes issued by the Group in accordance with the terms of the Scheme in respect of which HM Treasury issues a Guarantee Certificate (as defined in a deed of guarantee dated 20 March 2012 (the "Deed of Guarantee")). The Guarantor's obligations in that respect, are contained in the Deed of Guarantee, the form of which is available at www.dmo.gov.uk.

Competition

The Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand has been subdued as many customers have sought to delever and the UK economy has remained weak. Competition for retail deposits remains intense as institutions continue to target strong and diverse funding platforms for their balance sheets.

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities. In asset finance, the Group competes with banks and specialist asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets the Group competes with the large domestic banks active in these markets and with the major international banks.

In the small business banking market, the Group competes with other UK clearing banks, specialist finance providers and building societies.

In the personal banking segment, the Group competes with UK clearing banks, building societies and major retailers. In the mortgage market, the Group competes with UK clearing banks and building societies. The ambitions of non-traditional players in the UK market remain strong, with new entrants active and potentially seeking to build their platforms by acquiring businesses made available through restructuring of incumbents.

In the UK credit card market large, retailers and specialist card issuers are active in addition to the UK banks. In addition to physical distribution channels, providers compete through direct marketing activity and the internet.

In Wealth Management, The Royal Bank of Scotland International competes with other UK and international banks to offer offshore banking services. Coutts and Adam & Company compete as private banks with UK clearing and private banks, and with international private banks. Competition in wealth management remains strong as banks maintain their focus on competing for affluent and high net worth customers.

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market. The challenging conditions in the Irish economy persist and many of the domestic Irish banks have required State support and are engaged in significant restructuring actions.

In the United States, Citizens competes in the New England, Mid-Atlantic and Mid-West retail and mid-corporate banking markets with local and regional banks and other financial institutions. The Group also competes in the US in large corporate lending and specialised finance markets, and in fixed-income trading and sales. Competition is principally with the large US commercial and investment banks and international banks active in the US. The economic recovery in the US is proving weaker than expected and loan demand is weak in Citizens' markets.

Risk factors

Set out below is a summary of certain risks which could adversely affect the Group; it should be read in conjunction with the Risk and balance sheet management section of the Financial Review (pages 24 to 162). This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 283 to 296.

- The RBS Group's businesses, earnings and financial condition have been and will continue to be affected by geopolitical conditions, the global economy, the instability in the global financial markets and increased competition. Together with a perceived increased risk of default on the sovereign debt of certain European countries and unprecedented stresses on the financial system within the eurozone, these factors have resulted in significant changes in market conditions including interest rates, foreign exchange rates, credit spreads, and other market factors and consequent changes in asset valuations.

- The RBS Group's ability to meet its obligations including its funding commitments, depends on the RBS Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise could adversely affect the RBS Group's financial condition. Furthermore, the RBS Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings.

- The Independent Commission on Banking has published its final report on competition and possible structural reforms in the UK banking industry. The Government has indicated that it supports and intends to implement the recommendations substantially as proposed which could have a material adverse effect on the RBS Group.

- The RBS Group's ability to implement its Strategic Plan depends on the success of its efforts to refocus on its core strengths and its balance sheet reduction programme. As part of the RBS Group's Strategic Plan and implementation of the State Aid restructuring plan agreed with the European Commission and HM Treasury, the RBS Group is undertaking an extensive restructuring which may adversely affect the RBS Group's business, results of operations and financial condition and give rise to increased operational risk and may impair the RBS Group's ability to raise new Tier 1 capital due to restrictions on its ability to make discretionary dividend or coupon payments on certain securities.

- The occurrence of a delay in the implementation of (or any failure to implement) the approved proposed transfers of a substantial part of the business activities of RBS N.V. to the Bank may have a material adverse effect on the RBS Group.

- RBSG and its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures and various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the RBS Group's businesses.

- The actual or perceived failure or worsening credit of the RBS Group's counterparties or borrowers and depressed asset valuations resulting from poor market conditions have adversely affected and could continue to adversely affect the Group.

- The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate.

- The RBS Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements, including those arising out of Basel III implementation (globally or by European or UK authorities), or if the RBS Group is unable to issue Contingent B Shares to HM Treasury under certain circumstances.

- The RBS Group could fail to attract or retain senior management, which may include members of the RBS Group Board, or other key employees, and it may suffer if it does not maintain good employee relations.

- Any significant developments in regulatory or tax legislation could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the RBS Group is subject to uncertainty.

- The RBS Group is subject to substantial regulation and oversight, and any significant regulatory or legal developments could have an adverse effect on how the Group conducts its business and on its results of operations and financial condition. In addition, the RBS Group is, and may be, subject to litigation and regulatory investigations that may impact its business, results of operations and financial condition.

- Operational and reputational risks are inherent in the RBS Group's operations.

- The RBS Group may be required to make contributions to its pension schemes and government compensation schemes, either of which may have an adverse impact on the Group's results of operations, cash flow and financial condition.

- As a result of the UK Government's majority shareholding in RBSG it can, and in the future may decide to, exercise a significant degree of influence over the RBS Group. The offer or sale by the UK Government of all or a portion of its shareholding in the company could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of RBSG from the Official List.

Financial summary

Summary consolidated income statement for the year ended 31 December 2011

	2011 £m	2010 £m
Net interest income	11,298	12,111
Fees and commissions receivable	5,898	7,591
Fees and commissions payable	(1,047)	(2,060)
Income from trading activities	2,014	3,361
Gain on redemption of own debt	255	502
Other operating income	3,388	2,199
Non-interest income	10,508	11,593
Total income	21,806	23,704
Operating expenses	(15,494)	(14,475)
Profit before impairment losses	6,312	9,229
Impairment losses	(7,176)	(9,400)
Operating loss before tax	(864)	(171)
Tax	(731)	(713)
Loss for the year	(1,595)	(884)
Non-controlling interests	8	(29)
Preference dividends	(58)	(60)
Loss attributable to ordinary shareholders	(1,645)	(973)

Operating loss

Operating loss before tax was £864 million compared with £171 million in 2010. The reduction was primarily due to lower income, principally in Global Banking & Markets (GBM), and higher operating expenses which were affected by charges in relation to Payment Protection Insurance (PPI) claims and the bank levy; these were partially offset by lower impairment losses.

Total income

Total income was down 8% to £21,806 million, reflecting lower gains on redemption of own debt, losses on strategic disposals and a decline in revenues in GBM reflecting less favourable market conditions than a year ago, partially offset by favourable movements in the fair value of own debt and the APS credit default swap.

Net interest income

Net interest income fell by 7% to £11,298 million largely driven by the run-off of balances and exit of higher margin, higher risk segments in Non-Core.

Non-interest income

Non-interest income decreased to £10,508 million from £11,593 million in 2010, principally due to lower gains on redemption of own debt, losses on strategic disposals and a decline in trading income in GBM, partially offset by favourable movements in the fair value of own debt and the APS credit default swap.

Operating expenses

Operating expenses were £15,494 million compared with £14,475 million in 2010. This increase was principally due to a provision of £850 million in relation to PPI claims and a charge of £300 million for the bank levy.

Cost:income ratio

The Group's cost:income ratio was 71% compared with 61% in 2010. Excluding the gain on redemption of own debt and the PPI provision, the cost:income ratio was 68% compared with 62% in 2010.

Impairment losses

Impairment losses were £7,176 million compared with £9,400 million in 2010, with Core bank impairments falling by £617 million and Non-Core by £1,607 million despite ongoing challenges in the real estate and Ulster Bank portfolios, reflecting improvements in other asset classes.

Capital ratios

Capital ratios at 31 December 2011 were 9.2% (Core Tier 1), 11.0% (Tier 1) and 14.6% (Total).

Divisional performance

The results of each division are set out below. The results are stated before movements in the fair value of own debt, Asset Protection Scheme, Payment Protection Insurance costs, amortisation of purchased intangible assets, integration and restructuring costs, gain on redemption of own debt, strategic disposals, bonus tax, bank levy and write-down of goodwill and other intangible assets.

Business Services directly attributable costs have been allocated to the operating divisions, based on their service usage. Where services span more than one division an appropriate measure is used to allocate the costs on a basis which management considers reasonable. Business Services costs are fully allocated and there are no residual unallocated costs.

Operating profit/(loss) by division	2011 £m	2010 £m
UK Retail	2,168	1,476
UK Corporate	1,680	1,581
Wealth	299	287
Global Transaction Services	526	864
Ulster Bank	(964)	(624)
US Retail & Commercial	588	427
Retail & Commercial	4,297	4,011
Global Banking & Markets	1,487	3,235
Central items	(1,345)	(1,309)
Core	4,439	5,937
Non-Core	(3,057)	(4,735)
Operating profit	1,382	1,202
Fair value of own debt	731	(31)
Asset Protection Scheme	(906)	(1,550)
Payment Protection Insurance costs	(850)	—
Amortisation of purchased intangible assets	(68)	(63)
Integration and restructuring costs	(893)	(825)
Gain on redemption of own debt	255	502
Strategic disposals	(137)	645
Bonus tax	(78)	(50)
Bank levy	(300)	—
Write-down of goodwill and other intangible assets	—	(1)
Loss before tax	(864)	(171)

The performance of each division is reviewed on pages 9 to 20.

UK Retail

	2011 £m	2010 £m
Net interest income	4,320	4,082
Net fees and commissions	1,126	1,120
Other non-interest income	—	8
Non-interest income	1,126	1,128
Total income	5,446	5,210
Direct expenses		
- staff costs	(823)	(831)
- other	(409)	(407)
Indirect expenses	(1,258)	(1,336)
	(2,490)	(2,574)
Operating profit before impairment losses	2,956	2,636
Impairment losses	(788)	(1,160)
Operating profit	2,168	1,476

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross) (1)		
- mortgages	95.0	90.6
- personal	10.2	11.7
- cards	5.7	6.1
	110.9	108.4
Customer deposits (excluding bancassurance) (1)	102.2	99.3
Assets under management (excluding deposits)	5.5	5.7

Note:
(1) Includes disposal groups: loans and advances to customers - £7.3 billion; customer deposits - £8.8 billion.

In 2010, UK Retail set out an aspiration to become the UK's most helpful bank and launched the Customer Charter. In 2011, we made good progress on our Customer Charter commitments and the roll-out of innovation that actually helps customers. In December 2011, UK Retail refined its staff incentive scheme to further strengthen the role of customer service and to help build long lasting customer relationships.

Progress against the Customer Charter commitments is independently assessed and has shown encouraging results. By the end of 2011, we achieved the goal of serving 80% of our customers in less than 5 minutes in our busiest branches. Branch opening hours have also been extended and standardised, which means that our branches are now open for an additional 5,000 hours per week at times our customers have told us suit them.

Innovation has supported the delivery of Helpful Banking by focusing on solutions that make it easier for customers to bank with RBS and NatWest. An important example has been giving customers access to 24 hour emergency cash from NatWest and RBS ATMs when their cards are lost or stolen. We also updated our market-leading iPhone application and by the end of the year 1 million customers had downloaded the application. With successful apps also launched for iPad, Android and Blackberry, RBS is now the leading mobile bank in the UK.

UK Retail continued

2011 compared with 2010

UK Retail delivered strong full year results, as operating profit increased by £692 million to £2,168 million, despite continued uncertainty in the economic climate and the low interest rate environment. Profit before impairment losses was up £320 million or 12%, while impairments fell by £372 million, with further improvements in the unsecured book and continued careful mortgage underwriting.

The division continued to focus on growing secured lending while at the same time building customer deposits, thereby reducing the Group's reliance on wholesale funding. Loans and advances to customers grew 2%, with a change in mix from unsecured to secured as the Group actively sought to improve its risk profile. Mortgage balances grew by 5%, while unsecured lending contracted by 11%.

- Mortgage growth reflected continued strong new business levels. Gross mortgage lending market share of 10% continues above our stock position of 8%.

- Customer deposits grew 3%, in line with the market total deposit growth of 3%. Savings balances grew by £3 billion, or 3%, demonstrating the strength of our customer franchise and our strategy to further develop primary banking relationships.

Net interest income increased by 6% to £4,320 million, driven by strong balance sheet growth.

Non-interest income decreased modestly to £1,126 million, primarily driven by lower investment and protection income as a result of the dissolution of the bancassurance joint venture. In addition, a number of changes have been made to support delivery of Helpful Banking, such as 'Act Now' text alerts, which have decreased fee income.

Overall expenses decreased by 3%. Cost reductions were driven by a clear management focus on process re-engineering and operational efficiency together with benefits from the dissolution of the bancassurance joint venture, partly offset by higher inflation rates in utility and mail costs.

Impairment losses decreased 32% to £788 million reflecting the impact of a strengthened risk appetite, and a more stable economic environment.

UK Corporate

	2011 £m	2010 £m
Net interest income	2,724	2,584
Net fees and commissions	948	951
Other non-interest income	326	372
Non-interest income	1,274	1,323
Total income	3,998	3,907
Direct expenses		
- staff costs	(779)	(777)
- other	(334)	(359)
Indirect expenses	(421)	(429)
	(1,534)	(1,565)
Operating profit before impairment losses	2,464	2,342
Impairment losses	(784)	(761)
Operating profit	1,680	1,581
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross) (1)	108.6	111.5
Customer deposits (1)	100.9	100.0

Note:
(1) Includes disposal groups: loans and advances to customers - £12.2 billion; customer deposits - £21.8 billion.

In 2011, UK Corporate focused on supporting its customers through challenging economic times.

As a result of over 5,000 hours of customer research, UK Corporate launched the 'Ahead for Business' promise to its small and medium-sized enterprise (SME) customers.

To deliver on this, the division launched a number of initiatives to improve the service it offers to customers. For example, the 'Working with You' initiative, has seen over 4,600 visits to customer businesses since its launch in Q2 2011. Additionally, following the launch of the relationship manager accreditation programme, also in Q2 2011, almost all relationship managers have gained full accreditation in the initial phase.

UK Corporate continued to support new and existing businesses during 2011:

- launching its best ever fixed rate loan product for SMEs;
- reacting quickly after the August riots to give affected businesses access to special interest rate and fee free lending products;
- answering over 4,000 calls on the Start-up Hotline, offering free advice and a complementary business plan review service; and
- supporting more debt capital and loan market deals for larger corporates than any other bank.

The division also took measures to reduce the risk retained in the business allowing for quicker and more consistent decisions by simplifying the credit underwriting process and improving automated decision making.

2011 compared with 2010

Operating profit increased 6% to £1,680 million, as higher income and lower expenses were only partially offset by an increase in impairments.

Net interest income increased by 5% to £2,724 million. Net interest margin improved with benefits from re-pricing the lending portfolio and the revision to income deferral assumptions in Q1 2011 partially offset by increased funding costs together with continued pressure on deposit margins.

Non-interest income decreased by 4% as a result of lower GBM cross-sales and fee income, partially offset by increased Invoice Finance and Lombard income.

Excluding the £29 million OFT penalty in 2010, total costs remained broadly flat.

Impairments of £784 million were 3% higher due to increased specific impairments and collectively assessed provisions, partially offset by lower latent loss provisions.

Wealth

	2011 £m	2010 £m
Net interest income	645	554
Net fees and commissions	373	374
Other non-interest income	84	71
Non-interest income	457	445
Total income	1,102	999
Direct expenses		
- staff costs	(410)	(379)
- other	(193)	(142)
Indirect expenses	(175)	(173)
	(778)	(694)
Operating profit before impairment losses	324	305
Impairment losses	(25)	(18)
Operating profit	299	287

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- mortgages	8.3	7.8
- personal	6.9	6.7
- other	1.7	1.6
	16.9	16.1
Customer deposits	38.1	36.5
Assets under management (excluding deposits)	30.9	32.1

2011 has been a significant year for the Coutts businesses from a strategic perspective. In Q1 2011, a new divisional strategy was defined with the execution of early changes already making an impact.

Key strategic changes in 2011 included:

- A refreshed Coutts brand bringing Coutts UK and RBS Coutts under one single contemporary brand.
- A refocus on territories where the businesses have the opportunity for greatest scale or growth such as UK, Asia, Middle East, and Eastern Europe.
- Further development of client propositions as well as the portfolio of products and services for key international markets.
- Strategic investment in technology leading to the development of a single global technology platform for the Wealth division. The platform was successfully deployed in Adam & Company in 2011 with Coutts UK to follow in 2012.
- Strengthening the connectivity between Wealth and other Group divisions including referrals in international jurisdictions and improved connectivity with UK Corporate.
- Continued activity to ensure the division responds to new or expected regulatory changes with proactive solution design and preparation.
- Injection of new management into key roles from both internal and external sources including key segment heads, marketing, products & services, and international executive leadership.

Following the establishment of a single global brand in Q4 2011, focus turned to the reorganisation of key global functions such as marketing and product & services, as well as some local management structures. These reorganisations have realigned the division to maximise execution of the divisional strategy.

The execution plan for the strategy will continue into 2012 and position Wealth strongly against its peers.

2011 compared with 2010

Operating profit increased by 4% on 2010 to £299 million, driven by an 10% growth in income partially offset by increases in expenses and impairments.

Income increased by £103 million with a 24 basis points improvement in lending margins, strong treasury income and increases in lending and deposit volumes. Non-interest income rose 3%, with investment income growing 2% despite turbulent market conditions.

Expenses increased by £84 million, largely driven by adverse foreign exchange movements and headcount growth to service the increased revenue base. Additional strategic investment in technology enhancement, rebranding and programmes to support regulatory change also contributed to the increase.

Client assets and liabilities managed by the division decreased by 1%. Customer deposits grew 4% in a competitive environment and lending volumes grew 5%. Assets under management declined 4%, with fund outflows contributing 3% of the decrease and market conditions making up the balance.

Global Transaction Services

	2011 £m	2010 £m
Net interest income	442	421
Non-interest income	842	1,325
Total income	1,284	1,746
Direct expenses		
- staff costs	(245)	(287)
- other	(82)	(123)
Indirect expenses	(420)	(458)
	(747)	(868)
Operating profit before impairment losses	537	878
Impairment losses	(11)	(14)
Operating profit	526	864

	£bn	£bn
Balance sheet		
Total assets	17.1	14.7
Loans and advances	8.0	6.8
Customer deposits	45.8	41.0

Global Transaction Services (GTS) recognises the important role international trade plays in a strong global economy and throughout 2011 the division supported UK companies, both in the UK and overseas, to do more business internationally. This support included delivering a series of UK Government-backed ‘Doing Business in Asia’ events.

During the year, GTS invested in improving existing products and services and also in developing new ones. To help corporate treasurers manage their global positions, the division launched a global Liquidity Solutions Portal, giving its customers a view of their operational and investment balances and rates all in one place, improving transparency, and enabling them to execute and redeem investments effectively.

2011 compared with 2010
Operating profit was down 39%, partly reflecting the sale of Global Merchant Services (GMS) which completed on 30 November 2010. Adjusting for the disposal, operating profit decreased 21%.

Excluding GMS, income was broadly flat reflecting successful deposit-gathering initiatives, as deposits increased £4.8 billion in a competitive environment.

Excluding GMS, expenses increased by 20%, reflecting business improvement initiatives and investment in technology and support infrastructure.

Impairment losses decreased to £11 million compared with £14 million in 2010.

For the eleven months in 2010 before completion of the disposal, GMS generated income of £442 million, total expenses of £244 million and an operating profit of £198 million.

Ulster Bank

	2011 £m	2010 £m
Net interest income	713	860
Net fees and commissions	142	156
Other non-interest income	69	58
Non-interest income	211	214
Total income	924	1,074
Direct expenses		
- staff costs	(221)	(237)
- other	(67)	(74)
Indirect expenses	(216)	(226)
	(504)	(537)
Operating profit before impairment losses	420	537
Impairment losses	(1,384)	(1,161)
Operating loss	(964)	(624)
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- mortgages	20.0	21.2
- corporate		
- property	4.8	5.4
- other corporate	7.7	9.0
- other lending	1.6	1.3
	34.1	36.9
Customer deposits	21.8	23.1

2011 was another difficult year for the business due to the continued challenging economic environment. This was reflected in the financial performance, with ongoing pressure on income and a further increase in impairment losses.

Ulster Bank continues to make progress on its customer commitments and deposit gathering strategy, while cost management and targeting growth in areas that leverage competitive advantage, remain priorities. In 2011, customer numbers increased by 2%, representing a strong performance in current and savings accounts, driven by the enhanced customer service highlighted by our 'Help for what matters' programme.

Following a review of the cost base and operating model, 950 proposed job losses were announced in January 2012, the majority of which are expected by the end of 2012. This decision is a necessary part of the changes required to build a stronger sustainable business for the future.

2011 compared with 2010

Operating profit before impairment losses decreased by £117 million in 2011 with lower income partially mitigated by cost savings. Impairment losses of £1,384 million increased by 19% from 2010 resulting in an operating loss of £964 million, 54% higher than 2010.

Income fell by 14% driven by a contracting performing loan book coupled with higher funding costs. Loans and advances to customers decreased by 5% in constant currency terms during 2011.

Expenses fell by 6% reflecting tight management of the cost base across the business.

Impairment losses increased by 19% largely reflecting the deterioration in credit metrics on the mortgage portfolio driven by a combination of higher debt flow and further fall in asset prices.

Despite intense competition, retail and small business deposit balances have grown strongly throughout 2011, driven by the benefits of a focused deposit gathering strategy. However, total customer deposit balances fell by 6% largely driven by the outflow of wholesale customer balances due to rating downgrades.

US Retail & Commercial

	2011 US$m	2010 US$m	2011 £m	2010 £m
Net interest income	3,087	3,010	1,925	1,948
Net fees and commissions	1,138	1,126	709	729
Other non-interest income	473	465	295	300
Non-interest income	1,611	1,591	1,004	1,029
Total income	4,698	4,601	2,929	2,977
Direct expenses				
- staff costs	(1,313)	(1,212)	(819)	(784)
- other	(874)	(880)	(544)	(569)
Indirect expenses	(1,047)	(1,050)	(653)	(680)
	(3,234)	(3,142)	(2,016)	(2,033)
Operating profit before impairment losses	1,464	1,459	913	944
Impairment losses	(521)	(799)	(325)	(517)
Operating profit	943	660	588	427
Average exchange rate - US$/£			1.604	1.546
	US$bn	US$bn	£bn	£bn
Balance sheet				
Loans and advances to customers (gross)				
- residential mortgages	9.4	9.4	6.1	6.1
- home equity	23.1	23.6	14.9	15.2
- corporate and commercial	35.3	31.7	22.8	20.4
- other consumer	11.8	10.6	7.6	6.9
	79.6	75.3	51.4	48.6
Customer deposits (excluding repos)	92.1	91.2	59.5	58.7
Spot exchange rate - US$/£			1.548	1.552

US Retail & Commercial (R&C) continued to focus on its back-to-basics strategy, with good progress made in developing the division's customer franchise during 2011. The bank continued to re-energise the franchise through new branding, product development and competitive pricing.

To strengthen retail alignment and improve efficiencies, US R&C formed a consolidated Consumer Banking division by combining management of the retail banking franchise with the consumer lending division during H2 2011. This continued focus on alignment is expected to further contribute to the improved penetration of loan products to deposit households, which has already increased in ten consecutive quarters. The penetration of on-line banking customers, a key indicator of customer retention, also continued to improve during 2011.

To enhance the customer experience, in Q4 2011, Consumer Banking introduced four core Customer Commitments, built around feedback received from customers in Massachusetts. In Q1 2012, the Commitments will be rolled out to Citizens Financial Group's (CFG's) entire branch footprint.

Significant organisational changes and investment in Commercial Banking, including unification under the RBS Citizens brand, has been important in positioning the business for growth. The enhanced sales training programme for managers and sales colleagues in this business has begun to deliver results with both higher credit balances and increased client satisfaction. External researchers TNS awarded Citizens the second highest score in relationship manager satisfaction among its competitors for 2011.

Risk management was also an important focus for 2011 and in Q4 2011, CFG's Board of directors approved a new formal risk appetite statement aimed at ensuring sustained predictable earnings and further strengthening the control environment.

2011 compared with 2010

Operating profit increased to $943 million from $660 million, an increase of $283 million, or 43%. Excluding a credit of $113 million related to changes to the defined benefit plan in 2010, operating profit increased $396 million, or 72%, substantially driven by lower impairments and improved income.

The macroeconomic operating environment remained challenging, with low rates, high unemployment, a soft housing market, sluggish consumer activity and the continuing impact of legislative changes including the Durbin Amendment in the Dodd-Frank Act which became effective on 1 October 2011.

The Durbin Amendment lowers the allowable interchange on debit transactions to $0.23-$0.24 per transaction. The current annualised impact of the Durbin Amendment is estimated at $150 million.

Net interest income was up $77 million, or 3%. Non-interest income was up $20 million, or 1%, primarily driven by higher account and transaction fees, partially offset by the impact of legislative changes on debit card and deposit fees.

Excluding the defined benefit plan credit of $113 million in 2010, total expenses were down $21 million, or 1%, due to a number of factors including lower Federal Deposit Insurance Corporation (FDIC) deposit insurance levies, and lower litigation and marketing costs, partially offset by higher regulatory costs.

Impairment losses declined by $278 million, or 35%, largely reflecting an improved credit environment slightly offset by higher impairments related to securities.

Customer deposits were up 1% with particularly strong growth achieved in checking balances. Consumer checking balances grew by 6%, while small business checking balances grew by 5% over the year.

Global Banking & Markets

	2011 £m	2010 £m
Net interest income	496	901
Net fees and commissions	714	961
Income from trading activities	3,251	4,307
Other operating income	256	251
Non-interest income	4,221	5,519
Total income	4,717	6,420
Direct expenses		
- staff costs	(2,031)	(1,983)
- other	(729)	(498)
Indirect expenses	(480)	(415)
	(3,240)	(2,896)
Operating profit before impairment losses	1,477	3,524
Impairment recoveries/(losses)	10	(289)
Operating profit	1,487	3,235
	£bn	£bn
Balance sheet		
Loans and advances to customers	63.2	59.5
Loans and advances to banks	40.8	38.8
Reverse repos	98.7	89.9
Securities	101.1	88.8
Cash and eligible bills	19.2	29.2
Other	22.2	12.7
Total assets (excluding derivatives mark-to-market)	345.2	318.9
Customer deposits (excluding repos)	34.5	36.2

During Q4 2011, the market environment continued to weaken. Market volatility remained elevated and liquidity depressed as markets reacted to developments in the European sovereign debt crisis. Deal flow was weak reflecting investor pessimism about the outlook for the world economy. Throughout the year, GBM continued to deliver core products and innovative solutions to clients, while also focusing on management of its cost base and on tight control of its risk positions.

On 12 January 2012 the Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes will see the reorganisation of RBS's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities. The changes will ensure the wholesale businesses continue to deliver against the Group's strategy.

2011 compared with 2010

Operating profit fell by 54%, from £3,235 million for 2010 to £1,487 million for 2011, driven by a 27% decrease in revenue. The year was characterised by volatile and deteriorating credit markets, especially during the second half of the year when the European sovereign debt crisis drove a sharp widening in credit spreads.

Due to this deterioration in the markets both the Rates and Credit businesses suffered significantly, and income from trading activities fell from £4,307 million in 2010, to £3,251 million in 2011. The heightened volatility increased risk aversion amongst clients and limited opportunities for revenue generation in the secondary markets.

Portfolio Management and Origination revenue also fell sharply as clients curtailed new activity and continued to repay existing debt.

Total costs increased by 12% due to increased investment costs in 2011, which included a programme to meet new regulatory requirements.

Third party assets increased from £318.9 billion in 2010 to £345.2 billion in 2011 as a result of higher levels of activity and careful management of balance sheet exposures.

Central items

	2011 £m	2010 £m
Central items not allocated	(1,345)	(1,309)

Funding and operating costs have been allocated to operating divisions, based on direct service usage, requirement for market funding and other appropriate drivers where services span more than one division.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

2011 compared with 2010

Central items not allocated represented a charge of £1,345 million in 2011, an increase of £36 million compared with 2010.

Non-Core

	2011 £m	2010 £m
Net interest income	1,228	1,611
Net fees and commissions	72	243
Loss from trading activities	(613)	(55)
Other operating income	1,073	473
Non-interest income	532	661
Total income	1,760	2,272
Direct expenses		
- staff costs	(303)	(563)
- other	(529)	(812)
Indirect expenses	(116)	(156)
	(948)	(1,531)
Operating profit before impairment losses	812	741
Impairment losses	(3,869)	(5,476)
Operating loss	(3,057)	(4,735)

	£bn	£bn
Balance sheet		
Total assets (excluding derivatives)	83.9	122.4
Total assets (including derivatives)	94.8	139.1
Loans and advances to customers (gross)	72.7	98.6
Customer deposits	1.8	1.6

2011 compared with 2010

Total assets (excluding derivatives) fell to £84 billion in 2011. Ongoing disposal activity and portfolio run-off delivered a reduction of £38 billion compared to 2010.

2011 operating loss of £3,057 million was £1,678 million, or 35%, lower than 2010. The improvement in performance reflects the continued divestment of Non-Core and associated reductions in impairments and costs, partially offset by reduced income.

Total income fell by £512 million to £1,760 million in 2011. Net interest income reduced in line with the balance sheet. Losses from trading activities increased by £558 million compared with 2010, principally as a result of the disposal of RBS Sempra Commodities in 2010 and costs incurred as part of the division's focus on reducing capital intensive trading assets and mitigating future regulatory uplifts in risk-weighted assets. Other operating income improved following gains taken in relation to equity positions held within the division.

Divestment of Non-Core businesses and portfolios resulted in a reduction in direct costs of £543 million of which 62% related to the disposal of RBS Sempra Commodities.

Impairment losses fell by £1,607 million despite ongoing challenges in the real estate and Ulster Bank portfolios, reflecting improvements in other asset classes.

Consolidated balance sheet at 31 December 2011

	2011 £m	2010 £m
Assets		
Cash and balances at central banks	68,487	49,838
Net loans and advances to banks	59,380	46,975
Reverse repurchase agreements and stock borrowing	37,760	40,530
Loans and advances to banks	97,140	87,505
Net loans and advances to customers	428,142	469,161
Reverse repurchase agreements and stock borrowing	61,257	49,160
Loans and advances to customers	489,399	518,321
Debt securities	169,141	166,029
Equity shares	11,762	2,340
Settlement balances	6,902	8,748
Derivatives	532,807	429,005
Intangible assets	12,365	11,832
Property, plant and equipment	11,478	16,143
Deferred tax	3,320	1,790
Prepayments, accrued income and other assets	5,892	6,237
Assets of disposal groups	24,088	9,542
Total assets	1,432,781	1,307,330
Liabilities		
Bank deposits	70,197	56,626
Repurchase agreements and stock lending	38,900	28,594
Deposits by banks	109,097	85,220
Customer deposits	384,211	394,559
Repurchase agreements and stock lending	88,177	77,766
Customer accounts	472,388	472,325
Debt securities in issue	140,837	164,662
Settlement balances	6,778	8,501
Short positions	40,446	41,130
Derivatives	527,836	420,969
Accruals, deferred income and other liabilities	14,809	13,734
Retirement benefit liabilities	2,188	2,229
Deferred tax	1,384	1,422
Subordinated liabilities	32,324	32,023
Liabilities of disposal groups	22,840	7,508
Total liabilities	1,370,927	1,249,723
Non-controlling interests	128	597
Owners' equity	61,726	57,010
Total equity	61,854	57,607
Total liabilities and equity	1,432,781	1,307,330

Commentary on consolidated balance sheet

Total assets of £1,432.8 billion at 31 December 2011 were up £125.5 billion, 10%, compared with 31 December 2010. This principally reflects increases in cash and balances at central banks, the mark-to-market value of derivatives in Global Banking & Markets and equity shares, partly offset by a decrease in loans and advances to customers.

Cash and balances at central banks were up £18.6 billion, 37%, to £68.5 billion principally due to an improvement in the Group's structural liquidity position during 2011.

Loans and advances to banks increased by £9.6 billion, 11%, to £97.1 billion reflecting higher bank placings, up £12.4 billion, 26%, to £59.4 billion partly offset by lower reverse repurchase agreements and stock borrowing ('reverse repos'), down £2.8 billion, 7% to £37.7 billion.

Loans and advances to customers were down £28.9 billion, 6%, at £489.4 billion. Within this, reverse repos increased by 25%, £12.1 billion to £61.3 billion. Excluding reverse repos, lending decreased by £41.0 billion, 9% to £428.1 billion. This reflected the transfer to disposal groups of £18.7 billion of customer balances relating to the UK branch-based businesses together with declines in UK Corporate, Ulster Bank, UK Retail and Non-Core, offset in part by growth in Global Banking & Markets and US Retail and Commercial.

Debt securities increased by £3.1 billion, 2%, to £169.1 billion, driven mainly by increased holdings in Global Banking & Markets.

Equity shares increased by £9.4 billion to £11.8 billion as a result of the UK equities business having transferred from RBS N.V.

Settlement balances declined £1.8 billion, 21% to £6.9 billion as a result of decreased customer activity.

Movements in the value of derivative assets, up £103.8 billion, 24%, to £532.8 billion, and liabilities up £106.9 billion, 25%, to £527.8 billion, primarily reflect increases in interest rate contracts as a result of a significant downward shift in interest rates across all major currencies.

Deferred taxation increased £1.5 billion, 85%, to £3.3 billion, following the transfer of £3.0 billion from a fellow subsidiary, partially offset by the utilisation of tax losses brought forward.

The increase in assets and liabilities of disposal groups reflects the reclassification of the UK branch-based businesses and RBS Aviation Capital pending their disposal, partly offset by the completion of disposals, primarily the RBS Sempra Commodities JV and certain Non-Core project finance assets.

Deposits by banks increased by £23.9 billion, 28% to £109.1 billion due to increased inter-bank deposits, up £13.6 billion, 24%, to £70.2 billion and higher repurchase agreements and stock lending ('repos'), up £10.3 billion, 36%, to £38.9 billion.

Customer accounts were broadly flat at £472.4 billion. Within this, repos increased £10.4 billion, 13% to £88.2 billion. Excluding repos, deposits were down £10.3 billion, 3%, to £384.2 billion, reflecting the transfer to disposal groups of £21.8 billion customer balances relating to the UK branch-based businesses together with growth in UK Corporate, UK Retail and Global Transaction Services, partly offset by decreases in Global Banking & Markets and Ulster Bank.

Debt securities in issue were down £23.8 billion, 14% to £140.8 billion reflecting reductions in the level of certificates of deposit and commercial paper in Global Banking & Markets and Group Treasury.

Settlement balances declined £1.7 billion, 20% to £6.8 billion as a result of decreased customer activity.

Subordinated liabilities were up £0.3 billion, 1% to £32.3 billion, reflecting the issue of £0.9 billion undated loan capital partly offset by the redemption of £0.6 billion dated loan capital.

Non-controlling interests decreased by £0.5 billion, 79%, to £0.1 billion, due to the disposal of the majority of the RBS Sempra Commodities JV business.

Owners' equity increased by £4.7 billion, 8%, to £61.7 billion. This was due to increases in available-for-sale reserves of £1.3 billion and the cash flow hedging reserve of £1.1 billion together with capital contributions from the holding company of £4.5 billion, partly offset by the attributable loss for the period of £1.6 billion, actuarial losses of £0.5 billion and exchange rate and other movements of £0.1 billion.

Cash flow

	2011 £m	2010 £m
Net cash flows from operating activities	2,438	32,992
Net cash flows from investing activities	2,114	3,971
Net cash flows from financing activities	3,303	(1,480)
Effects of exchange rate changes on cash and cash equivalents	(1,196)	756
Net increase in cash and cash equivalents	6,659	36,239

2011

The major factors contributing to the net cash inflow from operating activities of £2,438 million were depreciation and amortisation of £1,590 million, the elimination of foreign exchange differences of £1,743 million and other non-cash items of £3,499 million, partially offset by the operating loss before tax of £864 million and a decrease of £3,645 million in operating assets and liabilities.

Net cash inflows from investing activities of £2,114 million related to the sale of property, plant and equipment of £1,794 million and net investments in business interests and intangible assets of £6,516 million partially offset by net outflows from sales and maturities of securities of £2,834 million and the purchase of property, plant and equipment of £3,362 million.

Net cash inflows from financing activities of £3,303 million primarily arose from the issue of subordinated liabilities of £940 million and a capital contribution of £4,539 million, offset in part by the redemption of non-controlling interests of £392 million, repayment of subordinated liabilities of £624 million and interest paid on subordinated liabilities of £1,062 million.

2010

The major factors contributing to the net cash inflow from operating activities of £32,992 million were the increase of £29,919 million in operating liabilities less operating assets, other non-cash items, £3,806 million, depreciation and amortisation, £1,689 million and interest on subordinated liabilities, £816 million. This was partly offset by the elimination of foreign exchange difference of £3,107 million.

Net cash inflows from investing activities of £3,971 million relate to the net inflows from sales and maturities of securities of £1,400 million and net investments in business interests and intangible assets of £2,607 million.

Net cash outflows from financing activities of £1,480 million primarily arose from the redemption of non-controlling interests of £549 million, dividends paid of £214 million, repayment of subordinated liabilities of £880 million and interest paid on subordinated liabilities of £895 million. This was offset in part by a capital contribution of £1,000 million.

Risk and balance sheet management

In this section (pages 24 to 162) of the Financial review, certain information has been audited and is part of the Group's financial statements as permitted by IFRS 7. Other disclosures are unaudited and are labelled with an asterisk (*).

Risk and balance sheet management are conducted on an overall basis within the RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these aspects reflect those in the RBS Group as relevant for businesses and operations in the Group. Data are provided for the Bank and its subsidiaries ('the Group'), as well as the Bank.

Introduction*

All the disclosures in this section (pages 24 to 31) are unaudited as indicated by an asterisk (*).

Risk management plays an integral role in the delivery of the RBS Group's strategic goal to be a safe and secure banking group. The implementation of a stronger and more effective culture of risk management and control provides the platform necessary to address historical vulnerabilities, rebuild upon the RBS Group's core strengths and position it on a sustainable and profitable path for future growth.

Financial strength and resilience are at the heart of the RBS Group's Strategic Plan. The RBS Group has defined this level of robustness as that which is capable of achieving and sustaining a standalone credit rating (i.e. without government support) that is in line with those of its strongest international peers.

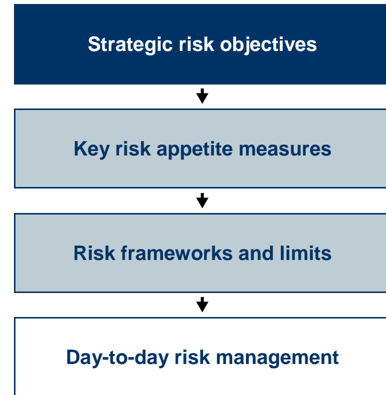
Given this central aim, in 2009 the RBS Group Board set out four key strategic risk objectives, aligned to the RBS Group's Strategic Plan. These are to:

- maintain capital adequacy: to ensure that the RBS Group has sufficient (and easily accessible) capital resources to meet regulatory requirements and to cover the potential for unexpected losses in its asset portfolio;
- deliver stable earnings growth: to ensure that strategic growth is based around a longer-term risk versus reward consideration, with significantly lower volatility in underlying profitability than was seen over the previous five years;
- ensure stable and efficient access to funding and liquidity: such that the RBS Group has sufficient funding to meet its obligations, taking account of the constraint that some forms of funding may not be available when they are most needed; and
- maintain stakeholder confidence: to ensure that stakeholders have confidence in the RBS Group's recovery plan, its ability to deliver its strategic objectives and the effectiveness of its business culture and operational controls.

Each objective is essential in its own right, but also mutually supportive of the others.

*unaudited

These strategic risk objectives are the bridge between the RBS Group-level business strategy and the frameworks, limits and tolerances that are used to set risk appetite and manage risk in the business divisions on a day-to-day basis.



In 2011, the RBS Group made significant progress in strengthening its approach to risk management in an external environment that remained challenging.

The task of setting a comprehensive risk appetite and aligning it with the RBS Group's business strategy demands a clear understanding of the types of risk the RBS Group faces and their potential size. With this goal in mind, over the past year the RBS Group has developed a catalogue of the risks it faces (a risk taxonomy) and undertaken a Group-wide material risk assessment to analyse the scale of each risk and the potential interactions between them (for a detailed discussion of risk appetite, see page 25).

The delivery of proactive and effective risk management relies on high quality data inputs on which to make assessments. It also requires robust forward-looking measurement and stress testing capabilities (see stress testing on page 26). Both of these areas continue to be enhanced and improvements embedded across the RBS Group.

Risk control frameworks are used to identify and address concentrations of risk. These systems are reinforced by the RBS Group Policy Framework (see page 26), which was enhanced during 2011, with assurance activity ongoing to ensure the policy standards it comprises remain appropriate.

Effective risk management also requires a robust governance framework. During 2011, the roles and responsibilities of the Executive Risk Forum and its supporting committees were reviewed and more clearly defined (see pages 28 to 30).

The RBS Group has launched a common set of values for the risk community that impact directly on behaviours and help to engender a risk management function that is widely respected and valued across the RBS Group. An RBS Group-wide policy that explicitly aligns remuneration with effective risk management has also been put in place.

The focus is now on fully embedding the RBS Group's strategy for risk management into the day-to-day management of its businesses, as well as preparing the RBS Group to face future challenges in a rapidly evolving external environment. More detailed discussions on how the RBS Group strengthened its approach to risk management in 2011 and the areas of focus going forward are contained within the relevant sub-sections on the following pages.

Risk appetite*

The RBS Group's focus on setting a clear risk appetite and embedding a strong culture of risk management and control is designed to ensure it is able to proactively identify and reduce risk exposures and has the resilience to respond effectively to any unforeseen shocks.

The RBS Group's risk appetite identifies and establishes the level and type of risks that it is able and willing to take in order to:

- *meet its strategic objectives* - this includes the RBS Group's stated objective of achieving and sustaining a standalone credit rating in line with those of its strongest international peers; and
- *meet its wider obligations to stakeholders* - the RBS Group's Strategic Plan is built on the core foundations of serving its customers well, acting responsibly and creating sustainable value for its shareholders.

A clear risk appetite provides a greater understanding across the RBS Group of the acceptable levels of risk for each business. It provides a solid platform from which the RBS Group can focus on its key business strengths and competitive advantages over the long-term.

Approach and key principles

The Strategic Plan set key performance indicators for capital, leverage, liquidity and funding, aligned with the RBS Group's strategic objectives. It also established a Non-Core division to manage, dispose of and run-off assets that the RBS Group was seeking to exit from, which by definition were outside its appetite.

Building on these core foundations, the RBS Group has developed a framework that sets and implements an appropriate risk appetite for the RBS Group (and its main businesses), supported by a regular monitoring and review process.

Under this framework, risk appetite targets - based on both the quantitative and qualitative aspects of risk - have been set by the RBS Group Board, aligned with the RBS Group and divisional strategic objectives. These targets support and augment the strategic, financial and risk controls that are already in place and help to shape the way the RBS Group operates at all levels. Clear roles and responsibilities are established to measure, cascade and report performance against risk appetite and to provide assurances that business is being conducted within approved risk limits and tolerances.

The development of this framework has been based on the following best practice principles:

- strong leadership from the RBS Group Board in establishing and setting risk appetite and in ensuring its purpose is understood and its use promoted as good business practice;
- a strong risk management culture, in which risk is clearly and meaningfully aligned with business behaviours and outcomes;
- a close collaborative partnership between the risk, strategy, treasury and finance functions that facilitates a broader internal debate on key issues; and
- clear accountability by each division (and business unit) for the level of risk it is prepared to take to achieve its business objectives.

RBS Group-wide stress testing is used to assess whether strategic plans are consistent with risk appetite and to measure the key drivers of risk (down to business unit level), with mitigating actions identified whenever the risk profile is considered to be outside (or close to) acceptable levels (see page 26).

Design to delivery

The RBS Group's risk appetite has been set by the RBS Group Board and is now operational. Significant progress has been made in establishing the underlying framework and rolling it out across the RBS Group and its divisions.

The key channels through which risk appetite is cascaded throughout and embedded in each division are:

- *divisional risk appetite statements* - each division has developed its own risk appetite statement, which is based on the four strategic risk objectives and is appropriate for its business plans but also aligned with the RBS Group's risk appetite targets;
- *risk control frameworks and limits* - risk control frameworks set clear guidance on acceptable limits and tolerances for all material risk types (e.g. credit, market and country risk), aligned with the RBS Group's risk appetite targets;
- *Group operational and conduct risk appetite* - the RBS Group has developed a robust control environment to ensure it conducts its activities in accordance with its regulatory and other obligations; and
- *culture, values and remuneration* - a programme of communication, engagement and training is being rolled out across the RBS Group to engender a wide understanding of the purpose of risk appetite.

The RBS Group regards the implementation of its risk appetite framework as an essential step in driving the cultural change required to achieve its strategic objectives and a dynamic, ongoing process. The Board Risk Committee reviews both the targets and the framework on a regular basis, to ensure they remain aligned to strategic objectives, business performance, emerging risks and changes in the external environment.

Introduction*: Stress testing

Stress testing describes the evaluation of a bank's financial position under severe but plausible stress scenarios. Stress testing refers to the application of individual stress tests and the broader framework under which these tests are developed, evaluated and used within the RBS Group's decision-making process in the context of the wider economic environment.

Internal stress tests

The RBS Group's stress testing framework is designed to embed stress testing as a key risk management technique into mainstream risk reporting, capital planning and business processes at both RBS Group and divisional levels.

The Executive Risk Forum (see Risk governance on page 29) is the main body overseeing the RBS Group's stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any RBS Group-wide stress test and ensuring that, where necessary, appropriate management actions are undertaken. The Board Risk Committee will provide oversight and challenge as appropriate.

Stress testing forms part of the RBS Group's risk and capital management framework and is a major component of the Group's Basel III requirements. It highlights to senior management potential adverse unexpected outcomes related to a mixture of risks and provides an indication of how much capital might be required to absorb losses should adverse scenarios materialise.

Stress testing is used at both divisional and the RBS Group levels to assess risk concentrations and estimate the impact of stressed earnings, impairments and write-downs on capital as well as the liquidity and funding position of the RBS Group. It determines overall capital adequacy under a variety of adverse scenarios.

A series of stress events are monitored on a regular basis to assess the potential impact of a severe yet plausible event on the RBS Group. There are four core types of scenario stress testing:

- macroeconomic stress testing, which considers the impact on both earnings and capital for a range of scenarios;
- enterprise-wide stress testing, which considers scenarios that are not macroeconomic in nature but are sufficiently broad to entail multiple risks or affect multiple divisions and are likely to affect earnings, capital and funding;
- cross-divisional stress testing, which includes scenarios that affect multiple divisions due to their sensitivity to a common risk factor; and
- divisional and risk-specific stress testing, which is undertaken to support risk identification and management.

Portfolio analysis, using historical performance and forward-looking indicators of change, uses stress testing to assess potential exposure to events and seeks to quantify the impact of an adverse change in factors that drive the performance and profitability of a portfolio.

Industry-wide stress tests

The RBS Group takes part in a number of industry-wide stress tests, in particular, the European Banking Authority Stress Test and IMF UK Financial Sector Assessment Program, results of which were published in July 2011. These confirmed that the RBS Group remains well capitalised with a strong Core Tier 1 capital ratio and a strong Total capital ratio under both baseline and adverse scenarios. During 2011, the RBS Group also undertook the FSA anchor scenario test.

In December 2011, the European Banking Authority published the results of its recapitalisation exercise - a review of banks' actual capital positions on sovereign exposures - showing the RBS Group had no overall capital shortfall after including the sovereign capital buffer.

Group Policy Framework*

Achieving and sustaining a robust control framework in line with those of the RBS Group's strongest international peers is critical to achieving the successful delivery of its risk objectives.

With this goal in mind, the Group Policy Framework (GPF) has been revised and broadened. The GPF consolidates a large number of individual policies under a consistent and structured overarching framework for conduct, control and governance. It provides clear guidance and controls on how the RBS Group does business, linked to its risk appetite, its business conduct and compliance responsibilities and its focus on delivering a control environment consistent with best practice against relevant external benchmarks.

The GPF and related initiatives aim to ensure that:

- the RBS Group has clear control standards and ethical principles to cover the risks that it faces to support effective risk management and meet regulatory and legal requirements;
- policies are followed across the RBS Group and compliance can be clearly evidenced, assessed and reported by line management; and
- the control environment is monitored and overseen through good governance.

Communication and training programmes are provided to all relevant staff as the policies are embedded, ensuring that staff are aware of their responsibilities. The GPF is structured to ensure that policy standard owners and sponsors review their policies on a regular basis, with any identified shortfalls against industry best practice documented and addressed within an agreed time frame.

*unaudited

The GPF was introduced in 2009. Enhancements applied in 2011 included the following:

- the RBS Group's policy standards, which comprise the GPF, were rewritten to ensure they clearly express the mandatory controls required to mitigate the key risks the Group faces;
- all of the RBS Group's policy standards were benchmarked against relevant external reference points such as peer organisations to challenge and verify the content of the policy standards. Where identified, further improvements to the policy standards are now being implemented;
- for each policy standard, appropriate risk based assurance activity was introduced to ensure each division is appropriately controlled and compliance with policy can be demonstrated; and
- risk appetite has its own policy standard within the GPF that clearly sets out roles and responsibilities in relation to the implementation of the risk appetite framework and provides assurance that risks are being actively managed within approved levels and tolerances.

The GPF will continue to be improved and embedded. The results of assurance activity, monitoring and analysis of the internal and external environment will be used to reassess the policy standards on a regular basis.

Risk governance*

The RBS Group is committed to achieving the highest standards of corporate governance in every aspect of the business, including risk management.

A key aspect of the RBS Group Board's responsibility as the main decision making body at RBS Group level is the setting of RBS Group risk appetite to ensure that the levels of risk that the RBS Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood.

To enable the RBS Group Board to carry out its objectives, it has delegated authority to senior Board and executive committees, as required and appropriate. A number of key committees specifically consider risk across the RBS Group, as set out in the diagram below.

comprises independent non-executive directors

Notes:
(1) The Capital and Stress Testing Committee is a sub-committee of the Group Asset and Liability Management Committee.
(2) The following specialist sub-committees report directly to the Group Risk Committee: Global Market Risk Committee, Group Country Risk Committee, Group Models Committee, Group Credit Risk Committee and Operational Risk Executive Committee. In addition, Divisional Risk Committees report to the Group Risk Committee.

Introduction*: Risk governance continued

The key risk responsibilities of each of these committees as well as their membership are set out in the table below.

These committees are supported at a divisional level by a risk governance structure embedded in the business. These committees play a key role in ensuring that the RBS Group's risk appetite is supported by effective risk management frameworks, limits and policies, together with clear accountabilities for approval, monitoring, oversight, reporting and escalation.

During 2011, the roles and responsibilities of the Executive Risk Forum and its supporting committees were reviewed and more clearly defined, to meet the future needs of the RBS Group.

In particular, the Executive Risk Forum was repositioned as a strategic committee focusing on strategic level risks and issues, and retaining the approval authority for the most material risk limits and decisions.

The Group Risk Committee was refocused to operate primarily as an oversight committee across risk types, concentrating particularly on thematic and emerging risks and issues.

The committees that sit below the Group Risk Committee were streamlined significantly, aligned more closely to key risk types and given clearer empowerment and accountability where required.

A Capital and Stress Testing Committee was created as a sub-committee of the RBS Group Asset and Liability Management Committee to cover risk and capital matters.

The improvements made in 2011 provide further clarity of roles and responsibilities, as well as clear reporting lines and accountabilities. They promote clearer and timelier decision making and more effective risk management and oversight.

The role and remit of the RBS Group committees is set out below. These committees are supported at a divisional level by a risk governance structure embedded in the business.

Board/Committee	Risk focus	Membership
Group Board	The Group Board ensures that the RBS Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer-term strategic threats to the Group's business operations.	The Board of directors
Executive Committee	The Executive Committee considers recommendations on risk management matters referred by the Executive Risk Forum and/or Group Risk Committee, including recommendations on risk appetite, risk policies and risk management strategies.	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers of divisions Head of Restructuring and Risk
Board Risk Committee	The Board Risk Committee provides oversight and advice to the Group Board on current and potential future risk exposures of the Group and future risk strategy, including determination of risk appetite and tolerance. It also provides a risk review of remuneration arrangements and provides advice to the Remuneration Committee. It operates under delegated authority from the Group Board.	At least three independent non-executive directors, one of whom is the Chairman of the Group Audit Committee.
Group Audit Committee	The Group Audit Committee reviews accounting policies and practices, controls and procedures established by management for compliance with regulatory and financial reporting requirements and requirements of external regulations. It has responsibility for monitoring relationships with regulatory authorities. It operates under delegated authority from the Group Board.	At least three independent non-executive directors, at least one of whom is a financial expert as defined in the SEC rules under the US Exchange Act and one of whom is Chairman of the Board Risk Committee.

*unaudited

Board/Committee	Risk focus	Membership
Group Remuneration Committee	The Group Remuneration Committee is responsible for the overview of the Group's policy on remuneration and receives advice from Risk Management and the Board Risk Committee to ensure that there is thorough risk input into incentive plan design and target setting as well as risk review of performance bonus pools and clawback. It operates under delegated authority from the Group Board.	At least three independent non-executive directors
Executive Risk Forum	The Executive Risk Forum operates as a committee of the Executive Committee with full authority to act on all risk and control matters across the RBS Group. The Executive Risk Forum approves the most material limits and decisions above defined thresholds and delegates decisions below these thresholds to sub-committees and appropriate individuals.	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers of divisions Head of Restructuring and Risk Deputy Chief Risk Officer
Group Asset and Liability Management Committee	The Group Asset and Liability Management Committee (GALCO) is a sub-committee of the Executive Risk Forum and is responsible for identifying, managing and controlling Group balance sheet risks in executing its chosen business strategy.	Group Finance Director Group Treasurer Chief Executive Officers of divisions Head of Restructuring and Risk Key Group Finance function heads Global Head of Markets
Group Risk Committee	The Group Risk Committee is a sub-committee of the Executive Risk Forum. It is an oversight committee which reviews and challenges risk and limits across the functional areas and plays a key role exercising and demonstrating effective risk oversight across the RBS Group. It reviews risks and issues on a thematic as well as a specific basis and focuses on forward-looking, emerging risks. It considers the overall risk profile across the RBS Group and identifies any key issues for escalation to the Executive Risk Forum.	Deputy Chief Risk Officer Divisional Chief Risk Officers Key Group Risk function heads
Capital and Stress Testing Committee	The Capital and Stress Testing Committee is a sub-committee of the Group Asset and Liability Management Committee and focuses on the broad risk capital agenda, including risk appetite, capital usage, stress testing, the Internal Capital Adequacy Assessment Process, capital planning, allocation and management, economic capital and prudential developments, including Basel oversight.	Group Finance Director Key Group Finance function heads Key Group Risk function heads

Introduction*: Risk governance continued

Board/Committee	Risk focus	Membership
Executive Credit Group	The Executive Credit Group decides on requests for the extension of existing or new credit limits on behalf of the RBS Group Board where the proposed aggregate facility limits are in excess of the credit approval authorities granted to individuals in divisions or in Group Risk Management, or where an appeal against a decline decision of the Group Chief Credit Officer (or delegates) or Group Chief Risk Officer is referred for final decision.	Group A members (1) Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer/Chief Credit Officer N.V. Head of Global Restructuring Group Chief Risk Officer, Non-Core division/APS (alternate) Group B members (1) Group Chief Executive Group Finance Director Divisional Chief Executive Officers (1) Decisions require input from at least one member from each of Group A and Group B.
Divisional Risk and Audit Committees	Divisional Risk and Audit Committees report to the Board Risk Committee and the Group Audit Committee on a quarterly basis. Their main responsibilities are to: • monitor the performance of the divisions relative to divisional and Group risk appetite; • review matters relative to accounting policies, internal control, financial reporting, internal audit, external audit and regulatory compliance as set out in their terms of reference; and • assist on such other matters as may be referred to them by the relevant divisional Executive Committee, the Group Audit Committee or the Board Risk Committee.	Members: at least three non-executive members who are executives of the RBS Group who do not have executive responsibility in the relevant division. Attendees: at least two executives of the division, as appropriate. Representatives from finance, risk, internal audit and external audit. Members of the Board Risk Committee and Group Audit Committee also have the right to attend.

*unaudited

Introduction*: Risk coverage

The main risk types facing the RBS Group, which are covered by the risk appetite framework and managed by the above committees, are shown below:

Risk type	Definition	Features
Capital, liquidity and funding risk	The risk that the Group has insufficient capital or is unable to meet its financial liabilities as they fall due.	Potential to disrupt the business model and stop normal functions of the Group. Potential to cause the Group to fail to meet the supervisory requirements of regulators. Significantly driven by credit risk losses. Refer to pages 32 to 48.
Credit risk (including counterparty risk)	The risk that the Group will incur losses owing to the failure of a customer to meet its obligation to settle outstanding amounts.	Loss characteristics vary materially across portfolios. Significant link between losses and the macroeconomic environment. Can include concentration risk - the risk of loss due to the concentration of credit risk to a specific product, asset class, sector or counterparty. Refer to pages 49 to 126.
Country risk	The risk of material losses arising from significant country-specific events.	Can arise from sovereign events, economic events, political events, natural disasters or conflicts. Potential to affect parts of the Group's credit portfolio that are directly or indirectly linked to the country in question. Refer to pages 127 to 143.
Market risk	The risk arising from changes in interest rates, foreign currency, credit spreads, equity prices and risk related factors such as market volatilities.	Frequent small losses which are material in aggregate. Infrequent large material losses due to stress events. Refer to pages 144 to 148.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent material losses. Refer to pages 149 to 151.
Compliance risk	The risk arising from non-compliance with national and international laws, rules and regulations.	Adverse impacts on strategy, capital structure, business models and operational effectiveness. Financial cost of adapting to changes in laws, rules or regulations or of penalties for non-compliance. Refer to pages 151 to 155.
Reputational risk	The risk of brand damage arising from financial and non-financial events arising from the failure to meet stakeholders' expectations of the Group's performance and behaviour.	Potential to put the entire business at risk. Otherwise, could lead to negative publicity, loss of revenue, costly litigation or a decline in customer base. Can arise from actions taken by the Group or a failure to take action. Refer to page 156.
Business risk	The risk of lower-than-expected revenues and/or higher-than-expected operating costs.	Influenced by many factors such as pricing, sales volume, input costs, regulations and market and economic conditions. Refer to page 156.
Pension risk	The risk that the Group will have to make additional contributions to its defined benefit pension schemes.	Funding position can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities. Refer to pages 157 and 158.

Each risk type maps into the RBS Group's risk appetite framework and contributes to the overall achievement of its strategic objectives with underlying frameworks and limits. The key frameworks and developments over the past year are described in the relevant sections indicated above.

Balance sheet management

All disclosures in this section (pages 32 to 48) are audited unless otherwise indicated by an asterisk (*).

Two of the RBS Group's four key strategic risk objectives relate to the maintenance of capital adequacy and ensuring stable and efficient access to liquidity and funding. This section on balance sheet management explains how the RBS Group is performing on achieving these objectives.

Capital management

Introduction*

The Group aims to maintain an appropriate level of capital to operate within the agreed risk appetite whilst optimising the use of shareholders' funds to deliver sustainable returns.

The appropriate level of capital is determined based on the dual aims of: (i) meeting minimum regulatory capital requirements; and (ii) ensuring the RBS Group maintains sufficient capital to uphold investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

Governance*

The RBS Group Asset and Liability Management Committee (GALCO) is responsible for ensuring the Group maintains adequate capital at all times. The newly established Capital and Stress Testing Committee (CAST) is a cross-functional body driving and directing integrated risk capital activities including stress testing economic capital and capital allocation. These activities have linkages to capital planning, risk appetite and regulatory change. CAST reports through GALCO and comprises senior representatives from Risk Management, Group Finance and Group Treasury.

Determining appropriate capital*

The minimum regulatory capital requirements are identified by RBS Group through the Internal Capital Adequacy Assessment Process and then agreed between the RBS Group Board and the appropriate supervisory authority.

The Group's own determination of how much capital is sufficient is derived from the desired credit rating level and the application of both internally and externally defined stress tests that identify potential changes in capital ratios over time.

Monitoring and maintenance*

Based on these determinations, which are continually reassessed, the Group aims to maintain capital adequacy both at Group level and in each regulated entity.

The RBS Group operates a rigorous capital planning process aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital positions of the regulated entities and the overall RBS Group. In the event that the projected position deteriorates beyond acceptable levels, the RBS Group would issue further capital and/or revise business plans accordingly.

Stress testing approaches are used to determine the level of capital required to ensure the RBS Group remains adequately capitalised.

Capital allocation*

Capital resources are allocated to the Group's businesses based on key performance parameters agreed by the RBS Group Board in the annual strategic planning process. Chief among these is a profitability metric which assesses the effective use of the capital allocated to the business. Projected and actual return on equity is assessed against the target returns set by the RBS Group Board. The allocations also reflect strategic priorities and balance sheet and funding metrics.

Economic profit is also planned and measured for each division during the annual planning process. It is calculated by deducting the cost of equity utilised in the particular business from its operating profit and measures the value added over and above the cost of equity.

The Group aims to deliver sustainable returns across the portfolio of businesses with projected business returns stressed to test key vulnerabilities.

The divisions use return on capital metrics when making pricing decisions on products and transactions with a view to ensuring customer activity is appropriately aligned with RBS Group and divisional targets and allocations.

The FSA uses the risk asset ratio as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its RWAs (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks); by international agreement the risk asset ratios should not be less that 8% with a Tier 1 component of not less than 4%.

* unaudited

Capital adequacy*

The Group's RWAs and risk asset ratios, calculated in accordance with FSA definitions are set out below.

	Group		
Risk-weighted assets by risk	2011 £bn	2010 £bn	2009 £bn
Credit risk	311.9	349.4	350.8
Counterparty risk	59.7	51.1	59.4
Market risk	59.4	78.9	63.2
Operational risk	37.0	35.9	33.7
	468.0	515.3	507.1
Asset Protection Scheme relief	(69.1)	(105.6)	(116.3)
	398.9	409.7	390.8

Risk asset ratios	%	%	%
Core Tier 1	9.2	8.4	8.6
Tier 1	11.0	10.1	10.5
Total	14.6	13.6	14.8

Key points

- Market risk RWAs were impacted by the new CRD III rules but decreased overall in 2011 reflecting re-risking of Non-Core and a reduction in trading VaR.
- APS relief decreased during 2011 reflecting pool movements, assets moving into default and changes in risk parameters.

Capital resources

The Group's regulatory capital resources in accordance with FSA definitions were as follows:

Shareholders' equity (excluding non-controlling interests)	2011 £m	2010 £m	2009 £m
Shareholders' equity per balance sheet	61,726	57,010	55,051
Other equity instruments	(1,421)	(1,421)	(1,421)
	60,305	55,589	53,630
Non-controlling interests per balance sheet	128	597	1,146
Regulatory adjustments and deductions			
Own credit	(1,157)	(622)	(650)
Unrealised (gains)/losses on AFS debt securities	(2,114)	(843)	279
Unrealised gains on AFS equity shares	(106)	(74)	(111)
Cash flow hedging reserve	(1,018)	81	129
Other adjustments for regulatory purposes	(230)	(277)	(586)
Goodwill and other intangible assets	(12,365)	(11,832)	(11,814)
50% excess of expected losses over impairment provisions (net of tax)	(2,553)	(1,998)	(2,560)
50% of securitisation positions	(1,605)	(1,916)	(1,270)
50% of APS first loss	(2,763)	(4,225)	(4,654)
	(23,911)	(21,706)	(21,237)
Core Tier 1 capital	36,522	34,480	33,539
Other Tier 1 capital			
Preference shares - debt	2,857	2,890	2,883
Innovative/hybrid Tier 1 securities	3,645	3,638	3,542
	6,502	6,528	6,425
Tier 1 deductions			
50% of material holdings	(235)	(242)	(132)
Tax on excess of expected losses over impairment provisions	920	797	1,020
	685	555	888
Total Tier 1 capital	43,709	41,563	40,852

Balance sheet management: Capital management continued

Qualifying Tier 2 capital	2011 £m	2010 £m	2009 £m
Undated subordinated debt	4,916	4,925	7,170
Dated subordinated debt - net of amortisation	17,272	18,067	18,860
Reserves arising on revaluation of property	—	—	73
Unrealised gains on AFS equity shares	106	74	111
Collectively assessed impairment provisions	584	672	796
Non-controlling Tier 2 capital	11	11	11
	22,889	23,749	27,021
Tier 2 deductions			
50% of securitisation positions	(1,605)	(1,916)	(1,270)
50% excess of expected losses over impairment provisions	(3,473)	(2,795)	(3,580)
50% of material holdings	(235)	(242)	(132)
50% of APS first loss	(2,763)	(4,225)	(4,654)
	(8,076)	(9,178)	(9,636)
Total Tier 2 capital	14,813	14,571	17,385
Supervisory deductions			
Unconsolidated investments	(111)	(116)	(121)
Other deductions	(184)	(267)	(93)
	(295)	(383)	(214)
Total regulatory capital	58,227	55,751	58,023

Movement in Core Tier 1 capital	2011 £m
At beginning of the year	34,480
Additional capital provided by parent undertaking	4,539
Attributable loss net of movements in fair value of own debt	(2,130)
Foreign currency reserves	(198)
Decrease in non-controlling interests	(469)
Increase in goodwill and other intangible assets	(533)
Decrease in capital deductions including APS first loss	1,218
Other movements	(385)
At end of the year	36,522

Asset Protection Scheme*

The Group acceded to the Asset Protection Scheme (APS or 'the Scheme') in December 2009.

Following the accession to the APS, HM Treasury provides loss protection against potential losses arising in a pool of assets. HM Treasury also subscribed to £25.5 billion of capital in the form of B shares and a Dividend Access Share, with a further £8 billion of capital in the form of B shares potentially available as contingent capital. The RBS Group pays annual fees in respect of the protection and contingent capital. The RBS Group has the option, subject to HM Treasury consent, to pay the annual premium, contingent capital and the exit fee payable in connection with any termination of the RBS Group's participation in the APS in whole or in part, by waiving the entitlements of members of the RBS Group to certain UK tax reliefs.

Following accession to the APS, arrangements were put in place within the RBS Group that extended effective APS protection to all other regulated entities holding assets covered by the APS.

* unaudited

Regulatory capital impact of the APS*

Methodology

The regulatory capital requirements for assets covered by the Scheme are calculated using the securitisation framework under the FSA prudential rules. The calculation is as follows (known as 'the uncapped amount'):

- *First loss* - the residual first loss, after impairments and write-downs, to date, is deducted from available capital, split equally between Core Tier 1 and Tier 2 capital;
- *HM Treasury share of covered losses* - after the first loss has been deducted, 90% of assets covered by HM Treasury are risk-weighted at nil; and
- *RBS share of covered losses* - the remaining 10% share of loss is borne by the RBS Group and is risk-weighted in the normal way.

Should the uncapped amount be higher than the capital requirements for the underlying assets calculated as normal, ignoring the Scheme, the capital requirements for the Scheme are capped at the level of the requirements for the underlying assets ('capped amount'). Where capped, the Group apportions the capped amount up to the level of the first loss as calculated above; any unused capped amount after the first loss capital deduction will be taken as RWAs for the Group's share of covered losses.

Adjustments to the regulatory capital calculation can be made for either currency or maturity mismatches. These occur where there is a difference between the currency or maturity of the protection and that of the underlying asset. These mismatches will have an impact upon the timing of the removal of the cap and level of regulatory capital benefit on the uncapped amount, but this effect is not material.

Impact

The RBS Group calculates its capital requirements in accordance with the capped basis. Accordingly, the APS has no impact on the Pillar 1 regulatory capital requirement in respect of the assets covered by the APS. It does, however, improve the Core Tier 1 capital ratios of the Group. The protection afforded by the APS assists the RBS Group in satisfying the forward-looking stress testing framework applied by the FSA.

Future regulatory capital effects

As impairments or write-downs on the pool of assets are recognised, they reduce the Core Tier 1 capital in the normal way. This will reduce the first loss deduction for the Scheme, potentially leading to a position where the capital requirement on the uncapped basis would no longer, for the assets covered by the APS, exceed the Non-APS requirement and as a result, the Group would expect to start reporting the regulatory capital treatment on the uncapped basis.

For further information on the assets covered by APS see pages 159 to 161.

Basel III*

The rules issued by the Basel Committee on Banking Supervision (BCBS), commonly referred to as Basel III, are a comprehensive set of reforms designed to strengthen the regulation, supervision, risk and liquidity management of the banking sector. In the EU they will be enacted through a revised Capital Requirements Directive referred to as CRD IV.

In December 2010, the BCBS issued the final text of the Basel III rules, providing details of the global standards agreed by the Group of Governors and Heads of Supervision, the oversight body of the BCBS and endorsed by the G20 leaders at their November 2010 Seoul summit. There are transition arrangements proposed for implementing these new standards as follows:

- National implementation of increased capital requirements will begin on 1 January 2013;
- There will be a phased five year implementation of new deductions and regulatory adjustments to Core Tier 1 capital commencing on 1 January 2014;
- The de-recognition of non-qualifying non-common Tier 1 and Tier 2 capital instruments will be phased in over 10 years from 1 January 2013; and
- Requirements for changes to minimum capital ratios, including conservation and countercyclical buffers, as well as additional requirements for Global Systemically Important Banks, will be phased in from 2013 to 2019.

The Group, in conjunction with the FSA, regularly evaluates its models for the assessment of RWAs ascribed to credit risk across various classes. This, together with the changes introduced by CRD IV relating primarily to counterparty risk, is expected to increase RWA requirements by the end of 2013 by £45 billion to £60 billion. These estimates are still subject to change; a degree of uncertainty remains around implementation details as the guidelines are not finalised and must still be enacted into EU law. There could be other future changes and associated impacts from these model reviews.

Other regulatory capital changes*

The Group is in the process of implementing changes to the RWA requirements for commercial real estate portfolios consistent with revised industry guidance from the FSA. This is projected to increase RWA requirements by circa £20 billion by the end of 2013, of which circa £10 billion will apply in 2012.

The Group is managing the changes to capital requirements from new regulation and model changes and the resulting impact on the common equity Tier 1 ratio, focusing on risk reduction and deleveraging. This is principally being achieved through the continued run-down and disposal of Non-Core assets and deleveraging in GBM as the business focuses on the most productive returns on capital.

The major categories of new deductions and regulatory adjustments which are being phased in over a five year period from 1 January 2014 include:

- Expected loss net of provisions;
- Deferred tax assets not relating to timing differences;
- Unrealised losses on available-for-sale securities; and
- Significant investments in non-consolidated financial institutions.

The net impact of these changes is expected to be manageable as the aggregation of these drivers is projected to be lower by 2014 and declining during the phase-in period.

Balance sheet management: Liquidity and funding risk

All disclosures in this section (pages 36 to 48) are audited unless otherwise indicated with an asterisk (*).

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its obligations, including financing maturities as they fall due. Liquidity risk is heavily influenced by the maturity profile and mix of the RBS Group's funding base, as well as the quality and liquidity value of its liquidity portfolio.

Liquidity risk is dynamic, being influenced by movements in markets and perceptions that are driven by firm specific or external factors. Managing liquidity risk effectively is a key component of the Group's risk reduction strategy. The Group's 2011 performance demonstrates continued improvements in managing liquidity risk and reflects actions taken in light of an uncertain economic outlook, which resulted in improvements in key measures:

- Deposit growth - Non-Core deleveraging, together with growth in Core retail and commercial deposits, took the Group loan:deposit ratio to 111%, compared with 122% at the end of 2010.

- Short-term wholesale funding (STWF) - the overall level of STWF fell by £17 billion to £85 billion.

- Liquidity portfolio - the liquidity portfolio of £132 billion was maintained against a backdrop of heightened market uncertainty in the second half of the year and was higher than STWF. This represents a £47 billion cushion over STWF.

Funding issuance

The Group has access to a variety of funding sources across the globe, including short-term money markets, repurchase agreement markets and term debt investors through its secured and unsecured funding programmes. Diversity in funding is provided by its active role in the money markets, along with access to global capital flows through GBM's international client base. The Group's wholesale funding franchise is well diversified by currency, geography, maturity and type.

Balance sheet composition

The Group's balance sheet composition is a function of the broad array of product offerings and diverse markets served by its Core divisions. The structural composition of the balance sheet is augmented as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

Diversification of the Group's funding base is central to its balance sheet management strategy. The Group's businesses have developed large customer franchises based on strong relationship management and high quality service. These customer franchises are strongest in the UK, the US and Ireland, but extend into Europe and Asia. Customer deposits provide large pools of stable funding to support the majority of the RBS Group's lending.

The Group also accesses professional markets funding by way of public and private debt issuances on an unsecured and secured basis. These debt issuance programmes are spread across multiple currencies and maturities, to appeal to a broad range of investor types and preferences around the world. This market-based funding supplements the RBS Group's structural liquidity needs and, in some cases, achieves certain capital objectives.

Stress testing

The strength of a bank's liquidity risk management can only be evaluated based on its ability to survive under stress. The RBS Group evaluates the survivability of the major legal entities and legal entity groups when subjected to simulated stress conditions.

Simulated liquidity stress testing is periodically performed for each business as well as the major operating subsidiaries. A variety of firm-specific and market-related scenarios are used at the consolidated level and in individual countries. These scenarios include assumptions about significant changes in key funding sources, credit ratings, contingent uses of funding, and political and economic conditions in certain countries.

The RBS Group's actual experiences from the 2008 and 2009 period factor heavily into the liquidity analysis. This systemic and name-specific crisis provides important data points in estimating stress severity.

Stress scenarios are applied to both on-balance sheet and off-balance sheet commitments, to provide a comprehensive view of potential cash flows.

Contingency planning

The RBS Group has a Contingency Funding Plan (CFP), which is updated as the balance sheet evolves. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. Limits in the business-as-usual environment are bounded by capacity to satisfy the RBS Group's liquidity needs in the stress environments. The CFP provides a detailed description of the availability, size and timing of all sources of contingent liquidity available to the RBS Group in a stress event. These are ranked in order of economic impact and effectiveness to meet the anticipated stress requirement. The CFP includes documented procedures and sign-offs for actions that may require businesses to provide access to customer assets for collateralised borrowing, securitisation or sale. Roles and responsibilities for the effective implementation of the CFP are also documented.

Liquidity reserves

The RBS Group maintains liquidity reserves sufficient to satisfy cash requirements, in the event of a severe disruption in its access to funding sources. The reserves consist of cash held on deposit at central banks, high quality unencumbered government securities and other unencumbered collateral. Government securities vary by type and jurisdiction based on local regulatory considerations. The currency mix of the reserves reflects the underlying balance sheet composition.

* unaudited

Regulatory oversight

The RBS Group operates in multiple jurisdictions and is subject to a number of regulatory regimes.

The Group's lead regulator is the UK Financial Services Authority (FSA). The FSA implemented a new liquidity regime on 1 June 2010. The new rules provide a standardised approach applied to all UK banks. At Group, the rules focus on UK Defined Liquidity Group (a subset comprising the Group's five UK banks, The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Co) and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment (ILAA). The ILAA informs the RBS Group Board and the FSA of the assessment and quantification of the RBS Group's liquidity risks and their mitigation, and how much current and future liquidity is required.

In the US, the Group's operations must meet liquidity requirements set out by the US Federal Reserve Bank, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Financial Industry Regulatory Authority.

Regulatory developments*

There have been a number of significant developments in the regulation of liquidity risk.

In December 2010, the Basel Committee on Banking Supervision issued the 'International framework for liquidity risk measurement, standards and monitoring' which confirmed the introduction of two liquidity ratios: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

The introduction of both of these ratios will be subject to an observation period, which includes review clauses to identify and address any unintended consequences.

After an observation period beginning in 2011, the LCR, including any revisions, will be introduced on 1 January 2015. The NSFR, including any revisions, will move to a minimum standard by 1 January 2018.

Funding sources

The table below shows the Group's primary funding sources including deposits in disposal groups and excluding third party repurchase agreements.

	2011			2010			2009		
	Third party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m	Third party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m	Third party £m	Amounts due to holding company and fellow subsidiaries £m	Total £m
Deposits by banks									
- central banks	3,680	—	3,680	6,655	—	6,655	8,535	—	8,535
- cash collateral	30,884	—	30,884	26,639	—	26,639	28,246	—	28,246
- other deposits	23,688	11,945	35,633	16,972	6,626	23,598	35,447	8,888	44,335
	58,252	11,945	70,197	50,266	6,626	56,892	72,228	8,888	81,116
Debt securities in issue									
- conduit asset backed commercial paper (ABCP)	11,164	—	11,164	15,075	—	15,075	17,888	—	17,888
- other commercial paper (CP)	3,031	—	3,031	4,689	—	4,689	5,328	—	5,328
- certificates of deposit (CDs)	14,422	—	14,422	35,370	—	35,370	56,585	—	56,585
- medium-term notes (MTNs)	88,405	—	88,405	86,606	—	86,606	76,738	—	76,738
- covered bonds	9,107	—	9,107	4,100	—	4,100	—	—	—
- securitisations	14,708	—	14,708	18,822	—	18,822	15,874	—	15,874
	140,837	—	140,837	164,662	—	164,662	172,413	—	172,413
Subordinated liabilities	16,552	15,772	32,324	16,995	15,028	32,023	19,751	14,966	34,717
Notes issued	157,389	15,772	173,161	181,657	15,028	196,685	192,164	14,966	207,130
Wholesale funding	215,641	27,717	243,358	231,923	21,654	253,577	264,392	23,854	288,246
Customer deposits									
- cash collateral	9,025	—	9,025	9,623	—	9,623	7,970	—	7,970
- other deposits	393,827	3,179	397,006	376,902	8,934	385,836	362,477	18,791	381,268
Total customer deposits	402,852	3,179	406,031	386,525	8,934	395,459	370,447	18,791	389,238
Total funding	618,493	30,896	649,389	618,448	30,588	649,036	634,839	42,645	677,484
Disposal group deposits included above									
- banks			—			266			560
- customers			21,820			900			1,961
			21,820			1,166			2,521

Balance sheet management: Liquidity and funding risk continued

Short-term wholesale funding excluding amounts due to holding company and fellow subsidiaries	2011 £bn	2010 £bn	2009 £bn
Deposits	23.4	20.3	39.7
Notes issued	61.3	81.3	98.1
STWF excluding derivative collateral	84.7	101.6	137.8
Derivative collateral	30.9	26.6	28.2
STWF including derivative collateral	115.6	128.2	166.0
Interbank funding excluding derivative collateral and amounts due from and to fellow subsidiaries			
- bank deposits	27.4	23.6	44.0
- bank loans	(14.1)	(17.6)	(14.2)
Net interbank funding	13.3	6.0	29.8

Key points

- Short-term wholesale funding excluding derivative collateral declined by £16.9 billion in 2011, from £101.6 billion to £84.7 billion. This is £47.1 billion lower than the Group's liquidity portfolio. Deleveraging in Non-Core and GBM has led to the reduced need for funding.

- The Group's customer deposits excluding cash collateral and balances due to the holding company and fellow subsidiaries grew by £16.9 billion in 2011.

The table below shows the Group's debt securities in issue and subordinated liabilities by remaining maturity.

	Debt securities in issue								
2011	Conduit ABCP £m	Other CP and CDs £m	MTNs £m	Covered bonds £m	Securitisations £m	Total £m	Subordinated liabilities £m	Total notes issued £m	Total notes issued %
Less than 1 year	11,164	17,173	32,278	—	27	60,642	684	61,326	35.4
1-3 years	—	278	19,702	2,760	479	23,219	3,389	26,608	15.4
3-5 years	—	1	13,236	3,673	—	16,910	4,971	21,881	12.6
More than 5 years	—	1	23,189	2,674	14,202	40,066	23,280	63,346	36.6
	11,164	17,453	88,405	9,107	14,708	140,837	32,324	173,161	100.0
2010									
Less than 1 year	15,075	39,344	25,726	—	88	80,233	1,076	81,309	41.3
1-3 years	—	700	32,850	1,078	12	34,640	269	34,909	17.7
3-5 years	—	10	11,493	1,294	34	12,831	6,748	19,579	10.0
More than 5 years	—	5	16,537	1,728	18,688	36,958	23,930	60,888	31.0
	15,075	40,059	86,606	4,100	18,822	164,662	32,023	196,685	100.0
2009									
Less than 1 year	17,888	61,384	15,844	—	1,616	96,732	1,366	98,098	47.4
1-5 years	—	529	51,666	—	142	52,337	4,228	56,565	27.3
More than 5 years	—	—	9,228	—	14,116	23,344	29,123	52,467	25.3
	17,888	61,913	76,738	—	15,874	172,413	34,717	207,130	100.0

Key point

- Debt securities in issue with a maturity of less than one year declined £19.6 billion from £80.2 billion at 31 December 2010 to £60.6 billion at 31 December 2011, largely due to the maturity of £20.1 billion of notes issued under the UK Government's Credit Guarantee Scheme (CGS). The remaining notes issued under the CGS are due to mature in 2012, £15.6 billion in the first quarter of the year and £5.7 billion in the second quarter.

Liquidity portfolio

The table below shows the composition of the Group's liquidity portfolio (at estimated liquidity value).

	2011 Average £m	2011 Period end £m	2010 Period end £m	2009 Period end £m
Cash and balances at central banks	65,881	57,932	46,485	22,586
Treasury bills	5,937	—	14,529	30,010
Central and local government bonds (1)				
- AAA rated governments and US agencies	34,114	29,632	37,167	19,931
- AA- to AA+ rated governments (2)	1,682	14,102	2,404	—
- governments rated below AA	4	—	—	—
- local government	15	—	—	—
	35,815	43,734	39,571	19,931
Unencumbered collateral				
- AAA rated	17,874	21,934	11,145	11,239
- below AAA rated and other high quality assets	9,683	8,247	13,518	17,730
	27,557	30,181	24,663	28,969
Total liquidity portfolio	135,190	131,847	125,248	101,496

Notes:
(1) Includes FSA eligible government bonds of £36.7 billion at 31 December 2011 (2010 - £34.7 billion; 2009 - £19.9 billion).
(2) Includes AAA rated US government guaranteed and US government sponsored agencies. The US government was downgraded from AAA to AA+ by S&P on 5 August 2011 although not by Moody's or Fitch. These securities are reflected here.

Key point

- In view of the continuing uncertain market conditions, the composition of the liquidity portfolio was altered to become more liquid and conservative, as cash and balances at central banks rose to 44% of the total portfolio at 31 December 2011, from 37% at 31 December 2010.

Loan:deposit ratio and funding gap

The table below shows the Group's loan:deposit ratio and customer funding gap, including disposal groups.

	Loan:deposit ratio %	Customer funding gap £bn
2011	111	43
2010	122	84
2009	135	130

Key points

- The Group's loan:deposit ratio improved 1,100 basis points to 111% during 2011, as loans declined and deposits grew.
- The customer funding gap almost halved to £43 billion with Non-Core run-off being the main contributing factor.

Balance sheet management: Liquidity and funding risk continued

Special purpose entities

The Group arranges securitisations to facilitate client transactions and undertakes securitisations to sell financial assets or to fund specific portfolios of assets. The Group also acts as an underwriter and depositor in securitisation transactions involving both client and proprietary transactions. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity (SPE) which then issues liabilities to third party investors. SPEs are vehicles established for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SPEs are also used in fund management activities to segregate custodial duties from the fund management advice provided by the Group.

The Group applies the guidance in IAS 27 ‘Consolidated and Separate Financial Statements’ and SIC 12 ‘Consolidation - Special Purpose Entities’ in determining whether or not to consolidate an SPE. SPEs are consolidated where the substance of the relationship between the Group and the SPE is such that the SPE is controlled by the Group. In determining whether the SPE is controlled by the Group, the Group considers whether the activities of the SPE are being conducted on its behalf so that it obtains benefits from its operation; whether the Group has the decision-making powers to obtain the majority of the benefits of the SPE’s activities; whether the Group has rights to obtain the majority of the benefits of the SPE; and whether the Group retains the majority of the residual or ownership risks related to the SPE or its assets so as to obtain benefits from its activities. As a result of applying these principles, the Group does not consolidate those SPEs where its interests in the SPE do not provide the Group with a majority of the benefits and/or residual or ownership risks and therefore the SPE is not controlled by the Group. SPEs that are in substance controlled by the Group are consolidated. The Group accounts for its interests, for example, holdings of securities issued and liquidity commitments, in SPEs it does not consolidate in accordance with its accounting policy for these items.

The Group sponsors and arranges own-asset securitisations, whereby the sale of assets or interests in a pool of assets into an SPE is financed by the issuance of securities to investors. The pool of assets held by the SPE may be originated by the Group, or (in the case of whole loan programmes) purchased from third parties, and may be of varying credit quality. Investors in the debt securities issued by the SPE are rewarded through credit-linked returns, according to the credit rating of their securities. The majority of securitisations are supported through liquidity facilities, other credit enhancements and derivative hedges extended by financial institutions, some of which offer protection against initial defaults in the pool of assets. Thereafter, losses are absorbed by investors in the lowest ranking notes in the priority of payments. Investors in the most senior ranking debt securities are typically shielded from loss, since any subsequent losses may trigger repayment of their initial principal.

The Group also employs synthetic structures, where assets are not sold to the SPE, but credit derivatives are used to transfer the credit risk of the assets to an SPE. Securities may then be issued by the SPE to investors, on the back of the credit protection sold to the Group by the SPE.

Residential and commercial mortgages and credit card receivables form the types of assets generally included in cash securitisations, while corporate loans and commercial mortgages typically serve as reference obligations in synthetic securitisations.

The Group sponsors own-asset securitisations primarily as a way of diversifying funding sources. The Group purchases the securities issued in own-asset securitisations and may pledge as collateral for repurchase agreements with major central banks.

Refer to Note 28 on the accounts on page 257 for the asset categories, together with the carrying value of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (discussed below), where the assets continue to be recorded on the Group's balance sheet.

Conduits

The Group sponsors and administers a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SPE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months.

Group-sponsored conduits can be divided into multi-seller conduits and own-asset conduits. In determining whether or not to consolidate a conduit the Group applies the same criteria as to SPEs. Liquidity commitments from the Group to the conduit exceed the nominal amount of assets funded by the conduit as liquidity commitments are sized to cover the funding cost of the related assets.

The Group’s involvement in conduits takes a number of forms. It may:

- Sponsor an ABCP programme i.e. establish the programme and approve the sellers permitted to participate in the programme and the asset pools to be purchased by the programme;
- Administer an ABCP programme;
- Provide the ABCP conduit with liquidity facilities;
- Provide the ABCP conduit with a programme-wide credit enhancement facility; or
- Purchase commercial paper from an ABCP conduit.

Total assets and other aspects relating to the Group's consolidated conduits are set out below.

	2011			2010			2009
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Total £m
Total assets held by the conduits	11,208	1,893	13,101	14,142	3,624	17,766	19,671
Commercial paper issued (1)	10,590	859	11,449	13,277	2,540	15,817	17,888
Liquidity and credit enhancements							
Deal specific liquidity							
- drawn	321	1,051	1,372	868	1,109	1,977	1,797
- undrawn	15,324	1,144	16,468	19,642	2,980	22,622	24,631
PWCE (2)	795	193	988	1,025	257	1,282	1,508
	16,440	2,388	18,828	21,535	4,346	25,881	27,936
Maximum exposure to loss (3)	15,646	2,194	17,840	20,510	4,089	24,599	26,428

Notes:

(1) Includes £0.3 billion of ABCP issued to RBS plc at 31 December 2011 (2010 - £0.7 billion).

(2) Programme-wide credit enhancement (PWCE) is an additional programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

(3) Maximum exposure to loss quantifies the Group's exposure to its sponsored conduits. It is determined as the Group's liquidity commitment to its sponsored conduits and additional PWCE which would absorb first loss on transactions where liquidity support is provided by third parties. Historically, PWCE has been greater than third party liquidity. Therefore the maximum exposure to loss is total deal specific liquidity.

(4) Liquidity commitments from the Group to the conduit exceed the nominal amount of assets funded by the conduit given that liquidity commitments are sized to cover the accrued funding cost of the related assets.

Key points

- During 2011, both multi-seller and own-asset conduit assets decreased, as deals terminated and Non-Core assets were sold. The total assets held by Group-sponsored conduits were £13.1 billion at 31 December 2011 (2010 - £17.8 billion; 2009 - £19.7 billion).

- The average maturity of ABCP issued by the Group's conduits at 31 December 2011 was 42.6 days (2010 - 64.8 days; 2009 - 68.6 days).

- The maturity of the commercial paper issued by the Group's conduits is managed to mitigate the short-term contingent liquidity risk of providing back-up facilities. The Group's limits sanctioned for such liquidity facilities in 2011 totalled approximately £16.8 billion for multi-seller conduits (2010 - £22.6 billion; 2009 - £25.0 billion).

- The weighted average life of the funded assets was 1.9 years at 31 December 2011 (2010 - 2.5 years; 2009 - 2.3 years).

- The Group's maximum exposure to loss on its multi-seller conduits is £16.7 billion (2010 - £22.8 billion; 2009 - £25.2 billion), being the total amount of the Group's liquidity commitments plus the extent of the programme-wide credit enhancement of conduit assets for which facilities were not provided by third parties.

- The Group holds a single own-asset conduit, which has assets funded by the Group. The Group's maximum exposure to loss on own-asset conduits was £1.1 billion in 2011 (2010 - £1.8 billion; 2009 - £1.2 billion), with no ABCP outstanding at that date (2010 and 2009 - nil).

- Multi-seller conduits accounted for 93% of the total liquidity and credit enhancements committed by the Group at 31 December 2011 (2010 - 92%; 2009 - 94%). The Group's multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance.

Balance sheet management: Liquidity and funding risk continued

Conduits continued

The Group has not utilised its own-asset conduit with a committed liquidity of £26 billion (2010 - £26 billion) to access the Bank of England's open market operations for contingent funding purposes. This conduit is not included above, or in the tables on pages 42 and 43.

Collateral analysis, profile, credit ratings and weighted average lives relating to the Group's consolidated conduits are detailed below.

	Funded assets			Undrawn commitments to fund assets	Liquidity from third parties	Total exposure
2011	Loans £m	Securities £m	Total £m	£m	£m	£m
Auto loans	3,663	390	4,053	2,241	—	6,294
Corporate loans	146	72	218	16	—	234
Credit card receivables	865	—	865	699	—	1,564
Trade receivables	1,136	126	1,262	649	—	1,911
Student loans	488	—	488	352	—	840
Consumer loans	1,362	—	1,362	101	—	1,463
Mortgages						
- prime	2,239	—	2,239	308	—	2,547
- non-conforming	727	—	727	34	—	761
- commercial	21	489	510	8	—	518
Other	760	617	1,377	331	—	1,708
	11,407	1,694	13,101	4,739	—	17,840
2010						
Auto loans	4,943	346	5,289	2,964	—	8,253
Corporate loans	115	92	207	61	—	268
Credit card receivables	2,088	—	2,088	1,209	—	3,297
Trade receivables	761	—	761	1,090	—	1,851
Student loans	757	—	757	532	(132)	1,157
Consumer loans	1,889	—	1,889	111	—	2,000
Mortgages						
- prime	2,569	3	2,572	752	—	3,324
- non-conforming	1,371	—	1,371	20	—	1,391
- sub-prime	103	—	103	19	—	122
- commercial	210	450	660	76	(21)	715
Other	1,072	997	2,069	(1)	(10)	2,058
	15,878	1,888	17,766	6,833	(163)	24,436
2009						
Auto loans	4,293	356	4,649	2,526	—	7,175
Corporate loans	106	—	106	7	—	113
Credit card receivables	4,083	—	4,083	1,058	—	5,141
Trade receivables	840	—	840	1,351	—	2,191
Student loans	915	—	915	263	(132)	1,046
Consumer loans	1,652	—	1,652	222	—	1,874
Mortgages						
- prime	2,739	3	2,742	750	—	3,492
- non-conforming	1,548	—	1,548	193	—	1,741
- commercial	413	458	871	155	(22)	1,004
Other	872	1,393	2,265	232	(12)	2,485
	17,461	2,210	19,671	6,757	(166)	26,262

	CP funded assets									
						Credit ratings (S&P equivalent)				
2011	UK £m	Europe £m	US £m	RoW £m	Total £m	AAA £m	AA £m	A £m	BBB £m	Below BBB £m
Auto loans	518	1,145	2,141	249	4,053	3,323	683	40	7	—
Corporate loans	—	160	58	—	218	9	94	27	88	—
Credit card receivables	—	—	865	—	865	774	—	91	—	—
Trade receivables	—	567	695	—	1,262	449	343	426	44	—
Student loans	—	—	488	—	488	488	—	—	—	—
Consumer loans	716	—	646	—	1,362	—	—	1,362	—	—
Mortgages										
- prime	182	—	—	2,057	2,239	1,446	737	39	17	—
- non-conforming	667	60	—	—	727	157	265	287	18	—
- commercial	489	—	—	21	510	2	5	498	5	—
Other	124	201	531	521	1,377	363	42	402	180	390
	2,696	2,133	5,424	2,848	13,101	7,011	2,169	3,172	359	390
2010										
Auto loans	429	962	3,434	464	5,289	4,827	354	101	7	—
Corporate loans	—	192	15	—	207	26	53	128	—	—
Credit card receivables	144	—	1,944	—	2,088	1,912	125	—	51	—
Trade receivables	—	261	500	—	761	265	353	95	48	—
Student loans	116	—	641	—	757	641	116	—	—	—
Consumer loans	766	462	661	—	1,889	16	—	1,873	—	—
Mortgages										
- prime	161	—	—	2,411	2,572	1,043	1,476	32	21	—
- sub-prime	103	—	—	—	103	—	68	—	35	—
- non-conforming	712	659	—	—	1,371	782	273	316	—	—
- commercial	627	—	—	33	660	16	5	635	4	—
Other	447	455	353	814	2,069	95	52	1,242	680	—
	3,505	2,991	7,548	3,722	17,766	9,623	2,875	4,422	846	—
2009										
Auto loans	476	982	2,621	570	4,649	2,965	1,547	137	—	—
Corporate loans	—	106	—	—	106	—	—	106	—	—
Credit card receivables	177	—	3,823	83	4,083	2,781	759	420	123	—
Trade receivables	—	334	472	34	840	480	266	60	34	—
Student loans	117	—	798	—	915	798	117	—	—	—
Consumer loans	733	800	119	—	1,652	34	50	1,553	15	—
Mortgages										
- prime	138	—	—	2,604	2,742	949	1,746	28	3	16
- non-conforming	599	949	—	—	1,548	1,070	379	99	—	—
- commercial	641	194	—	36	871	25	3	840	—	3
Other	121	670	298	1,176	2,265	170	249	950	896	—
	3,002	4,035	8,131	4,503	19,671	9,272	5,116	4,193	1,071	19

Balance sheet management: Liquidity and funding risk continued

Assets and liabilities by contractual cash flow maturity

The table below shows the contractual undiscounted cash flows receivable and payable, up to a period of twenty years, including future receipts and payments of interest of on-balance sheet assets by contractual maturity. The balances in the table below do not agree directly with the consolidated balance sheet, as the table includes all cash flows relating to principal and future coupon payments, presented on an undiscounted basis. The tables have been prepared on the following basis:

The contractual maturity of on-balance sheet assets and liabilities highlights the maturity transformation which underpins the role of banks to lend long-term, but to fund themselves predominantly by short-term liabilities such as customer deposits. This is achieved through the diversified funding franchise of the Group across an extensive retail, wealth and SME customer base, and across a wide geographic network. In practice, the behavioural profiles of many assets and liabilities exhibit greater stability and longer maturity than the contractual maturity.

Financial assets have been reflected in the time band of the latest date on which they could be repaid, unless earlier repayment can be demanded by the Group. Financial liabilities are included at the earliest date on which the counterparty can require repayment, regardless of whether or not such early repayment results in a penalty. If the repayment of a financial instrument is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the time band that contains the latest date on which it can be repaid, regardless of early repayment. The liability is included in the time band that contains the earliest possible date on which the conditions could be fulfilled, without considering the probability of the conditions being met.

For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period, whatever the level of the index at the year end. The settlement date of debt securities in issue, issued by certain securitisation vehicles consolidated by the Group, depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations is shown on the earliest date that the asset can be prepaid, as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after twenty years or where the counterparty has no right to repayment of the principal are excluded from the table, as are interest payments after twenty years. Amounts due to and from holding company and fellow subsidiaries are included with the relevant captions.

	Group					
2011	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	68,487	—	—	—	—	—
Loans and advances to banks	28,732	711	281	230	180	—
Debt securities	3,852	6,441	13,682	14,254	27,492	12,184
Settlement balances	6,902	—	—	—	—	—
Other financial assets	—	9	—	16	8	—
Total maturing assets	107,973	7,161	13,963	14,500	27,680	12,184
Loans and advances to customers	88,029	85,074	103,432	52,538	59,594	55,164
Derivatives held for hedging	449	1,419	3,113	1,561	570	129
	196,451	93,654	120,508	68,599	87,844	67,477
Liabilities by contractual maturity						
Deposits by banks	35,596	4,487	5,256	400	1,008	364
Debt securities in issue	63,623	11,342	17,869	14,241	15,640	3,380
Subordinated liabilities	13,819	2,341	5,315	5,085	7,700	9,700
Settlement balances and other liabilities	8,461	5	10	3	1	1
Total maturing liabilities	121,499	18,175	28,450	19,729	24,349	13,445
Customer accounts	351,077	22,742	12,282	5,076	1,207	758
Derivatives held for hedging	216	524	1,174	739	739	583
	472,792	41,441	41,906	25,544	26,295	14,786
Maturity gap	(13,526)	(11,014)	(14,487)	(5,229)	3,331	(1,261)
Cumulative maturity gap	(13,526)	(24,540)	(39,027)	(44,256)	(40,925)	(42,186)
Guarantees and commitments notional amount						
Guarantees (1, 2)	9,244	—	—	—	—	—
Commitments (3)	221,145	—	—	—	—	—

For the notes relating to this table refer to page 46.

2010	Group 0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	49,837	—	—	1	—	—
Loans and advances to banks	18,751	906	408	352	290	71
Debt securities	6,199	5,898	14,576	10,980	31,186	16,782
Settlement balances	8,500	208	—	—	41	—
Other financial assets	—	8	—	15	7	—
Total maturing assets	83,287	7,020	14,984	11,348	31,524	16,853
Loans and advances to customers	96,116	80,731	111,158	64,094	74,733	61,841
Derivatives held for hedging	457	1,434	2,174	515	132	41
	179,860	89,185	128,316	75,957	106,389	78,735
Liabilities by contractual maturity						
Deposits by banks	26,306	3,298	1,276	385	612	374
Debt securities in issue	82,291	36,368	14,783	12,667	12,190	4,100
Subordinated liabilities	13,230	2,741	8,032	5,770	7,404	10,327
Settlement balances and other liabilities	10,309	32	78	67	204	25
Total maturing liabilities	132,136	42,439	24,169	18,889	20,410	14,826
Customer accounts	371,310	17,859	7,459	3,729	2,117	719
Derivatives held for hedging	240	549	919	428	285	28
	503,686	60,847	32,547	23,046	22,812	15,573
Maturity gap	(48,849)	(35,419)	(9,185)	(7,541)	11,114	2,027
Cumulative maturity gap	(48,849)	(84,268)	(93,453)	(100,994)	(89,880)	(87,853)
Guarantees and commitments notional amount						
Guarantees (1, 2)	10,393	—	—	—	—	—
Commitments (3)	234,203	—	—	—	—	—

For the notes relating to this table refer to page 46.

Balance sheet management: Liquidity and funding risk continued

Assets and liabilities by contractual cash flow maturity continued

	Group					
2009	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	27,053	—	—	1	—	—
Loans and advances to banks	16,795	1,252	491	38	211	290
Debt securities	14,823	5,056	17,063	13,042	21,473	15,954
Settlement balances	9,148	5	—	—	—	—
Other financial assets	—	7	—	17	9	—
Total maturing assets	67,819	6,320	17,554	13,098	21,693	16,244
Loans and advances to customers	79,143	56,308	109,649	86,842	110,926	120,046
Derivatives held for hedging	317	1,008	1,105	231	252	83
	147,279	63,636	128,308	100,171	132,871	136,373
Liabilities by contractual maturity						
Deposits by banks	44,112	7,622	2,959	1,371	135	11
Debt securities in issue	75,943	28,689	43,068	8,806	7,095	1,599
Subordinated liabilities	2,231	2,291	4,607	5,107	13,678	2,523
Settlement balances and other liabilities	9,817	39	93	91	233	83
Total maturing liabilities	132,103	38,641	50,727	15,375	21,141	4,216
Customer accounts	379,452	9,988	3,784	2,387	3,277	2,011
Derivatives held for hedging	391	1,008	1,174	173	14	19
	511,946	49,637	55,685	17,935	24,432	6,246
Maturity gap	(64,284)	(32,321)	(33,173)	(2,277)	552	12,028
Cumulative maturity gap	(64,284)	(96,605)	(129,778)	(132,055)	(131,503)	(119,475)
Guarantees and commitments notional amount						
Guarantees (1, 2)	11,202	—	—	—	—	—
Commitments (3)	248,529	—	—	—	—	—

Notes:

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.

(2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £5,753 million (2010 - £12,479 million; 2009 - £20,680 million) between the Bank and a fellow subsidiary.

(3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

Held-for-trading assets of £773 billion and liabilities of £717 billion (2010 - £646 billion assets, £587 billion liabilities; 2009 - £638 billion assets, £576 billion liabilities) have been excluded from the table in view of their short-term nature.

Interest rate risk

The banking book consists of interest bearing assets, liabilities and derivative instruments used to mitigate risks which are accounted for on an accrual basis, as well as non-interest bearing balance sheet items, which are not subjected to fair value accounting.

The Group provides financial products to satisfy a variety of customer requirements. Loans and deposits are designed to meet customer objectives with regard to repricing frequency, tenor, index, prepayment, optionality and other features. When aggregated, they form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates.

However, mismatches in these sensitivities give rise to net interest income (NII) volatility as interest rates rise and fall. For example, a bank with a floating rate loan portfolio and largely fixed rate deposits will see its NII rise as interest rates rise and fall as rates decline. Due to the long-term nature of many banking book portfolios, varied interest rate repricing characteristics and maturities, it is likely the NII will vary from period to period, even if interest rates remain the same. New business volumes originated in any period will alter the interest rate sensitivity of a bank if the resulting portfolio differs from portfolios originated in prior periods.

The Group assesses interest rate risk in the banking book (IRRBB) using a set of standards to define, measure and report the market risk. It is the RBS Group's policy to minimise interest rate sensitivity in banking book portfolios and where interest rate risk is retained, to ensure that appropriate measures and limits are applied. Key measures used to evaluate IRRBB are subjected to approval of divisional Asset and Liability Management Committees (ALCOs) and the RBS Group Asset and Liability Management Committee (GALCO).

Limits on IRRBB are proposed by the Group Treasurer for approval by the Executive Risk Forum annually.

The Group uses a variety of approaches to quantify its interest rate risk. IRRBB is measured using a version of the same value-at-risk (VaR) methodology that is used for the Group's trading portfolios. Net interest income exposures are measured in terms of sensitivity over time to movements in interest rates. Additionally, Citizens measures the sensitivity of the market value of equity to changes in forward interest rates.

With the exception of Citizens and GBM, divisions are required to manage IRRBB through internal transactions with Group Treasury, to the greatest extent possible. Residual risks in divisions must be measured and reported as described below.

Group Treasury aggregates exposures arising from its own external activities and positions transferred to it from divisions. Where appropriate, Group Treasury nets off-setting risk exposures to determine a residual exposure to interest rate movements. Hedging transactions using cash and derivative instruments are executed to manage IRRBB exposures, within the GALCO approved VaR limits.

Citizens and GBM manage their own IRRBB exposures within approved limits to satisfy their business objectives.

IRRBB VaR for the Group's retail and commercial banking activities at a 99% confidence level was as follows:

	Average £m	Period end £m	Maximum £m	Minimum £m
2011	156	153	177	109
2010	114	193	193	65
2009	176	167	237	134

Balance sheet management: Structural foreign currency exposures

Structural foreign exchange exposures represent net investment in subsidiaries, associates and branches, the functional currencies of which are currencies other than sterling. The Group hedges structural foreign currency exposures only in limited circumstances. The Group's objective is to ensure, where practical, that its consolidated capital ratios are largely protected from the effect of changes in exchange rates.

The table below shows the Group's structural foreign currency exposures.

2011	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
US dollar	16,454	(1,218)	15,236
Euro	6,069	(266)	5,803
Swiss franc	1,108	(1,108)	—
Other non-sterling	1,049	(880)	169
	24,680	(3,472)	21,208
2010			
US dollar	16,042	(1,250)	14,792
Euro	5,111	(211)	4,900
Swiss franc	1,122	(1,110)	12
Other non-sterling	988	(920)	68
	23,263	(3,491)	19,772
2009			
US dollar	14,904	(3,208)	11,696
Euro	5,340	(259)	5,081
Swiss franc	937	(908)	29
Brazilian real	870	(853)	17
	22,051	(5,228)	16,823

Key points

- The Group's structural foreign currency exposure at 31 December 2011 was £21.2 billion, an increase of £1.4 billion from the end of 2010, mainly due to increased net euro investments.

- Changes in foreign currency exchange rates will affect equity in proportion to structural foreign currency exposure. A 5% strengthening in foreign currencies against sterling would result in a gain of £1.1 billion (2010 - £1.0 billion; 2009 - £0.8 billion) in equity, while a 5% weakening would result in a loss of £1.0 billion (2010 - £0.9 billion; 2009 - £0.8 billion) in equity.

Risk management

Introduction

This section focuses on each of the key types of risk that the Group faces - explaining how the RBS Group manages these risks and highlighting the enhancements made as a result of progress under the RBS Group’s ongoing initiatives to strengthen its approach to risk management.

Credit risk

All the disclosures in this section (pages 49 to 126) are audited unless otherwise indicated by an asterisk (*).

Credit risk is the risk of financial loss owing to the failure of a customer to meet its obligation to settle outstanding amounts. The quantum and nature of credit risk assumed across the Group's different businesses vary considerably, while the overall credit risk outcome usually exhibits a high degree of correlation with the macroeconomic environment.

Organisation

The existence of a strong credit risk management function is vital to support the ongoing profitability of the Group. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and through a focus on the importance of sustainable lending practices. The role of the credit risk management function is to own the credit approval, concentration and credit risk control frameworks and to act as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound lending environment within risk appetite.

Responsibility for development of RBS Group-wide policies, credit risk frameworks, RBS Group-wide portfolio management and assessment of provision adequacy, sits within the RBS Group Credit Risk (GCR) function under the management of the RBS Group Chief Credit Officer. Execution of these policies and frameworks is the responsibility of the risk management functions, located within the RBS Group’s business divisions. These divisional credit risk functions work together with GCR to ensure that the RBS Group Board’s expressed risk appetite is met, within a clearly defined and managed control environment. The credit risk function within each division is managed by a Chief Credit Officer, who reports jointly to a divisional Chief Risk Officer and to the RBS Group Chief Credit Officer. Divisional activities within credit risk include credit approval, transaction and portfolio analysis, early problem recognition and ongoing credit risk stewardship.

GCR is additionally responsible for verifying compliance by the divisions with all RBS Group credit policies.

In the final quarter of 2011, the Executive Risk Forum (ERF) approved a change to the management of the credit portfolio, delegating greater authority to the RBS Group Chief Credit Officer as chair of the functional credit committees that analyse and recommend the limits to the ERF. With effect from October 2011, the RBS Group Chief Credit Officer chairs a single Credit Risk Committee, with the authority to approve limits for the majority of portfolios across the RBS Group. The ERF retains its strategic role as the most senior risk committee outside the RBS Group Board and will continue to approve material portfolio concentrations and higher risk portfolios such as commercial real estate. This change strengthens individual accountability across the risk organisation and encourages the engagement of business leaders in first line of defence risk activity.

Risk appetite

Credit concentration risk is managed and controlled through a series of frameworks designed to limit concentration by product/asset class, sector, single name and country. These are supported by a suite of RBS Group-wide and divisional policies, setting out the risk parameters within which business units may operate. Information on the RBS Group’s credit portfolios is reported to the Group Board by way of the divisional and RBS Group-level risk committees.

Throughout 2011, GCR’s emphasis was on embedding the new risk management frameworks introduced in 2009 and 2010 and on ensuring alignment with the strategic risk objectives being pursued across the RBS Group. Risk appetite has been expressed by the RBS Group Board by reference to earnings volatility and stable capital and these principles underpin the frameworks that GCR has established, and is continuing to refine, to manage the RBS Group’s concentration risks in the Core balance sheet, by product/asset class, sector, single name and country.

In the two years since the new concentration framework was rolled out across the RBS Group, the ERF has reviewed all material industry and product portfolios and agreed a risk appetite commensurate with the franchises represented in these reviews. In particular, limits have been reviewed and re-sized, to refine the RBS Group’s risk appetite in areas where it faces significant balance sheet concentrations or franchise challenges. The product/asset class, sector, single name and country limits are now firmly embedded in the risk management processes of the RBS Group and form a pivotal part of the Risk function’s engagement with the businesses on the appropriateness of risk appetite choices.

The new sector and asset class limits have been informed by the work undertaken to stress the portfolios and historical loss experience. In addition, they factor in the future consequences for risk and return in asset classes likely to be affected by the introduction of new regulatory capital rules under Basel III.

Risk management: Credit risk continued

Risk appetite continued

Product/asset class concentration framework

- Retail - a formal framework establishes RBS Group-level statements and thresholds that are cascaded through all retail franchises in the RBS Group and to granular business lines. These include measures that relate both to aggregate portfolios and to asset quality at origination, which are tracked frequently to ensure consistency with RBS Group standards and appetite. This appetite setting and tracking then informs the processes and parameters employed in origination activities, which require a large volume of small-scale credit decisions, particularly those involving an application for a new product or a change in facilities on an existing product. The majority of these decisions are based upon automated strategies utilising credit and behaviour scoring techniques. Scores and strategies are typically segmented by product, brand and other significant drivers of credit risk. These data driven strategies utilise a wide range of credit information relating to a customer including, where appropriate, information across customer holdings. A small number of credit decisions are subject to additional manual underwriting by authorised approvers in specialist units. These include higher-value, more complex, small business and personal unsecured transactions and some residential mortgage applications.

- Wholesale - formal policies, specialised tools and expertise, tailored monitoring and reporting and, in certain cases, specific limits and thresholds are deployed to address certain lines of business across the RBS Group, where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. For example, in response to volatile conditions in the syndicated loan, fixed income and equities markets during 2011, the RBS Group engaged in only selective underwriting activity in these markets. In addition to the limit structures the RBS Group has in place to manage its overall exposure to underwriting activity, market-linked controls were introduced in the loan underwriting book in 2011, to align the risk profile more closely to asset price movements. Those portfolios identified as potentially representing a concentration or heightened risk are subject to formal governance, including periodic review, at either RBS Group or divisional level, depending on materiality.

Sector concentration framework

Across wholesale portfolios, exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Through this sector framework, appetite and portfolio strategies are agreed and set at aggregate and more granular levels where exposures have the potential to represent excessive concentration or where trends in both external factors and internal portfolio performance give cause for concern. Formal periodic reviews are undertaken at RBS Group or divisional level depending on materiality. These may include an assessment of the RBS Group's franchise in a particular sector, an analysis of the outlook (including downside outcomes), identification of key vulnerabilities and stress/scenario tests. Specific reporting on trends in sector risk and on status versus agreed appetite and portfolio strategies is provided to senior management and to the RBS Group Board.

As a result of the reviews carried out in 2011, the RBS Group has reduced its risk appetite in the higher-risk sectors of leisure, media, commercial real estate, construction, automotive, and airlines and aerospace.

In response to the severe budgetary cuts mandated by the UK Government in 2010, the UK and Northern Ireland teams conducted a full review of the likely impact of the austerity measures on their corporate and retail lending portfolios. Areas of specific focus, such as local authority lending, where budgetary pressures will be hard felt, and portfolios exposed to discretionary consumer spend, such as the retail and leisure industries, were stressed using downside assumptions on further house price deterioration and higher unemployment. The output of these activities was reviewed by the Executive Risk Forum and actions agreed in the event that these scenarios threaten to materialise.

The impact of the eurozone crisis has been felt most significantly in the financial institutions sector, where widening credit spreads and regulatory demand for increases in Tier 1 capital have exacerbated the risk management challenges already posed by the sector's continued weakness, as provisions and write-downs remain elevated. A material percentage of the global banking activity in risk mitigation now passes through the balance sheets of the top global players, increasing the systemic risks to the sector. The RBS Group's exposures to these banks continue to be closely managed. The increased use of central clearing houses to reduce counterparty credit risk, including settlement risk, among the larger banks is a welcome move but one that will bring its own challenges. The weaker banks in the eurozone have also been the subject of heightened scrutiny and the RBS Group's risk appetite for these banks was adjusted continuously throughout 2011.

Single name concentration framework*

Within wholesale portfolios, much of the activity undertaken by the credit risk function is organised around the assessment, approval and management of the credit risk associated with a borrower or group of related borrowers.

A formal single name concentration framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes specific and elevated approval requirements, additional reporting and monitoring, and the requirement to develop plans to address and reduce excess exposures over an appropriate timeframe.

Credit approval authority is discharged by way of a framework of individual delegated authorities, which requires at least two individuals to approve each credit decision, one from the business and one from the credit risk management function. Both parties must hold sufficient delegated authority under the RBS Group-wide authority grid. Whilst both parties are accountable for the quality of each decision taken, the credit risk management approver holds ultimate sanctioning authority. The level of authority granted to individuals is dependent on their experience and expertise, with only a small number of senior executives holding the highest authority provided under the framework. Daily monitoring of individual counterparty limits is undertaken.

* unaudited

At a minimum, credit relationships are reviewed and re-approved annually. The renewal process addresses: borrower performance, including reconfirmation or adjustment of risk parameter estimates; the adequacy of security; and compliance with terms and conditions. For certain counterparties, early warning indicators are also in place to detect deteriorating trends in limit utilisation or account performance, and to prompt additional oversight.

Since 2009, the RBS Group has been managing its corporate exposures to reduce concentrations and align its appetite for future business to the RBS Group's broader strategies for its large corporate franchises. In the last quarter of 2011, the RBS Group announced further refinements to the single name exposure management controls already in place, which brings them more closely in line with market best practice and which allows the RBS Group to differentiate more consistently between the different risk types. These changes are expected to be implemented during the first quarter of 2012. The RBS Group is continually reviewing its single name concentration framework to ensure that it remains appropriate for current economic conditions and in line with improvements in the RBS Group's risk measurement models.

Country

For information on how the RBS Group manages credit risk by country, refer to the Country risk section on page 127.

Controls and assurance*

A strong independent assurance function is an important element of a sound control environment. During 2011, the RBS Group took the decision to strengthen its credit quality assurance (CQA) activities and moved all divisional CQA resources under the centralised management of RBS Group Credit Risk. The benefits of this action are already apparent in greater consistency of standards and cross utilisation of resources. Reviews planned for 2012 will benefit from the availability of subject matter experts across all material products and classes and an improved ability to track control breaches and strengthen processes.

Work began in the second half of 2011 on a major revision of the RBS Group's key credit policies. This will ensure that the RBS Group's control environment is appropriately aligned to the risk appetite that the RBS Group Board has approved and provide a sound basis for the RBS Group's independent audit and assurance activities across the credit risk function. The work is expected to be concluded by the end of the second quarter of 2012.

The Group Credit Risk function launched an assurance process to provide the Group Chief Credit Officer with additional evidence of the effectiveness of the controls in place across the Group to manage risk. The results of these reviews will be provided to the Executive Risk Forum and to the Board Risk Committee on a regular basis in support of the self-certification that Group Credit Risk is obliged to complete under the Group Policy Framework (refer to Operational risk on pages 149 to 151).

Problem debt management

The RBS Group's procedures for managing problem debts differ between wholesale and retail customers, as discussed below.

Wholesale customers

The controls and processes for managing wholesale problem debts are embedded within the divisions' credit approval frameworks and form an essential part of the ongoing credit assessment of customers. Any necessary approvals will be required in accordance with the delegated authority grid governing the extension of credit.

Early problem recognition

Each division has established Early Warning Indicators (EWIs) designed to identify those performing exposures that require close attention due to financial stress or heightened operational issues. Such identification may also take place as part of the annual review cycle. EWIs vary from division to division and comprise both internal parameters (e.g. account level information) and external parameters (e.g. the share price of publicly listed customers).

Customers identified through either the EWIs or annual review are reviewed by portfolio management and/or credit officers within the division, who determine whether or not the customer's circumstances warrant placing the exposure on the Watchlist process (detailed below).

Watchlist process*

There are three Watchlist ratings - amber, red and black - reflecting progressively deteriorating conditions. Watchlist Amber loans are performing loans where the counterparty or sector shows early signs of potential stress or has other characteristics such that they warrant closer monitoring. Watchlist Red loans are performing loans where indications of the borrower's declining creditworthiness are such that the exposure requires active management, usually by the Global Restructuring Group (GRG). Watchlist Black loans comprise risk elements in lending and potential problem loans.

Once on the Watchlist process, customers come under heightened scrutiny. The relationship strategy is reassessed by a forum of experienced credit, portfolio management and remedial management professionals within the division. In accordance with RBS Group-wide policies, a number of mandatory actions will be taken, including a review of the customer's credit grade and facility security documentation. Other appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt. Such circumstances include deteriorating trading performance, an imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

Risk management: Credit risk continued

Problem debt management continued

For all Watchlist Red cases, the division is required to consult with the GRG on whether the relationship should be transferred to the GRG (see more on the GRG below). Relationships managed by the divisions tend to be with companies operating in niche sectors such as airlines or products such as securitisation special purpose vehicles. The divisions may also manage those exposures when subject matter expertise is available in the divisions rather than within the GRG.

At 31 December 2011, exposure to customers reported as Watchlist Red and managed within the divisions totalled £4 billion.

Strategies that are available within divisions include granting the customer various types of concessions. Any decision to approve a concession will be a function of the division's specific country and sector appetite, the key credit metrics of the customer, the market environment and the loan structure/security. Only those concessions deemed to be outside current market norms are reported as restructurings in the discussions below.

Other potential outcomes of the review of the relationship are to: take the customer off Watchlist and return it to the mainstream loan book; offer further lending and maintain ongoing review; transfer the relationship to the GRG for those customers requiring such stewardship; or exit the relationship altogether.

Global Restructuring Group

In cases where the Group's exposure to the customer exceeds £1 million, the relationship may be transferred to the GRG following consultation with the originating division. The GRG's primary function is active management of the exposures to minimise loss for the RBS Group and where feasible return the exposure to the Group's mainstream loan book following an assessment by the GRG that no further losses are expected.

At 31 December 2011, credit risk assets relating to exposures under GRG management (excluding those placed under GRG stewardship for operational reasons rather than concerns over credit quality and those in the AQ10 internal asset quality (AQ) band) totalled £20.9 billion.

The following table shows a sector breakdown of these exposures:

Watchlist Red credit risk assets under GRG management	Core £m	Non-Core £m	Total £m
2011			
Property	6,213	5,994	12,207
Transport	1,041	2,195	3,236
Retail and leisure	1,501	620	2,121
Services	711	117	828
Other	1,703	811	2,514
Total	11,169	9,737	20,906

Types of wholesale restructurings

A number of options are available to the Group when corrective action is deemed necessary. The Group may offer a temporary covenant waiver, a recalibration of covenants and/or an amendment of restrictive covenants to mitigate a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan. Such covenant-related concessions are not included in the quantitative loan restructuring disclosures below.

The reported restructurings comprise the following types of concessions:

- *Variation in margin* - the contractual margin may be amended to bolster the customer's day-to-day liquidity, with the aim of helping to sustain the customer's business as a going concern. This would normally be seen as a short-term solution and is typically accompanied by the RBS Group receiving an exit payment, a payment in kind or a deferred fee.
- *Payment holidays and loan rescheduling* - payment holidays or changes to the contracted amortisation profile including extensions in contracted maturity or roll-overs may be granted to improve the customer's liquidity. Such concessions often depend on the expectation that the customer's liquidity will recover when market conditions improve or will benefit from access to alternative sources of liquidity e.g. an issue of equity capital. Recently, these types of concessions have become more common in commercial real estate transactions, particularly where a shortage of market liquidity rules out immediate refinancing and makes short-term forced collateral sales unattractive.
- *Forgiveness of all or part of the outstanding debt* - debt may be forgiven or exchanged for equity in cases where a fundamental shift in the customer's business or economic environment means that the customer is incapable of servicing current debt obligations and other forms of restructuring are unlikely to succeed in isolation. Debt forgiveness is often an element in leveraged finance transactions, which are typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Provided that the underlying business model and strategy are considered viable, maintaining the business as a going concern with a sustainable level of debt is the preferred option, rather than realising the value of the underlying assets.

The vast majority of the restructurings reported by the Group take place within the GRG. Forgiveness of debt and exchange for equity is only available to customers in the GRG.

The wholesale restructured loan data presented in the tables below, which relate to exposures of the Group managed either within the divisions or by the GRG, include only those arrangements that achieved legal completion during 2011 and that individually exceed respective thresholds set at divisional level, which range from nil to £10 million. Within this population, restructurings amounting to £8.1 billion achieved legal completion during 2011. A further £14.1 billion was in the process of being completed at year end (these loans are not included in the tables below). Of the loans that were subject to restructuring during 2011 by the divisions, 81% remained in the performing book at 31 December 2011. Of those restructured within the GRG during the year, 16% had been returned to satisfactory by year end.

The asset quality of the restructured loans, the sectors affected and provision coverage are as follows:

Wholesale restructurings by sector	AQ1-AQ9 (1) £m	AQ10 (2) £m	AQ10 (2) provision coverage %
2011			
Property	1,980	2,540	18
Transport	677	632	5
Non-bank financial institutions	166	357	76
Retail and leisure	423	148	24
Other	934	220	32
Total	4,180	3,897	22

Notes:
(1) Probability of default less than 100%.
(2) Probability of default is 100%.

The incidence of the main types of restructuring is analysed below:

Wholesale restructurings by type of arrangement	Loans by value %
2011	
Variation in margin	13
Payment holidays and loan rescheduling	87
Forgiveness of all or part of the outstanding debt	31
Other	8

Note:
(1) The total above exceeds 100% as an individual case can involve more than one type of arrangement.

Provisioning for impaired loans

Any one of the above types of restructuring may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows from the restructured loan resulting in the recognition of an impairment loss. Restructurings that include forgiveness of all or part of the outstanding debt account for the majority of such cases.

The customer's financial position, anticipated prospects and the likely effect of the restructuring, including any concessions granted, are considered in order to establish whether an impairment provision is required.

Provisions on exposures greater than £1 million are individually assessed by the GRG. Exposures smaller than £1 million are deemed not to be individually significant and are assessed collectively by the originating division.

In the case of non-performing loans that are restructured, the loan impairment provision assessment (based on management's best estimate of the incurred loss) almost invariably takes place prior to the restructuring. The quantum of the loan impairment provision may change once the terms of the restructuring are known, resulting in an additional provision charge or a release of the provision in the period the restructuring takes place.

Refer to Impairment loss provision methodology on page 123.

Risk management: Credit risk continued

Problem debt management: Global Restructuring Group continued

Recoveries and active insolvency management

The ultimate outcome of a restructuring strategy is unknown at the time of execution. It is highly dependent on the cooperation of the borrower and the continued existence of a viable business. The following are generally considered to be options of last resort:

- *Enforcement of security or otherwise taking control of assets* - where the Group holds collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. The Group's preferred strategy is to consider other possible options prior to exercising these rights.

- *Insolvency* - where there is no suitable restructuring option or the business is no longer regarded as sustainable, insolvency will be considered. Insolvency may be the only option that ensures that the assets of the business are properly and efficiently distributed to relevant creditors.

Retail customers

Early problem recognition and collections

There are collections functions in each of the retail businesses. Their role is to provide support and assistance to customers who are experiencing difficulties in meeting their financial obligations to the Group. Evidence of such difficulties includes, for example, a missed payment on their loan, or a balance that is in excess of the agreed credit limit. Additionally, in UK Retail and Ulster Bank, a dedicated support team aims to identify and help customers who may be facing financial difficulty but who are current with their payments.

Within collections, a range of tools is deployed to initiate contact with the customer, establish the cause of their financial difficulty and, where possible, return the customer to a satisfactory position using, where appropriate, forbearance strategies. If these strategies are unsuccessful, the customer is transferred to the recoveries team.

Recoveries

The goal of the recoveries function is to collect the total amount outstanding and reduce the loss to the Group by maximising the level of cash recovery whilst treating customers fairly. A range of treatment options are available within recoveries, including litigation procedures for secured assets. In UK Retail and Ulster Bank, no repossession procedures are initiated until at least six months following the emergence of arrears. Additionally, certain forbearance options are made available to customers within recoveries.

Forbearance

Within the Group's retail businesses, forbearance generally occurs when the business, for reasons relating to the actual or potential financial stress of a borrower, grants a permanent or temporary concession to that borrower. Forbearance is granted following an assessment of the customer's ability to pay. It is granted principally to customers with mortgages. Granting of forbearance to unsecured customers is less extensive.

Identification of forbearance

Mortgages are identified for forbearance treatment following initial contact from the customer, in the event of payment arrears or when the customer is transferred to collection or recoveries.

Types of retail forbearance

A number of forbearance options are utilised by the Group's retail businesses. These include, but are not limited to, reduced repayments, payment holidays, capitalisation of arrears, term extensions and conversion to interest only. Within UK Retail, interest only conversions are generally made available only to those customers who are current on payments and have a defined repayment source.

The principal types of forbearance granted in RBS Citizens' mortgage portfolio are the US government mandated HAMP (Home Affordable Modification Program) and Citizens' proprietary modification programme. Both programmes typically feature a combination of a term extensions, capitalisations of arrears, temporary interest rate reductions and conversions from interest only to amortising. These tend to be permanent changes to contractual terms. Borrowers seeking a modification must meet government specified qualifications for HAMP and internal qualifications for Citizens' modification programme. Both are designed to evidence that the borrower is in financial difficulty as well as demonstrating willingness to pay.

For those loans classified as non-performing, the Group's objective in granting forbearance is to minimise the loss on these accounts and wherever possible, return the customer to the performing book. For those loans that are performing, the aim is to enable customers to continue to service the loan.

The mortgage forbearance population is reviewed regularly to ensure that customers are meeting the agreed terms of the arrangement. Key metrics have been developed to record the proportion of customers who fail to meet the agreed terms over time as well as the proportion of customers who return to a performing state with no arrears.

The mortgage arrears information for retail accounts in forbearance and related provision arrangements are shown in the table below:

Arrears status and provisions	No missed payments		1-3 months in arrears		>3 months in arrears		Total		
	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Accounts forborne %
2011									
UK Retail (1,2)	3,677	16	351	13	407	59	4,435	88	4.7
Ulster Bank (1,2)	893	78	516	45	421	124	1,830	247	9.1
Citizens	—	—	91	10	89	10	180	20	0.8
Wealth	121	—	—	—	2	—	123	—	1.3
Total	4,691	94	958	68	919	193	6,568	355	4.4

Notes:
(1) Includes all forbearance arrangements regardless of whether or not the customer is experiencing financial difficulty.
(2) Comprises the current stock position of forbearance deals agreed since January 2008 for UK Retail and since July 2008 for Ulster Bank.
(3) Refer to page 63 for details of the proportion of UK Retail and Citizens mortgage loans that have missed three or more payments, compared to the forbearance population above.

The incidence of the main types of retail forbearance on the balance sheet as at 31 December 2011 is analysed below. For a small proportion of mortgages, more than one forbearance type applies.

Forbearance arrangements	UK Retail (1) £m	Ulster Bank (1) £m	Citizens £m	Wealth £m	Total (2) £m
2011					
Interest only conversions	1,269	795	—	3	2,067
Term extensions - capital repayment and interest only	1,805	58	—	97	1,960
Payment concessions/holidays	198	876	180	—	1,254
Capitalisation of arrears	864	101	—	—	965
Other	517	—	—	23	540
Total	4,653	1,830	180	123	6,786

Notes:
(1) Comprises the current stock position of forbearance deals agreed since January 2008 for UK Retail and since July 2008 for Ulster Bank.
(2) As an individual case can include more than one type of arrangement, the analysis in the table above can exceed the total forbearance.

For unsecured portfolios in UK Retail, 1.1% of the total unsecured population was subject to forbearance at 31 December 2011 and comprises either debt consolidation loans provided to customers subject to collections activity who do not meet the RBS Group's standard underwriting criteria or repayment arrangements where the customer's overdraft limit is increased to accommodate account excesses and/or loan arrears. Additionally, support is provided to customers experiencing financial difficulties through 'breathing space initiatives' on all unsecured products, including credit cards, whereby a 30-day period is given to allow customers to establish a debt repayment plan. During this time, the RBS Group suspends collection activity and a further extension of 30 days can be granted if progress is made and discussions are continuing. Arrears continue to accrue for customer loans benefiting from breathing space.

Within Citizens, granting of forbearance is significantly less extensive for non real estate portfolios, as it is predominantly restricted to the granting of short-term (1-3 months) loan extensions to customers to alleviate the financial burden caused by temporary hardship. Such extensions are offered only if a customer has demonstrated a capacity and willingness to pay following the extension term. The number and frequency of extensions are limited per customer. Additionally, in the case of loans secured by vehicles and credit cards, Citizens may offer temporary interest rate modifications but no principal reduction. For loans secured by vehicles, this is now restricted to three-month interest rate modifications. For credit cards, customers may be offered short-term (6-12 months) or longer-term (up to 60 months) interest rate modifications. Citizens may also provide forbearance to student loan borrowers consistent with the policy guidelines of the US Office of the Comptroller of the Currency.

Risk management: Credit risk continued

Problem debt management: Forbearance continued

Provisioning for retail customers

Within UK Retail and Ulster Bank, provisions are assessed in accordance with the RBS Group's provisioning policies (refer to Impairment loss provision methodology on page 123). For the non-performing population, a collective assessment is made. Within the performing book, latent loss provisions are held for those losses that are incurred but not yet identified.

The majority of mortgage accounts subject to forbearance in these divisions remain in the performing book but are identified and monitored separately from other performing accounts. They are subject to higher provisioning rates than the remainder of the performing book (currently approximately five times higher in UK Retail and approximately eight times higher in Ulster Bank). These rates are reviewed quarterly in UK Retail and monthly in Ulster Bank. Once forbearance is granted, the account continues to be assessed separately for latent provisioning for 24 months (UK Retail only) or until the forbearance period expires. After that point, the account is no longer separately identified for latent provisioning.

Non-performing mortgage accounts that have been granted forbearance carry the same provision rate as non-forborne accounts.

In Citizens, the amount of recorded impairment depends upon whether the loan is collateral dependent. If the loan is considered collateral dependent, the excess of the loan's carrying amount over the fair value of the collateral is the impairment amount. If the loan is not deemed collateral dependent, the excess of the loan's carrying amount over the present value of expected future cash flows is the impairment amount.

Credit risk mitigation

Introduction*

The RBS Group employs a number of structures and techniques to mitigate credit risk. Netting of debtor and creditor balances is undertaken in accordance with relevant regulatory and internal policies. Exposure on over-the-counter derivative and secured financing transactions is further mitigated by the exchange of financial collateral and the use of market standard documentation. Further mitigation may be undertaken in a range of transactions, from retail mortgage lending to large wholesale financing. This can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Such techniques are used in the management of credit portfolios, typically to mitigate credit concentrations in relation to an individual obligor, a borrower group or a collection of related borrowers.

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the RBS Group cover:

- The suitability of qualifying credit risk mitigation types and any conditions or restrictions applicable to those mitigants;
- The means by which legal certainty is to be established, including required documentation and all necessary steps required to establish legal rights;
- Acceptable methodologies for initial and any subsequent valuations of collateral and the frequency with which collateral is to be revalued and the use of collateral haircuts;
- Actions to be taken in the event that the value of mitigation falls below required levels;
- Management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation;
- Management of concentration risks, for example, by setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and
- Collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

* unaudited

Collateral and other credit enhancements received

Within its secured portfolios, the Group has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to the Group arising from the failure of a customer to meet its obligations. These include: cash deposits; charges over residential and commercial property, debt securities and equity shares; and third-party guarantees. The existence of collateral may affect the pricing of a facility and its regulatory capital requirement. When a collateralised financial asset becomes impaired, the impairment charge directly reflects the realisable value of collateral and any other credit enhancements.

Corporate exposures

The type of collateral taken by the Group's commercial and corporate businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- *Physical assets* - these include business assets such as stock, plant and machinery, vehicles, ships and aircraft. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.
- *Real estate* - the RBS Group takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically exceed the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm length transaction by a willing seller to a willing buyer.
- *Receivables* - when taking a charge over receivables, the RBS Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.

The security charges may be floating or fixed, with the type of security likely to impact (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

The RBS Group does not recognise certain asset classes as collateral: for example, short leasehold property and equity shares of the borrowing company. Collateral whose value is correlated to that of the obligor is assessed on a case-by-case basis and, where necessary, over-collateralisation may be required.

The RBS Group uses industry-standard loan and security documentation wherever possible. Non standard documentation is typically prepared by external lawyers on a case-by-case basis. The RBS Group's business and credit teams are supported by in-house specialist documentation teams.

The existence of collateral has an impact on provisioning. Where the RBS Group no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Corporate risk elements in lending and potential problem loans (excluding commercial real estate)	Group			
	2011		2010	
	Loans £m	Provisions £m	Loans £m	Provisions £m
Secured	7,206	2,925	6,121	2,329
Unsecured	1,582	1,179	1,462	926

Commercial real estate

The table below analyses commercial real estate lending by loan-to-value (LTV). Due to market conditions in Ireland and to a lesser extent in the UK, there is a shortage of market based data. In the absence of external valuations, the Group deploys a range of alternative approaches including internal expert judgement and indexation.

LTVs	Ulster Bank		Rest of the Group		Group	
	AQ1-AQ9 £m	AQ10 £m	AQ1-AQ9 £m	AQ10 £m	AQ1-AQ9 £m	AQ10 £m
2011						
<= 50%	81	28	7,091	332	7,172	360
> 50% and <= 70%	642	121	14,105	984	14,747	1,105
> 70% and <= 90%	788	293	10,042	1,191	10,830	1,484
> 90% and <= 100%	541	483	2,616	1,679	3,157	2,162
> 100% and <= 110%	261	322	1,524	1,928	1,785	2,250
> 110% and <= 130%	893	1,143	698	1,039	1,591	2,182
> 130%	1,468	10,004	672	2,994	2,140	12,998
Total with LTVs	4,674	12,394	36,748	10,147	41,422	22,541
Other (1)	7	38	8,994	1,844	9,001	1,882
Total	4,681	12,432	45,742	11,991	50,423	24,423
Total portfolio average LTV (2)	140%	259%	69%	129%	77%	201%

Notes:

(1) Other performing loans of £9.0 billion include unsecured lending to commercial real estate clients, such as major UK homebuilders. The credit quality of these exposures is consistent with that of the performing portfolio overall. Other non-performing loans of £1.9 billion are subject to the Group's standard provisioning policies.

(2) Weighted average by exposure.

Risk management: Credit risk continued
Credit risk mitigation continued
Wholesale markets exposures
As set out in the table below, the Group receives collateral for reverse repurchase transactions and for derivatives, typically in the form of cash, quoted debt securities or equities. The risks inherent in both types of transaction are further mitigated through master bilateral netting arrangements. Industry standard documentation such as master repurchase agreements and credit support annexes accompanied by legal opinion, is used for financial collateral taken as part of trading activities.

	2011 £bn	2010 £bn	2009 £bn
Reverse repurchase agreements	99.0	89.7	64.6
Securities received as collateral (1)	(97.9)	(88.9)	(64.3)
Derivative assets gross exposure			
- balances with holding company and fellow subsidiaries	10.4	17.5	32.0
- balances with third parties	522.4	411.5	414.4
Counterparty netting	(440.9)	(327.7)	(352.5)
Cash collateral held	(36.4)	(29.6)	(28.5)
Securities received as collateral	(5.3)	(2.9)	(3.6)

Note:
(1) In accordance with normal market practice, at 31 December 2011 £95.9 billion (2010 - £88.8 billion; 2009 - £62.8 billion) had been resold or re-pledged as collateral for the Group's own transactions.

Retail exposures
Within the Group's retail book, mortgage and home equity lending portfolios are secured by residential property. The Group's portfolio of US automobile loans is secured by motor cars or other vehicles. Student loans and credit card lending are all unsecured. The vast majority of personal loans are also unsecured.

All borrowing applications, whether secured or not, are subject to appropriate credit risk underwriting processes including affordability assessments. Pricing is typically higher on unsecured than secured loans. For secured loans, pricing will typically vary by LTV. Higher LTV products are typically subject to higher interest rates commensurate with the associated risk.

The value of a property intended to secure a mortgage is assessed during the loan underwriting process using industry-standard methodologies. Property values supporting home equity lending reflect either an individual appraisal or valuations generated by statistically valid automated valuation models. Property values are updated each quarter using the relevant house price index (the Halifax Quarterly Regional House Price Index in the UK, the Case-Shiller Home Value Index in the US, and the Central Statistics Office Residential Property Price Index and the Nationwide House Price Index in Ireland).

For automobile lending in the US, new vehicles are valued at cost and used vehicles at the average trade-in value. As at 31 December 2011, this portfolio amounted to £4.8 billion (2010 - £5.1 billion; 2009 - £5.7 billion), all of which was fully secured and predominantly (over 99%) in the performing book.

The existence of collateral has an impact on provisioning levels. Once a secured loan is classified as non-performing, the realisable value of the underlying collateral and the costs associated with repossession are used to estimate the provision required.

Residential mortgages
The table below shows period end LTVs for the Group's residential mortgage portfolio split between performing and non-performing and calculated on a value basis. Loan balances are as at the end of the year whereas property values are calculated using the appropriate index at 30 September 2011.

	2011		2010		2009	
Residential mortgages by average LTV	Performing £m	Non-performing £m	Performing £m	Non-performing £m	Performing £m	Non-performing £m
<= 70%	60,799	1,137	59,598	1,036	55,920	791
> 70% and <= 90%	42,923	1,022	41,964	906	38,807	697
> 90% and <= 110%	17,856	990	20,104	951	23,853	754
> 110% and <= 130%	5,809	573	7,211	622	8,604	507
> 130% (1)	6,684	1,188	3,793	507	3,059	269
Total	134,071	4,910	132,670	4,022	130,243	3,018
Total portfolio average LTV (by value)	73.2%	101.4%	72.4%	91.7%	73.5%	90.1%

Note:
(1) 83% of residential mortgages with LTV > 130% are within Ulster Bank due to the continued challenging economic environment in Ireland.

* unaudited

Credit risk measurement*

Credit risk models are used throughout the RBS Group to support the quantitative risk assessment element within the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. Credit risk models used by the RBS Group may be divided into three categories, as follows.

Probability of default/customer credit grade

These models assess the probability that a customer will fail to make full and timely repayment of its obligations. The probability of a customer failing to do so is measured over a one year period through the economic cycle, although certain retail scorecards use longer periods for business management purposes.

Wholesale businesses - as part of the credit assessment process, each counterparty is assigned an internal credit grade derived from a default probability. There are a number of different credit grading models in use across the RBS Group, each of which considers risk characteristics particular to that type of customer. The credit grading models score a combination of quantitative inputs (for example, recent financial performance) and qualitative inputs (for example, management performance or sector outlook).

Retail businesses - each customer account is separately scored using models based on the most material drivers of default. In general, scorecards are statistically derived using customer data. Customers are assigned a score, which in turn is mapped to a probability of default. The probabilities of default are used to support automated credit decision making and to group customers into risk pools for regulatory capital calculations.

Exposure at default

Facility usage models estimate the expected level of utilisation of a credit facility at the time of a borrower's default. For revolving and variable draw down type products which are not fully drawn, the exposure at default (EAD) will typically be higher than the current utilisation. The methodologies used in EAD modelling provide an estimate of potential exposure and recognise that customers may make more use of their existing credit facilities as they approach default.

Counterparty credit risk exposure measurement models are used for derivatives and other traded instruments, where the amount of credit risk exposure may be dependent upon one or more underlying market variables, such as interest or foreign exchange rates. These models drive internal credit risk management activities such as limit and excess management.

Loss given default

These models estimate the economic loss that may be experienced (the amount that cannot be recovered) by the RBS Group on a credit facility in the event of default. The RBS Group's loss given default models take into account both borrower and facility characteristics for unsecured or partially unsecured facilities, as well as the quality of any risk mitigation that may be in place for secured facilities, the cost of collections and a time discount factor for the delay in cash recovery.

Key credit portfolios*

Commercial real estate

The commercial real estate lending portfolio totalled £74.8 billion at 31 December 2011, a 14% decrease (2010 - £87.1 billion). The commercial real estate sector comprises exposure to entities involved in the development of or investment in commercial and residential properties (including homebuilders). The analysis below excludes rate risk management and contingent obligations.

	2011			2010			2009		
By division	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m
Core									
UK Corporate	25,101	5,023	30,124	24,879	5,819	30,698	27,143	7,331	34,474
Ulster Bank	3,882	881	4,763	4,284	1,090	5,374	6,131	3,838	9,969
US Retail & Commercial	4,235	70	4,305	4,322	93	4,415	2,812	1,084	3,896
Global Banking & Markets	1,013	360	1,373	904	577	1,481	1,543	590	2,133
	34,231	6,334	40,565	34,389	7,579	41,968	37,629	12,843	50,472
Non-Core									
UK Corporate	3,957	2,020	5,977	7,591	3,263	10,854	7,390	3,959	11,349
Ulster Bank	3,860	8,490	12,350	3,854	8,760	12,614	2,061	6,271	8,332
US Retail & Commercial	901	28	929	1,325	70	1,395	1,409	431	1,840
Global Banking & Markets	14,689	336	15,025	19,906	379	20,285	24,638	873	25,511
	23,407	10,874	34,281	32,676	12,472	45,148	35,498	11,534	47,032
Total	57,638	17,208	74,846	67,065	20,051	87,116	73,127	24,377	97,504

Risk management: Credit risk continued

Key credit portfolios*: Commercial real estate continued

By geography	Investment Commercial £m	Investment Residential £m	Development Commercial £m	Development Residential £m	Total £m	Investment Core £m	Investment Non-Core £m	Development Core £m	Development Non-Core £m	Total £m
2011										
UK (excluding NI) (1)	28,653	6,359	1,198	6,511	42,721	25,904	9,108	5,118	2,591	42,721
Ireland (ROI & NI) (1)	5,146	1,132	2,591	6,317	15,186	3,157	3,121	793	8,115	15,186
Western Europe	7,649	1,048	9	52	8,758	422	8,275	20	41	8,758
US	5,552	1,279	59	46	6,936	4,521	2,310	71	34	6,936
RoW	785	35	141	284	1,245	227	593	332	93	1,245
	47,785	9,853	3,998	13,210	74,846	34,231	23,407	6,334	10,874	74,846
2010										
UK (excluding NI) (1)	32,333	7,255	1,520	8,288	49,396	26,167	13,421	5,997	3,811	49,396
Ireland (ROI & NI) (1)	5,051	1,148	2,785	6,578	15,562	3,154	3,044	963	8,401	15,562
Western Europe	10,448	643	25	34	11,150	289	10,802	17	42	11,150
US	7,298	1,296	69	175	8,838	4,589	4,005	173	71	8,838
RoW	1,568	25	138	439	2,170	190	1,404	429	147	2,170
	56,698	10,367	4,537	15,514	87,116	34,389	32,676	7,579	12,472	87,116
2009										
UK (excluding NI) (1)	36,801	7,042	1,871	10,499	56,213	29,230	14,613	7,650	4,720	56,213
Ireland (ROI & NI) (1)	5,308	1,047	3,484	5,961	15,800	4,658	1,697	3,530	5,915	15,800
Western Europe	12,156	815	184	77	13,232	471	12,500	67	194	13,232
US	6,513	1,355	881	778	9,527	3,184	4,684	1,289	370	9,527
RoW	2,068	22	238	404	2,732	86	2,004	307	335	2,732
	62,846	10,281	6,658	17,719	97,504	37,629	35,498	12,843	11,534	97,504

Note:
(1) ROI: Republic of Ireland; NI: Northern Ireland.

By sub-sector	UK (excl NI) £m	Ireland (ROI & NI) £m	Western Europe £m	US £m	RoW £m	Total £m
2011						
Residential	12,871	7,449	1,096	1,325	319	23,060
Office	7,155	1,354	2,248	404	352	11,513
Retail	8,709	1,641	1,893	285	275	12,803
Industrial	4,317	507	520	24	105	5,473
Mixed/other	9,669	4,235	3,001	4,898	194	21,997
	42,721	15,186	8,758	6,936	1,245	74,846
2010						
Residential	15,543	7,726	677	1,471	464	25,881
Office	8,539	1,178	2,876	663	837	14,093
Retail	10,607	1,663	1,849	1,000	479	15,598
Industrial	4,912	515	711	58	106	6,302
Mixed/other	9,795	4,480	5,037	5,646	284	25,242
	49,396	15,562	11,150	8,838	2,170	87,116
2009						
Residential	17,197	7,352	892	2,134	425	28,000
Office	9,381	1,536	5,034	1,614	974	18,539
Retail	5,760	680	998	492	700	8,630
Industrial	11,374	2,599	3,592	2,044	402	20,011
Mixed/other	12,501	3,633	2,716	3,243	231	22,324
	56,213	15,800	13,232	9,527	2,732	97,504

Note:
(1) Excludes commercial real estate lending in Wealth as these loans are generally supported by personal guarantees in addition to collateral. This portfolio, which totalled £1.3 billion at 31 December 2011, continues to perform in line with expectations and requires minimal provision.

* unaudited

Key points

- In line with the Group's strategy, exposure to commercial real estate was reduced during 2011, affecting mainly the UK and Western Europe given that these regions account for the majority of the portfolio. Overall this portfolio decreased circa 23% from the end of 2009 to the end of 2011.
- Most of the decrease is in Non-Core due to run-off and asset sales. The Non-Core portfolio totalled £34.3 billion (46% of the portfolio) at 31 December 2011 (2010 - £45.1 billion, or 52% of the portfolio) and includes exposures in Ulster Bank as discussed on page 70.
- With the exception of exposure in Spain and in Ireland, the Group has minimal commercial real estate exposure to other eurozone periphery countries. Exposure in Spain is predominantly in the Non-Core portfolio and totals £2.3 billion, of which 36% is in AQ1-AQ9. The remainder of the Spanish portfolio has already been subject to material write-off and provision levels have been assessed based on re-appraised values. There are significant differences in values based on geographic location and asset type.
- The UK portfolio is focused on London and the South East (44%), with the remainder well spread across the UK regions.
- Short-term lending to property developers without sufficient pre-let revenue at origination to support investment financing after practical completion is classified as speculative. Speculative lending at origination represents approximately 1% of the portfolio. The RBS Group's appetite for originating speculative commercial real estate lending is very limited and any such business requires senior management approval.
- The commercial real estate market is expected to remain challenging in key markets and new business will be accommodated from run-off of existing Core exposure. As liquidity in the market remains tight, the Group is focusing on re-financings and supporting its existing client base.

Maturity profile of portfolio

2011	UK Corporate £m	Ulster Bank £m	US Retail & Commercial £m	Global Banking & Markets £m	Total £m
Core					
< 1 year (1)	8,268	3,030	1,056	142	12,496
1-2 years	5,187	391	638	278	6,494
2-3 years	3,587	117	765	363	4,832
> 3 years	10,871	1,225	1,846	590	14,532
Not classified (2)	2,211	—	—	—	2,211
Total	30,124	4,763	4,305	1,373	40,565
Non-Core					
< 1 year (1)	3,224	11,089	293	7,093	21,699
1-2 years	508	692	163	3,064	4,427
2-3 years	312	177	152	1,738	2,379
> 3 years	1,636	392	321	3,126	5,475
Not classified (2)	297	—	—	4	301
Total	5,977	12,350	929	15,025	34,281

Notes:
(1) Includes on demand and past due assets.
(2) Predominantly comprises multi-option facilities for which there is no single maturity date.

Key point

- The majority of Ulster Bank Group's commercial real estate portfolio is categorised as < 1 year, including on demand assets, owing to the high level of non-performing assets in the portfolio. Ulster Bank places most restructured facilities on demand rather than extending the maturity date.

Breakdown of portfolio by asset quality (AQ) band

2011	AQ1-AQ2 £m	AQ3-AQ4 £m	AQ5-AQ6 £m	AQ7-AQ8 £m	AQ9 £m	AQ10 £m	Total £m
Core	1,094	6,714	19,054	6,254	3,111	4,338	40,565
Non-Core	680	1,287	5,951	3,893	2,385	20,085	34,281
Total	1,774	8,001	25,005	10,147	5,496	24,423	74,846

Key point

- Approximately 13% of the commercial real estate exposure is within the AQ1-AQ4 bands. This includes unsecured lending to property companies and real estate investment trusts. The high proportion of the exposure in the AQ10 band is driven by Ulster Bank Group (Core and Non-Core) and GBM (Non-Core).

Risk management: Credit risk continued

Key credit portfolios*: Commercial real estate continued

The table below analyses commercial real estate lending by loan-to-value (LTV). Due to market conditions in Ireland and to a lesser extent in the UK, there is a shortage of market based data. In the absence of external valuations, the Group deploys a range of alternative approaches including internal expert judgement and indexation.

LTVs	Ulster Bank AQ1-AQ9 £m	Ulster Bank AQ10 £m	Rest of the Group AQ1-AQ9 £m	Rest of the Group AQ10 £m	Group AQ1-AQ9 £m	Group AQ10 £m
2011						
<= 50%	81	28	7,091	332	7,172	360
> 50% and <= 70%	642	121	14,105	984	14,747	1,105
> 70% and <= 90%	788	293	10,042	1,191	10,830	1,484
> 90% and <= 100%	541	483	2,616	1,679	3,157	2,162
> 100% and <= 110%	261	322	1,524	1,928	1,785	2,250
> 110% and <= 130%	893	1,143	698	1,039	1,591	2,182
> 130%	1,468	10,004	672	2,994	2,140	12,998
Total with LTVs	4,674	12,394	36,748	10,147	41,422	22,541
Other (1)	7	38	8,994	1,844	9,001	1,882
Total	4,681	12,432	45,742	11,991	50,423	24,423
Total portfolio average LTV (2)	140%	259%	69%	129%	77%	201%

Notes:

(1) Other performing loans of £9.0 billion include unsecured lending to commercial real estate clients, such as major UK homebuilders. The credit quality of these exposures is consistent with that of the performing portfolio overall. Other non-performing loans of £1.9 billion are subject to the Group's standard provisioning policies.

(2) Weighted average by exposure.

Key points

- Nearly 85% of the commercial real estate portfolio with LTV > 100% is within Ulster Bank Group (Core and Non-Core) and GBM (Non-Core). A majority of portfolios are managed within the GRG and are subject to monthly reviews. Significant levels of provisions have been taken against these portfolios; provisions as a percentage of risk elements in lending for the Ulster Bank Group commercial real estate portfolio were 53% at 31 December 2011 (2010 - 44%). The reported LTV levels are based on gross loan values. The weighted average LTV for AQ10 excluding Ulster Bank is 129%.
- The average interest coverage ratios (ICR) for UK Corporate (Core and Non-Core) and GBM (Non-Core) investment properties are 2.37x and 1.25x respectively. The US Retail & Commercial portfolio is managed on the basis of debt service coverage, which includes scheduled principal amortisation. The average debt service interest coverage for this portfolio on this basis was 1.24x at 31 December 2011. There are a number of different approaches used within the Group and across the industry to calculate ICR. Ratios for different portfolio types, and organisations may not therefore be comparable.

Retail assets

The Group's retail lending portfolio includes mortgages, credit cards, unsecured loans, auto finance and overdrafts. The majority of personal lending exposures are in the UK, Ireland and the US. The analysis below includes both Core and Non-Core balances.

Personal credit loans and receivables	2011 £m	2010 £m	2009 £m
UK Retail			
- mortgages	96,388	92,592	85,529
- cards, loans and overdrafts	16,004	18,072	20,316
Ulster Bank			
- mortgages	20,020	21,162	22,304
- other personal	1,533	1,017	1,172
Citizens			
- mortgages	23,829	24,575	26,534
- auto and cards	5,731	6,062	6,917
- other (1)	2,111	3,455	4,205
Other	15,130	14,588	12,345
	180,746	181,523	179,322

Note:

(1) Mainly student loans and loans secured by recreational vehicles or marine vessels.

*unaudited

Residential mortgages

The tables below detail the distribution of residential mortgages by indexed LTV. LTV averages are calculated by transaction volume and transaction value. Refer to the section on Ulster Bank Group on page 69 for analysis of residential mortgages.

LTV distribution calculated on a volume basis	UK Retail			Citizens		
	2011 %	2010 %	2009 %	2011 %	2010 %	2009 %
<= 70%	62.1	61.6	60.2	43.5	43.4	43.6
> 50% and <= 90%	27.1	26.2	24.5	26.9	27.6	26.8
> 90% and <= 110%	9.4	10.4	12.5	16.7	17.2	18.0
> 110% and <= 130%	1.4	1.7	2.7	6.9	6.0	5.4
> 130%	—	0.1	0.1	6.0	5.8	6.2
Total portfolio average LTV at 31 December	57.8	58.2	59.1	73.8	75.3	74.5
Average LTV on new originations during the year	58.4	64.2	67.2	63.8	64.8	62.6

LTV distribution calculated on a value basis	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
<= 70%	47,811	44,522	37,666	9,669	10,375	11,675
> 50% and <= 90%	34,410	32,299	28,280	7,011	7,196	7,440
> 90% and <= 110%	11,800	12,660	15,112	3,947	4,080	4,569
> 110% and <= 130%	1,713	1,924	3,104	1,580	1,488	1,486
> 130%	74	73	86	1,263	1,252	1,540
Total portfolio average LTV at 31 December	67.2%	68.1%	70.4%	75.9%	75.4%	74.7%
Average LTV on new originations during the year	63.0%	68.0%	70.3%	65.8%	65.3%	64.4%

Residential mortgages which are three months or more in arrears (by volume)	2011 %	2010 %	2009 %
UK Retail (1)	1.6	1.7	1.6
Citizens	2.0	1.4	1.5

Note:

(1) The 'One Account' current account mortgage is excluded (£5.4 billion - 5.6% of assets) at 31 December 2011, 0.9% of these accounts were 90 days continually in excess of the limit (2010 - 0.8%). Consistent with the way the Council of Mortgage Lenders publishes member arrears information, the 3+ months arrears rate now excludes accounts in repossession and cases with shortfalls post property sale.

Risk management: Credit risk continued

Key credit portfolios*: Retail assets continued

Key points

UK Retail

- The UK Retail mortgage portfolio totalled £96.4 billion (98.6% in Core) at 31 December 2011, an increase of 4.1% from 2010, due to continued strong sales growth and lower redemption rates from before the financial crisis.

- Of the total portfolio, 98.6% is designated as Core business, primarily comprising mortgages branded the Royal Bank of Scotland, NatWest, the One Account and First Active. Non-Core comprises Direct Line Mortgages.

- The assets are prime mortgages and include 7.2% (£6.9 billion) of exposure to residential buy-to-let. There is a small legacy self-certification book (0.3% of total assets). Self-certified mortgages were withdrawn from sale in 2004.

- Gross new mortgage lending in 2011 remained strong at £14.7 billion. The average LTV for new business during 2011 declined in comparison to 2010 and the maximum LTV available to new customers remained at 90%. Based on the Halifax House Price index at September 2011, the book average indexed LTV improved marginally when compared to December 2010, with the proportion of balances with an LTV over 100% also lower. Refer to the table on page 63, which details LTV information on a volume and value basis.

- The arrears rate (more than three payments in arrears, excluding repossessions and shortfalls post property sale) has remained broadly stable since late 2009 at 1.6%.

- The number of properties repossessed in 2011 was 1,671, up from 1,392 in 2010.

- The mortgage impairment charge was £187 million for 2011, an increase of 2% from 2010. A significant part of the mortgage impairment charge related to reduced expectations of cash recovery on already defaulted debt. It also included an additional provision charge for mortgage customers who received forbearance.

- Default and arrears rates remain sensitive to economic developments and are currently supported by the low interest rate environment and strong book growth, with recent business yet to fully mature.

Citizens real estate

- Citizens' residential mortgage portfolio totalled £23.8 billion at 31 December 2011, a reduction of 3% from 2010 (£24.6 billion).

- The mortgage portfolio comprises £6.4 billion of residential mortgages (99% in first lien position: Core - £5.8 billion; Non-Core - £0.6 billion) and £17.4 billion of home equity loans and lines (41% in first lien position: Core - £14.9 billion; Non-Core - £2.5 billion). Home equity Core consists of 47% in first lien position.

- Citizens continues to focus on the 'footprint' states of New England, Mid Atlantic and Mid West, targeting low risk products and maintaining conservative risk policies. At 31 December 2011, the portfolio consisted of £19.5 billion (82% of the total portfolio) within footprint.

- Loan acceptance criteria were tightened during 2009 to address deteriorating economic and market conditions.

- Non-Core comprises 13% of the residential mortgage portfolio. Its largest component (74%) is the serviced by others (SBO) home equity portfolio. The SBO portfolio consists of purchased pools of home equity loans and lines, which resulted in an annualised charge-off rate of 8.7% in 2011. It is characterised by out-of-footprint geographies, high second lien concentration (95%) and high average LTV (113% at 31 December 2011). The SBO book has been closed to new purchases since the third quarter of 2007 and is in run-off, with exposure down from £2.8 billion in 2010, to £2.3 billion at 31 December 2011. The arrears rate of the SBO portfolio decreased from 3.0% in 2010, to 2.3% at 31 December 2011, as the legacy of poorer assets receded, and account servicing and collections became more effective following a servicer conversion in 2009.

*unaudited

Retail credit assets: Personal lending

The Group's personal lending portfolio includes credit cards, unsecured loans, auto finance and overdrafts. The majority of personal lending exposures exist in the UK and the US. Impairment charges as a proportion of average loans and receivables are shown in the following table.

	2011		2010		2009	
Personal lending	Average loans and receivables £m	Impairment charge as a % of average loans and receivables %	Average loans and receivables £m	Impairment charge as a % of average loans and receivables %	Average loans and receivables £m	Impairment charge as a % of average loans and receivables %
UK Retail cards (1)	5,675	3.0	6,025	5.0	6,101	8.7
UK Retail loans(1)	7,755	2.8	9,863	4.8	12,062	5.9
Citizens cards (2)	936	5.1	1,005	9.9	1,145	9.7
Citizens auto loans (2)	4,856	0.2	5,256	0.6	6,306	1.2

Notes:
(1) The ratio for UK Retail assets refers to the impairment charges for the year. This is the Core UK loans book and excludes the Non-Core direct loans book that was sold in late 2011.
(2) The ratio for Citizens refers to the impairment charges in the year, net of recoveries realised in the year.

Key points

UK Retail

- The UK personal lending portfolio, of which 99.4% is in Core businesses, comprises credit cards, unsecured loans and overdrafts, and totalled £16.0 billion at 31 December 2011 (2010 - £18.1 billion).
- The decrease in portfolio size of 11.6% was driven by continued subdued loan recruitment activity and a continuing general market trend of customers repaying unsecured debt.
- The Non-Core portfolio consists of the direct finance loan portfolios (Direct Line, Lombard, Mint and Churchill) and totalled £0.1 billion at 31 December 2011 (2010 - £0.4 billion). In the last quarter of 2011, a portfolio of £170 million of balances was disposed of.
- Risk appetite continues to be actively managed across all products with investment in collection and recovery processes continuing, addressing both continued support for the Group’s customers and the management of impairments.
- Support continues for customers experiencing financial difficulties through ‘breathing space initiatives’. Refer to the disclosures on forbearance on page 55 for more information.
- The impairment charge on unsecured lending was £579 million for the year, down 42% on 2010, reflecting the effect of risk appetite tightening. The sale of the direct finance loan book gave rise to a one-off benefit of approximately £30 million.
- Impairments remain sensitive to the external environment, including unemployment levels and interest rates.
- Industry benchmarks for cards arrears remain stable, with the Group continuing to perform favourably.

Citizens

- Citizens’ average credit card portfolio totalled £936 million during 2011, with Core assets comprising 90.2% of the portfolio. Citizens’ cards business has traditionally adopted conservative risk strategies compared with the US market and given the economic climate, has introduced tighter lending criteria and lower credit limits. These actions have led to improving new business quality and a business performing better than industry benchmarks (provided by VISA). The latest available metrics show the 60+ days delinquency as a percentage of total outstandings at 2.15% at November 2011 (compared to an industry figure of 2.45%) and net contractual charge-offs as a percentage of total outstandings at 2.89% at November 2011 (compared to an industry figure of 3.69%).
- Citizens’ average auto loan portfolio totalled £4.9 billion during 2011, of which 98% is considered Core. £101 million (2%) is Non-Core and anticipated to run off by 2013. Citizens’ vehicle financing business lends to US consumers through a network of 4,200 auto dealers in 25 US states. Citizens’ credit policy is considered conservative, targeting prime customers and has historically experienced credit losses below those of industry peers.
- The net write-off rate on the total auto portfolio fell to 0.18% at 31 December 2011, from 0.34% in 2010. The 30+ days past due delinquency rate fell to 1.04% at 31 December 2011, from 1.57% in 2010.

Risk management: Credit risk continued

Key credit portfolios*: Ulster Bank Group (Core and Non-Core)

At 31 December 2011, Ulster Bank Group accounted for 10% of the RBS Group's total customer loans (2010 - 10%; 2009 - 10%) and 9% of the RBS Group's Core customer loans (2010 - 9%; 2009 - 9%). Ulster Bank's financial performance continues to be overshadowed by the challenging economic climate in Ireland, with impairments remaining elevated as high unemployment, coupled with higher taxation and limited liquidity in the economy, continues to depress the property market and domestic spending.

The impairment charge of £3,717 million for 2011 (2010 - £3,843 million; 2009 - £1,926 million) was driven by a combination of new defaulting customers and deteriorating security values. Provisions as a percentage of risk elements in lending increased from 44% in 2010, to 53% at 31 December 2011, predominantly as a result of the deterioration in the value of the Non-Core commercial real estate development portfolio.

Core

The impairment charge for the year of £1,384 million (2010 - £1,161 million; 2009 - £649 million) reflects the difficult economic climate in Ireland, with elevated default levels across both mortgage and other corporate portfolios. The mortgage sector accounted for £570 million (41%) of the total 2011 impairment charge.

Non-Core

The impairment charge for the year was £2,333 million (2010 - £2,682 million; 2009 - £1,277 million), with the commercial real estate sector accounting for £2,160 million (93%) of the total 2011 charge.

Loans, risk elements in lending (REIL) and impairments by sector

2011	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Mortgages	20,020	2,184	945	10.9	43	4.7	570	11
Personal unsecured	1,533	201	184	13.1	92	12.0	56	25
Commercial real estate								
- investment	3,882	1,014	413	26.1	41	10.6	225	—
- development	881	290	145	32.9	50	16.5	99	16
Other corporate	7,736	1,834	1,062	23.7	58	13.7	434	72
	34,052	5,523	2,749	16.2	50	8.1	1,384	124
Non-Core								
Commercial real estate								
- investment	3,860	2,916	1,364	75.5	47	35.3	609	1
- development	8,490	7,536	4,295	88.8	57	50.6	1,551	32
Other corporate	1,630	1,159	642	71.1	55	39.4	173	16
	13,980	11,611	6,301	83.1	54	45.1	2,333	49
Ulster Bank Group								
Mortgages	20,020	2,184	945	10.9	43	4.7	570	11
Personal unsecured	1,533	201	184	13.1	92	12.0	56	25
Commercial real estate								
- investment	7,742	3,930	1,777	50.8	45	23.0	834	1
- development	9,371	7,826	4,440	83.5	57	47.4	1,650	48
Other corporate	9,366	2,993	1,704	32.0	57	18.2	607	88
	48,032	17,134	9,050	35.7	53	18.8	3,717	173

*unaudited

2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Mortgages	21,162	1,566	439	7.4	28	2.1	294	7
Personal unsecured	1,282	185	158	14.4	85	12.3	48	30
Commercial real estate								
- investment	4,284	598	332	14.0	56	7.7	259	—
- development	1,090	65	37	6.0	57	3.4	116	—
Other corporate	9,039	1,205	667	13.3	55	7.4	444	11
	36,857	3,619	1,633	9.8	45	4.4	1,161	48
Non-Core								
Mortgages	—	—	—	—	—	—	42	—
Commercial real estate								
- investment	3,854	2,391	1,000	62.0	42	25.9	630	—
- development	8,760	6,341	2,783	72.4	44	31.8	1,759	—
Other corporate	1,970	1,310	561	66.5	43	28.5	251	—
	14,584	10,042	4,344	68.9	43	29.8	2,682	—
Ulster Bank Group								
Mortgages	21,162	1,566	439	7.4	28	2.1	336	7
Personal unsecured	1,282	185	158	14.4	85	12.3	48	30
Commercial real estate								
- investment	8,138	2,989	1,332	36.7	45	16.4	889	—
- development	9,850	6,406	2,820	65.0	44	28.6	1,875	—
Other corporate	11,009	2,515	1,228	22.8	49	11.2	695	11
	51,441	13,661	5,977	26.6	44	11.6	3,843	48

Risk management: Credit risk continued

Key credit portfolios*: Ulster Bank Group (Core and Non-Core) continued

Loans, risk elements in lending (REIL) and impairements by sector continued

2009	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Mortgages	16,199	558	102	3.4	18	0.6	74	3
Personal unsecured	2,433	174	145	7.2	83	6.0	66	27
Commercial real estate								
- investment	6,131	250	105	4.1	42	1.7	84	—
- development	3,838	428	284	11.2	66	7.4	221	4
Other corporate	11,106	850	326	7.7	38	2.9	204	—
	39,707	2,260	962	5.7	43	2.4	649	34
Non-Core								
Mortgages	6,002	324	51	5.4	16	0.8	42	—
Commercial real estate								
- investment	2,061	1,498	308	72.7	21	14.9	286	—
- development	6,271	3,840	822	61.2	21	13.1	732	—
Other corporate	1,373	1,126	322	82.0	29	23.5	217	—
	15,707	6,788	1,503	43.2	22	9.6	1,277	—
Ulster Bank Group								
Mortgages	22,201	882	153	4.0	17	0.7	116	3
Personal unsecured	2,433	174	145	7.2	83	6.0	66	27
Commercial real estate								
- investment	8,192	1,748	413	21.3	24	5.0	370	—
- development	10,109	4,268	1,106	42.2	26	10.9	953	4
Other corporate	12,479	1,976	648	15.8	33	5.2	421	—
	55,414	9,048	2,465	16.3	27	4.4	1,926	34

Key points

- REIL increased by £3.5 billion during the year, which reflects continuing difficult conditions in both the commercial and residential sectors in Ireland. Growth moderated in the last two quarters of 2011 as default trends for corporate portfolios declined.
- At 31 December 2011, 68% of REIL was in Non-Core (2010 - 74%; 2009 - 75%). The majority of the Non-Core commercial real estate development portfolio (89%) is REIL with a 57% provision coverage.

*unaudited

Residential mortgages

The tables below show how the continued decrease in property values has affected the distribution of residential mortgages by indexed LTV. LTV is based upon gross loan amounts and whilst including defaulted loans, does not take account of provisions made.

LTV distribution calculated on a volume basis*	2011 %	2010 %	2009 %
<= 70%	45.0	50.3	59.2
> 70% and <= 90%	11.4	13.0	12.0
> 90% and <= 110%	12.0	14.5	13.4
> 110% and <= 130%	10.9	13.5	11.3
> 130%	20.7	8.7	4.1
Total portfolio average LTV at 31 December	81.0	71.2	62.5
Average LTV on new originations during the year	67.0	75.9	72.8

LTV distribution calculated on a value basis	2011 £m	2010 £m	2009 £m
<= 70%	4,526	5,928	7,393
> 70% and <= 90%	2,501	3,291	3,830
> 90% and <= 110%	3,086	4,256	4,907
> 110% and <= 130%	3,072	4,391	4,491
> 130%	6,517	2,958	1,681
Total portfolio average LTV at 31 December	106.1%	91.7%	86.2%
Average LTV on new originations during the year	73.9%	78.9%	78.5%

Key points

- The residential mortgage portfolio across Ulster Bank Group totalled £20 billion at 31 December 2011, with 89% in the Republic of Ireland and 11% in Northern Ireland. At constant exchange rates the portfolio decreased by 4% from 2010, as a result of natural amortisation and limited growth due to low market demand.

- The mortgage REIL continued to increase as a result of the continued challenging economic environment. At 31 December 2011, REIL as a percentage of gross mortgages was 10.9% (by value) compared with 7.4% in 2010. The impairment charge for 2011 was £570 million compared with £336 million for 2010. Repossession levels were higher than in 2010, with a total of 161 properties repossessed during 2011 (compared with 76 during 2010). 76% of repossessions during 2011 were through voluntary surrender or abandonment of the property.

- Ulster Bank is assisting customers in this difficult environment. Mortgage forbearance policies which are deployed through the 'Flex' initiative are aimed at assisting customers in financial difficulty. At 31 December 2011, 9.1% (by value) of the mortgage book (£1.8 billion) was on a forbearance arrangement compared with 5.8% (£1.2 billion) at 31 December 2010. The majority of these forbearance arrangements are in the performing book (77%) and not 90 days past due.

Risk management: Credit risk continued

Key credit portfolios*: Ulster Bank Group (Core and Non-Core) continued

Commercial real estate

The commercial real estate lending portfolio for Ulster Bank Group totalled £17.1 billion at 31 December 2011, of which £12.3 billion or 72% is Non-Core. The geographic split of the total Ulster Bank Group commercial real estate portfolio remained similar to 2010, with 26% in Northern Ireland, 63% in the Republic of Ireland and 11% in the UK.

Exposure by geography	Development		Investment		
	Commercial £m	Residential £m	Commercial £m	Residential £m	Total £m
2011					
Ireland (ROI & NI)	2,591	6,317	5,097	1,132	15,137
UK (excluding NI)	95	336	1,371	111	1,913
RoW	—	32	27	4	63
	2,686	6,685	6,495	1,247	17,113
2010					
Ireland (ROI & NI)	2,785	6,578	5,032	1,098	15,493
UK (excluding NI)	110	359	1,869	115	2,453
RoW	—	18	23	1	42
	2,895	6,955	6,924	1,214	17,988
2009					
Ireland (ROI & NI)	3,075	5,961	5,314	1,031	15,381
UK (excluding NI)	217	849	1,692	132	2,890
RoW	—	7	20	3	30
	3,292	6,817	7,026	1,166	18,301

Key points

- Commercial real estate remains the primary driver of the increase in the defaulted loan book for Ulster Bank Group. The outlook remains challenging, with limited liquidity in the marketplace to support sales or refinancing. The decrease in asset valuations has placed pressure on the portfolio.
- Within its early problem management framework, Ulster Bank may agree various remedial measures with customers whose loans are performing but who are experiencing temporary financial difficulties. During 2011, commercial real estate loans amounting to £0.8 billion (exposures greater than £10 million) benefited from such measures.
- During 2011, impaired commercial real estate loans amounting to £1 billion (exposures greater than £10 million) were restructured and remain in the non-performing book.

*unaudited

Balance sheet analysis

The following tables provide an analysis of credit concentration of financial assets by sector, geography and internal credit quality gradings. Total committed exposures (TCE) analysed on the preceding pages are reported internally to senior management. However, they exclude certain exposures, primarily trading securities, and take account of legal agreements, including master netting arrangements that provide a right of legal set-off but do not meet the criteria for offset in IFRS. The analysis below is therefore provided to supplement the TCE analysis and to reconcile to the consolidated balance sheet.

Credit concentration: Sector and geographical region

The tables on pages 71 to 91 analyse total financial assets gross of provisions by sector and geographical region.

Sector concentration

The tables on pages 71 to 73 analyse total financial assets by sector.

	Group											
		Loans and advances			Securities							
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Total												
Central and local government	2,247	8,337	517	8,854	106,341	328	106,669	5,455	549	123,774	1,098	122,676
Finance	95,993	74,344	2,959	77,303	58,271	3,909	62,180	492,856	74,103	802,435	524,611	277,824
Residential mortgages	—	138,321	4,355	142,676	—	—	—	48	—	142,724	—	142,724
Personal lending	—	30,151	1,330	31,481	—	—	—	52	7	31,540	7	31,533
Property	—	38,310	37,693	76,003	462	174	636	4,446	1	81,086	1,274	79,812
Construction	—	6,169	2,512	8,681	50	29	79	905	—	9,665	1,139	8,526
Manufacturing	254	18,030	4,035	22,065	446	1,921	2,367	3,317	306	28,309	2,214	26,095
Service industries and business activities												
- retail, wholesale and repairs	—	18,175	2,000	20,175	366	2,406	2,772	1,045	—	23,992	1,671	22,321
- transport and storage	436	15,675	4,576	20,251	207	68	275	3,382	—	24,344	206	24,138
- health, education and recreation	—	13,171	1,371	14,542	119	13	132	871	—	15,545	973	14,572
- hotels and restaurants	—	7,118	1,111	8,229	107	3	110	669	—	9,008	184	8,824
- utilities	—	4,959	1,627	6,586	608	285	893	3,266	—	10,745	450	10,295
- other	23	20,354	2,256	22,610	1,093	2,754	3,847	6,003	455	32,938	854	32,084
Agriculture, forestry and fishing	—	3,374	124	3,498	8	11	19	39	—	3,556	148	3,408
Finance leases and instalment credit	—	8,355	6,059	14,414	127	2	129	73	—	14,616	16	14,600
Interest accruals	64	599	85	684	720	—	720	—	—	1,468	—	1,468
Total third-party	99,017	405,442	72,610	478,052	168,925	11,903	180,828	522,427	75,421	1,355,745	534,845	820,900
Amounts due from holding company and fellow subsidiaries	—	27,960	64	28,024	802	—	802	10,380	—	39,206	—	39,206
Total gross of provisions	99,017	433,402	72,674	506,076	169,727	11,903	181,630	532,807	75,421	1,394,951	534,845	860,106
Provisions	—	(7,751)	(10,803)	(18,554)	(586)	(141)	(727)	—	—	(19,281)	n/a	(19,281)
Total	99,017	425,651	61,871	487,522	169,141	11,762	180,903	532,807	75,421	1,375,670	534,845	840,825

Comprising:	
Repurchase agreements	15,246
Derivative balances	477,304
Derivative collateral	30,345
Other	11,950
	534,845

For the notes relating to this table refer to page 81.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

	Group											
		Loans and advances			Securities							
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Total												
Central and local government	626	6,473	667	7,140	104,735	767	105,502	7,228	285	120,781	3,916	116,865
Finance	88,496	81,641	7,262	88,903	52,783	751	53,534	385,873	57,904	674,710	396,404	278,306
Residential mortgages	—	140,351	5,326	145,677	—	—	—	6	—	145,683	19	145,664
Personal lending	—	32,552	3,452	36,004	1	—	1	15	7	36,027	11	36,016
Property	—	41,934	47,081	89,015	2,620	190	2,810	3,730	28	95,583	1,046	94,537
Construction	—	8,163	3,092	11,255	48	—	48	740	—	12,043	1,406	10,637
Manufacturing	389	19,271	5,469	24,740	696	23	719	2,880	—	28,728	2,156	26,572
Service industries and business activities												
- retail, wholesale and repairs	—	18,635	2,551	21,186	404	13	417	1,057	—	22,660	2,467	20,193
- transport and storage	—	14,972	6,773	21,745	353	6	359	2,576	—	24,680	224	24,456
- health, education and recreation	—	17,267	1,737	19,004	1,464	26	1,490	1,151	—	21,645	1,047	20,598
- hotels and restaurants	—	8,149	1,472	9,621	276	—	276	515	—	10,412	253	10,159
- utilities	—	6,038	1,807	7,845	1,084	11	1,095	2,043	2	10,985	985	10,000
- other	124	19,591	2,867	22,458	1,259	670	1,929	3,668	390	28,569	1,377	27,192
Agriculture, forestry and fishing	—	3,618	133	3,751	28	1	29	40	—	3,820	115	3,705
Finance leases and instalment credit	—	8,273	8,530	16,803	10	2	12	14	—	16,829	134	16,695
Interest accruals	55	745	220	965	742	—	742	—	—	1,762	—	1,762
Total third-party	89,690	427,673	98,439	526,112	166,503	2,460	168,963	411,536	58,616	1,254,917	411,560	843,357
Amounts due from holding company and fellow subsidiaries	—	6,624	170	6,794	11	—	11	17,469	—	24,274	—	24,274
Total gross of provisions	89,690	434,297	98,609	532,906	166,514	2,460	168,974	429,005	58,616	1,279,191	411,560	867,631
Provisions	—	(7,349)	(9,421)	(16,770)	(485)	(120)	(605)	—	—	(17,375)	n/a	(17,375)
Total	89,690	426,948	89,188	516,136	166,029	2,340	168,369	429,005	58,616	1,261,816	411,560	850,256

Comprising:	
Repurchase agreements	10,712
Derivative balances	357,281
Derivative collateral	28,245
Other	15,322
	411,560

For the notes relating to this table refer to page 81.

2009	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
	Group											
Total												
Central and local government	129	5,739	808	6,547	109,821	780	110,601	6,924	172	124,373	1,723	122,650
Finance	63,966	69,298	8,836	78,134	63,456	1,102	64,558	388,786	36,006	631,450	365,912	265,538
Residential mortgages	—	127,867	12,332	140,199	—	—	—	11	—	140,210	7	140,203
Personal lending	—	34,172	5,168	39,340	1	—	1	38	7	39,386	21	39,365
Property	—	48,505	49,626	98,131	3,907	178	4,085	4,136	1	106,353	1,114	105,239
Construction	—	9,039	4,909	13,948	113	114	227	908	45	15,128	1,450	13,678
Manufacturing	182	22,174	8,661	30,835	563	4	567	2,900	14	34,498	3,120	31,378
Service industries and business activities												
- retail, wholesale and repairs	—	19,653	3,958	23,611	502	8	510	976	—	25,097	2,549	22,548
- transport and storage	—	15,865	7,664	23,529	523	12	535	1,811	—	25,875	201	25,674
- health, education and recreation	21	18,369	3,129	21,498	1,995	52	2,047	1,292	—	24,858	1,057	23,801
- hotels and restaurants	—	9,653	1,678	11,331	411	—	411	832	—	12,574	284	12,290
- utilities	—	5,322	2,578	7,900	571	6	577	2,572	—	11,049	445	10,604
- other	281	19,192	5,072	24,264	1,936	375	2,311	3,087	1	29,944	1,258	28,686
Agriculture, forestry and fishing	—	3,545	486	4,031	1	1	2	44	—	4,077	76	4,001
Finance leases and instalment credit	—	8,140	11,946	20,086	282	3	285	16	—	20,387	39	20,348
Interest accruals	63	1,083	298	1,381	771	—	771	—	—	2,215	—	2,215
Total third-party	64,642	417,616	127,149	544,765	184,853	2,635	187,488	414,333	36,246	1,247,474	379,256	868,218
Amounts due from holding company and fellow subsidiaries	—	7,145	78	7,223	873	—	873	32,020	—	40,116	—	40,116
Total gross of provisions	64,642	424,761	127,227	551,988	185,726	2,635	188,361	446,353	36,246	1,287,590	379,256	908,334
Provisions	—	(6,067)	(5,953)	(12,020)	(545)	(230)	(775)	—	—	(12,795)	n/a	(12,795)
Total	64,642	418,694	121,274	539,968	185,181	2,405	187,586	446,353	36,246	1,274,795	379,256	895,539

For the notes relating to this table refer to page 81.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

Loans and advances to banks and customers by geographical region

The table below analyses loans and advances including reverse repos, gross of provisions by geographical region (location of office).

	Group		
	2011 £m	2010 £m	2009 £m
Loans and advances to banks (1)			
- UK	50,455	62,015	44,729
- US	7,932	9,770	8,501
- Europe	2,961	4,469	3,265
- RoW	8,645	6,491	6,762
Total third-party	69,993	82,745	63,257
Amounts due from fellow subsidiaries	27,232	4,848	5,274
	97,225	87,593	68,531
Loans and advances to customers			
- UK	347,872	364,373	366,219
- US	89,520	89,313	89,689
- Europe	59,085	64,649	74,306
- RoW	10,599	14,722	15,936
Total third-party	507,076	533,057	546,150
Amounts due from holding company and fellow subsidiaries	792	1,946	1,949
	507,868	535,003	548,099
	605,093	622,596	616,630

Note:
(1) Loans and advances to banks includes £82 million of accrued interest (2010 - £52 million; 2009 - £116 million).

	Group											
		Loans and advances			Securities							
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
UK												
Central and local government	2,130	8,012	25	8,037	75,754	8	75,762	5,198	548	91,675	1,098	90,577
Finance	63,452	55,524	2,287	57,811	24,820	3,188	28,008	298,971	42,836	491,078	328,255	162,823
Residential mortgages	—	99,302	1,423	100,725	—	—	—	48	—	100,773	—	100,773
Personal lending	—	19,218	127	19,345	—	—	—	51	—	19,396	7	19,389
Property	—	31,142	24,585	55,727	167	137	304	4,181	—	60,212	1,265	58,947
Construction	—	5,291	1,882	7,173	20	26	46	874	—	8,093	1,115	6,978
Manufacturing	254	9,611	789	10,400	336	1,908	2,244	2,077	—	14,975	2,205	12,770
Service industries and business activities												
- retail, wholesale and repairs	—	11,071	1,441	12,512	307	2,404	2,711	902	—	16,125	1,647	14,478
- transport and storage	436	8,585	2,869	11,454	51	67	118	2,138	—	14,146	200	13,946
- health, education and recreation	—	8,734	757	9,491	45	8	53	744	—	10,288	965	9,323
- hotels and restaurants	—	5,599	569	6,168	14	-	14	662	—	6,844	178	6,666
- utilities	—	2,462	931	3,393	324	266	590	2,870	—	6,853	450	6,403
- other	—	13,938	1,530	15,468	607	2,640	3,247	3,914	453	23,082	829	22,253
Agriculture, forestry and fishing	—	2,659	76	2,735	1	10	11	29	—	2,775	117	2,658
Finance leases and instalment credit	—	5,618	5,598	11,216	—	2	2	73	—	11,291	16	11,275
Interest accruals	51	349	—	349	454	—	454	—	—	854	—	854
Total third-party	66,323	287,115	44,889	332,004	102,900	10,664	113,564	322,732	43,837	878,460	338,347	540,113
Amounts due from holding company and fellow subsidiaries	—	26,782	41	26,823	785	—	785	8,119	—	35,727	—	35,727
Total gross of provisions	66,323	313,897	44,930	358,827	103,685	10,664	114,349	330,851	43,837	914,187	338,347	575,840
US												
Central and local government	—	176	4	180	22,069	317	22,386	9	1	22,576	—	22,576
Finance	24,657	9,526	266	9,792	31,082	677	31,759	165,465	27,945	259,618	168,616	91,002
Residential mortgages	—	20,311	2,926	23,237	—	—	—	—	—	23,237	—	23,237
Personal lending	—	7,505	936	8,441	—	—	—	—	—	8,441	—	8,441
Property	—	2,407	1,370	3,777	26	23	49	38	—	3,864	—	3,864
Construction	—	412	45	457	21	3	24	11	—	492	—	492
Manufacturing	—	6,511	42	6,553	101	12	113	452	—	7,118	—	7,118
Service industries and business activities												
- retail, wholesale and repairs	—	4,932	98	5,030	52	—	52	63	—	5,145	—	5,145
- transport and storage	—	1,832	935	2,767	26	1	27	1,084	—	3,878	—	3,878
- health, education and recreation	—	2,947	88	3,035	74	4	78	93	—	3,206	—	3,206
- hotels and restaurants	—	627	57	684	93	3	96	1	—	781	—	781
- utilities	—	936	8	944	243	16	259	295	—	1,498	—	1,498
- other	23	4,788	361	5,149	429	105	534	1,421	—	7,127	—	7,127
Agriculture, forestry and fishing	—	27	—	27	7	—	7	6	—	40	—	40
Finance leases and instalment credit	—	2,471	—	2,471	—	—	—	—	—	2,471	—	2,471
Interest accruals	6	178	44	222	259	—	259	—	—	487	—	487
Total third-party	24,686	65,586	7,180	72,766	54,482	1,161	55,643	168,938	27,946	349,979	168,616	181,363
Amounts due from holding company and fellow subsidiaries	—	307	8	315	17	—	17	1,019	—	1,351	—	1,351
Total gross of provisions	24,686	65,893	7,188	73,081	54,499	1,161	55,660	169,957	27,946	351,330	168,616	182,714

For the notes relating to this table refer to page 81.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

2011	Reverse repos £m	Loans and advances Core £m	Loans and advances Non-Core £m	Loans and advances Total £m	Securities Debt £m	Securities Equity £m	Securities Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Europe												
Central and local government	—	114	444	558	333	3	336	58	—	952	—	952
Finance	247	3,512	371	3,883	148	31	179	124	840	5,273	1	5,272
Residential mortgages	—	18,328	6	18,334	—	—	—	—	—	18,334	—	18,334
Personal lending	—	1,921	267	2,188	—	—	—	—	7	2,195	—	2,195
Property	—	4,559	11,212	15,771	—	—	—	167	—	15,938	9	15,929
Construction	—	466	576	1,042	—	—	—	18	—	1,060	24	1,036
Manufacturing	—	1,527	3,173	4,700	5	1	6	10	—	4,716	9	4,707
Service industries and business activities												
- retail, wholesale and repairs	—	1,910	435	2,345	4	2	6	5	—	2,356	24	2,332
- transport and storage	—	5,044	589	5,633	2	—	2	13	—	5,648	6	5,642
- health, education and recreation	—	1,134	301	1,435	—	1	1	2	—	1,438	8	1,430
- hotels and restaurants	—	878	485	1,363	—	—	—	6	—	1,369	6	1,363
- utilities	—	1,190	415	1,605	36	3	39	33	—	1,677	—	1,677
- other	—	1,094	341	1,435	50	7	57	4	—	1,496	25	1,471
Agriculture, forestry and fishing	—	649	48	697	—	1	1	1	—	699	31	668
Finance leases and instalment credit	—	255	435	690	—	—	—	—	—	690	—	690
Interest accruals	7	72	41	113	—	—	—	—	—	120	—	120
Total third-party	254	42,653	19,139	61,792	578	49	627	441	847	63,961	143	63,818
Amounts due from holding company and fellow subsidiaries	—	206	15	221	—	—	—	5	—	226	—	226
Total gross of provisions	254	42,859	19,154	62,013	578	49	627	446	847	64,187	143	64,044
RoW												
Central and local government	117	35	44	79	8,185	—	8,185	190	—	8,571	—	8,571
Finance	7,637	5,782	35	5,817	2,221	13	2,234	28,296	2,482	46,466	27,739	18,727
Residential mortgages	—	380	—	380	—	—	—	—	—	380	—	380
Personal lending	—	1,507	—	1,507	—	—	—	1	—	1,508	—	1,508
Property	—	202	526	728	269	14	283	60	1	1,072	—	1,072
Construction	—	—	9	9	9	—	9	2	—	20	—	20
Manufacturing	—	381	31	412	4	—	4	778	306	1,500	—	1,500
Service industries and business activities												
- retail, wholesale and repairs	—	262	26	288	3	—	3	75	—	366	—	366
- transport and storage	—	214	183	397	128	—	128	147	—	672	—	672
- health, education and recreation	—	356	225	581	—	—	—	32	—	613	—	613
- hotels and restaurants	—	14	—	14	—	—	—	—	—	14	—	14
- utilities	—	371	273	644	5	—	5	68	—	717	—	717
- other	—	534	24	558	7	2	9	664	2	1,233	—	1,233
Agriculture, forestry and fishing	—	39	—	39	—	—	—	3	—	42	—	42
Finance leases and instalment credit	—	11	26	37	127	—	127	—	—	164	—	164
Interest accruals	—	—	—	—	7	—	7	—	—	7	—	7
Total third-party	7,754	10,088	1,402	11,490	10,965	29	10,994	30,316	2,791	63,345	27,739	35,606
Amounts due from holding company and fellow subsidiaries	—	665	—	665	—	—	—	1,237	—	1,902	—	1,902
Total gross of provisions	7,754	10,753	1,402	12,155	10,965	29	10,994	31,553	2,791	65,247	27,739	37,508

Group

For the notes relating to this table refer to page 81.

2010	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
	Group											
UK												
Central and local government	611	5,727	154	5,881	69,586	1	69,587	6,982	173	83,234	3,916	79,318
Finance	56,693	60,197	5,980	66,177	25,776	603	26,379	238,329	30,026	417,604	250,121	167,483
Residential mortgages	—	99,927	1,665	101,592	—	—	—	6	—	101,598	14	101,584
Personal lending	—	22,101	428	22,529	1	—	1	9	—	22,539	11	22,528
Property	—	34,970	30,492	65,462	2,222	174	2,396	3,639	28	71,525	1,041	70,484
Construction	—	7,026	2,296	9,322	39	—	39	724	—	10,085	1,392	8,693
Manufacturing	389	11,929	1,538	13,467	277	—	277	2,087	—	16,220	2,150	14,070
Service industries and business activities												
- retail, wholesale and repairs	—	12,393	1,788	14,181	258	11	269	858	—	15,308	2,452	12,856
- transport and storage	—	7,890	4,040	11,930	195	3	198	1,477	—	13,605	219	13,386
- health, education and recreation	—	13,496	1,046	14,542	156	22	178	832	—	15,552	1,047	14,505
- hotels and restaurants	—	6,559	808	7,367	172	—	172	509	—	8,048	249	7,799
- utilities	—	3,067	1,019	4,086	488	5	493	1,753	2	6,334	985	5,349
- other	—	13,756	1,488	15,244	430	399	829	1,853	337	18,263	1,354	16,909
Agriculture, forestry and fishing	—	2,872	67	2,939	—	—	—	35	—	2,974	94	2,880
Finance leases and instalment credit	—	5,589	7,785	13,374	10	2	12	14	—	13,400	134	13,266
Interest accruals	49	453	100	553	479	—	479	—	—	1,081	—	1,081
Total third-party	57,742	307,952	60,694	368,646	100,089	1,220	101,309	259,107	30,566	817,370	265,179	552,191
Amounts due from holding company and fellow subsidiaries	—	4,903	151	5,054	11	—	11	14,212	—	19,277	—	19,277
Total gross of provisions	57,742	312,855	60,845	373,700	100,100	1,220	101,320	273,319	30,566	836,647	265,179	571,468
US												
Central and local government	—	169	6	175	24,946	766	25,712	5	112	26,004	—	26,004
Finance	25,001	10,152	464	10,616	23,858	103	23,961	121,717	21,372	202,667	123,862	78,805
Residential mortgages	—	20,548	3,653	24,201	—	—	—	—	—	24,201	—	24,201
Personal lending	—	6,816	2,704	9,520	—	—	—	—	—	9,520	—	9,520
Property	—	1,595	3,318	4,913	95	4	99	23	—	5,035	—	5,035
Construction	—	441	79	520	5	—	5	16	—	541	—	541
Manufacturing	—	4,936	143	5,079	412	22	434	583	—	6,096	—	6,096
Service industries and business activities												
- retail, wholesale and repairs	—	4,205	237	4,442	132	—	132	68	—	4,642	—	4,642
- transport and storage	—	1,786	1,404	3,190	99	2	101	929	—	4,220	—	4,220
- health, education and recreation	—	2,380	313	2,693	1,308	3	1,311	292	—	4,296	—	4,296
- hotels and restaurants	—	486	136	622	104	—	104	3	—	729	—	729
- utilities	—	986	6	992	567	2	569	244	—	1,805	—	1,805
- other	124	3,891	503	4,394	789	261	1,050	1,200	43	6,811	—	6,811
Agriculture, forestry and fishing	—	31	—	31	28	—	28	3	—	62	—	62
Finance leases and instalment credit	—	2,315	—	2,315	—	—	—	—	—	2,315	—	2,315
Interest accruals	6	179	70	249	240	—	240	—	—	495	—	495
Total third-party	25,131	60,916	13,036	73,952	52,583	1,163	53,746	125,083	21,527	299,439	123,862	175,577
Amounts due from holding company and fellow subsidiaries	—	797	5	802	—	—	—	1,506	—	2,308	—	2,308
Total gross of provisions	25,131	61,713	13,041	74,754	52,583	1,163	53,746	126,589	21,527	301,747	123,862	177,885

For the notes relating to this table refer to page 81.

Financial review continued

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

	Group											
		Loans and advances			Securities							
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Europe												
Central and local government	—	211	507	718	676	—	676	64	—	1,458	—	1,458
Finance	18	5,142	458	5,600	364	38	402	399	3,911	10,330	1	10,329
Residential mortgages	—	19,467	8	19,475	—	—	—	—	—	19,475	5	19,470
Personal lending	—	2,183	320	2,503	—	—	—	—	7	2,510	—	2,510
Property	—	4,829	12,087	16,916	—	—	—	—	—	16,916	5	16,911
Construction	—	617	677	1,294	—	—	—	—	—	1,294	14	1,280
Manufacturing	—	2,211	3,552	5,763	7	1	8	—	—	5,771	6	5,765
Service industries and business activities												
- retail, wholesale and repairs	—	1,787	441	2,228	5	2	7	—	—	2,235	15	2,220
- transport and storage	—	5,099	996	6,095	2	1	3	—	—	6,098	5	6,093
- health, education and recreation	—	1,263	362	1,625	—	1	1	—	—	1,626	—	1,626
- hotels and restaurants	—	1,039	528	1,567	—	—	—	—	—	1,567	4	1,563
- utilities	—	1,169	508	1,677	24	4	28	—	—	1,705	—	1,705
- other	—	1,344	268	1,612	37	8	45	—	1	1,658	23	1,635
Agriculture, forestry and fishing	—	712	66	778	—	1	1	—	—	779	21	758
Finance leases and instalment credit	—	369	745	1,114	—	—	—	—	—	1,114	—	1,114
Interest accruals	—	86	49	135	—	—	—	—	—	135	—	135
Total third-party	18	47,528	21,572	69,100	1,115	56	1,171	463	3,919	74,671	99	74,572
Amounts due from holding company and fellow subsidiaries	—	332	14	346	—	—	—	8	—	354	—	354
Total gross of provisions	18	47,860	21,586	69,446	1,115	56	1,171	471	3,919	75,025	99	74,926
RoW												
Central and local government	15	366	—	366	9,527	—	9,527	177	—	10,085	—	10,085
Finance	6,784	6,150	360	6,510	2,785	7	2,792	25,428	2,595	44,109	22,420	21,689
Residential mortgages	—	409	—	409	—	—	—	—	—	409	—	409
Personal lending	—	1,452	—	1,452	—	—	—	6	—	1,458	—	1,458
Property	—	540	1,184	1,724	303	12	315	68	—	2,107	—	2,107
Construction	—	79	40	119	4	—	4	—	—	123	—	123
Manufacturing	—	195	236	431	—	—	—	210	—	641	—	641
Service industries and business activities												
- retail, wholesale and repairs	—	250	85	335	9	—	9	131	—	475	—	475
- transport and storage	—	197	333	530	57	—	57	170	—	757	—	757
- health, education and recreation	—	128	16	144	—	—	—	27	—	171	—	171
- hotels and restaurants	—	65	—	65	—	—	—	3	—	68	—	68
- utilities	—	816	274	1,090	5	—	5	46	—	1,141	—	1,141
- other	—	600	608	1,208	3	2	5	615	9	1,837	—	1,837
Agriculture, forestry and fishing	—	3	—	3	—	—	—	2	—	5	—	5
Finance leases and instalment credit	—	—	—	—	—	—	—	—	—	—	—	—
Interest accruals	—	27	1	28	23	—	23	—	—	51	—	51
Total third-party	6,799	11,277	3,137	14,414	12,716	21	12,737	26,883	2,604	63,437	22,420	41,017
Amounts due from holding company and fellow subsidiaries	—	592	—	592	—	—	—	1,743	—	2,335	—	2,335
Total gross of provisions	6,799	11,869	3,137	15,006	12,716	21	12,737	28,626	2,604	65,772	22,420	43,352

For the notes relating to this table refer to page 81.

2009	Group											
		Loans and advances			Securities							
	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
UK												
Central and local government	129	4,349	204	4,553	77,943	1	77,944	6,714	4	89,344	1,723	87,621
Finance	42,000	46,730	5,891	52,621	33,313	1,018	34,331	239,965	23,688	392,605	232,517	160,088
Residential mortgages	—	90,687	1,896	92,583	—	—	—	11	—	92,594	7	92,587
Personal lending	—	23,496	951	24,447	1	—	1	9	—	24,457	21	24,436
Property	—	36,383	35,401	71,784	3,180	170	3,350	4,056	1	79,191	1,114	78,077
Construction	—	6,964	3,605	10,569	42	113	155	849	45	11,618	1,450	10,168
Manufacturing	182	13,517	3,076	16,593	345	—	345	2,265	—	19,385	3,120	16,265
Service industries and business activities												
- retail, wholesale and repairs	—	13,153	2,631	15,784	354	7	361	817	—	16,962	2,549	14,413
- transport and storage	—	10,050	4,719	14,769	306	11	317	987	—	16,073	201	15,872
- health, education and recreation	21	15,474	1,186	16,660	297	50	347	997	—	18,025	1,057	16,968
- hotels and restaurants	—	7,573	1,034	8,607	313	—	313	824	—	9,744	284	9,460
- utilities	—	2,530	1,606	4,136	445	2	447	2,301	—	6,884	445	6,439
- other	—	12,244	2,978	15,222	962	151	1,113	1,793	—	18,128	1,258	16,870
Agriculture, forestry and fishing	—	2,946	138	3,084	—	—	—	39	—	3,123	76	3,047
Finance leases and instalment credit	—	5,343	10,843	16,186	282	3	285	16	—	16,487	39	16,448
Interest accruals	60	805	153	958	430	—	430	—	—	1,448	—	1,448
Total third-party	42,392	292,244	76,312	368,556	118,213	1,526	119,739	261,643	23,738	816,068	245,861	570,207
Amounts due from holding company and fellow subsidiaries	—	5,096	27	5,123	873	—	873	26,238	—	32,234	—	32,234
Total gross of provisions	42,392	297,340	76,339	373,679	119,086	1,526	120,612	287,881	23,738	848,302	245,861	602,441
US												
Central and local government	—	172	6	178	23,824	779	24,603	9	141	24,931	—	24,931
Finance	17,391	10,098	1,711	11,809	27,157	62	27,219	125,606	10,944	192,969	113,670	79,299
Residential mortgages	—	21,842	4,317	26,159	—	—	—	—	—	26,159	—	26,159
Personal lending	—	7,373	3,599	10,972	—	—	—	—	—	10,972	—	10,972
Property	—	1,436	3,788	5,224	58	—	58	30	—	5,312	—	5,312
Construction	—	490	132	622	71	1	72	50	—	744	—	744
Manufacturing	—	5,369	336	5,705	218	3	221	580	—	6,506	—	6,506
Service industries and business activities												
- retail, wholesale and repairs	—	3,836	411	4,247	142	—	142	108	—	4,497	—	4,497
- transport and storage	—	1,680	1,518	3,198	108	1	109	737	—	4,044	—	4,044
- health, education and recreation	—	1,595	1,336	2,931	1,698	—	1,698	272	—	4,901	—	4,901
- hotels and restaurants	—	772	88	860	98	—	98	7	—	965	—	965
- utilities	—	944	6	950	113	—	113	204	—	1,267	—	1,267
- other	280	4,147	781	4,928	943	216	1,159	1,129	—	7,496	—	7,496
Agriculture, forestry and fishing	—	27	—	27	1	—	1	2	—	30	—	30
Finance leases and instalment credit	—	2,417	—	2,417	—	—	—	—	—	2,417	—	2,417
Interest accruals	3	200	89	289	334	—	334	—	—	626	—	626
Total third-party	17,674	62,398	18,118	80,516	54,765	1,062	55,827	128,734	11,085	293,836	113,670	180,166
Amounts due from holding company and fellow subsidiaries	—	703	—	703	—	—	—	2,812	—	3,515	—	3,515
Total gross of provisions	17,674	63,101	18,118	81,219	54,765	1,062	55,827	131,546	11,085	297,351	113,670	183,681

For the notes relating to this table refer to page 81.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

2009	Reverse repos £m	Loans and advances Core £m	Loans and advances Non-Core £m	Loans and advances Total £m	Securities Debt £m	Securities Equity £m	Securities Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
	Group											
Europe												
Central and local government	—	129	598	727	666	—	666	33	24	1,450	—	1,450
Finance	—	4,016	758	4,774	819	17	836	475	455	6,540	—	6,540
Residential mortgages	—	14,948	6,119	21,067	—	—	—	—	—	21,067	—	21,067
Personal lending	—	1,865	618	2,483	—	—	—	—	7	2,490	—	2,490
Property	—	10,485	8,683	19,168	—	—	—	—	—	19,168	—	19,168
Construction	—	1,572	958	2,530	—	—	—	—	—	2,530	—	2,530
Manufacturing	—	3,023	4,869	7,892	—	1	1	—	—	7,893	—	7,893
Service industries and business activities												
- retail, wholesale and repairs	—	2,601	832	3,433	6	1	7	—	—	3,440	—	3,440
- transport and storage	—	3,924	1,064	4,988	1	—	1	—	—	4,989	—	4,989
- health, education and recreation	—	1,092	581	1,673	—	2	2	—	—	1,675	—	1,675
- hotels and restaurants	—	1,186	556	1,742	—	—	—	—	—	1,742	—	1,742
- utilities	—	1,329	604	1,933	1	4	5	—	—	1,938	—	1,938
- other	—	2,190	497	2,687	13	8	21	—	—	2,708	—	2,708
Agriculture, forestry and fishing	—	569	348	917	—	1	1	—	—	918	—	918
Finance leases and instalment credit	—	380	1,084	1,464	—	—	—	—	—	1,464	—	1,464
Interest accruals	—	54	39	93	—	—	—	—	—	93	—	93
Total third-party	—	49,363	28,208	77,571	1,506	34	1,540	508	486	80,105	—	80,105
Amounts due from holding company and fellow subsidiaries	—	434	51	485	—	—	—	7	—	492	—	492
Total gross of provisions	—	49,797	28,259	78,056	1,506	34	1,540	515	486	80,597	—	80,597

For the notes relating to this table refer to page 81.

	Group											
		Loans and advances			Securities							
	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
RoW												
Central and local government	—	1,089	—	1,089	7,388	—	7,388	168	3	8,648	—	8,648
Finance	4,575	8,454	476	8,930	2,167	5	2,172	22,740	919	39,336	19,725	19,611
Residential mortgages	—	390	—	390	—	—	—	—	—	390	—	390
Personal lending	—	1,438	—	1,438	—	—	—	29	—	1,467	—	1,467
Property	—	201	1,754	1,955	669	8	677	50	—	2,682	—	2,682
Construction	—	13	214	227	—	—	—	9	—	236	—	236
Manufacturing	—	265	380	645	—	—	—	55	14	714	—	714
Service industries and business activities												
- retail, wholesale and repairs	—	63	84	147	—	—	—	51	—	198	—	198
- transport and storage	—	211	363	574	108	—	108	87	—	769	—	769
- health, education and recreation	—	208	26	234	—	—	—	23	—	257	—	257
- hotels and restaurants	—	122	—	122	—	—	—	1	—	123	—	123
- utilities	—	519	362	881	12	—	12	67	—	960	—	960
- other	1	611	816	1,427	18	—	18	165	1	1,612	—	1,612
Agriculture, forestry and fishing	—	3	—	3	—	—	—	3	—	6	—	6
Finance leases and instalment credit	—	—	19	19	—	—	—	—	—	19	—	19
Interest accruals	—	24	17	41	7	—	7	—	—	48	—	48
Total third-party	4,576	13,611	4,511	18,122	10,369	13	10,382	23,448	937	57,465	19,725	37,740
Amounts due from holding company and fellow subsidiaries	—	912	—	912	—	—	—	2,963	—	3,875	—	3,875
Total gross of provisions	4,576	14,523	4,511	19,034	10,369	13	10,382	26,411	937	61,340	19,725	41,615

Notes:

(1) Includes cash and balances at central banks of £68,487 million (2010 - £49,838 million; 2009 - £27,060 million) and settlement balances of £6,902 million (2010 - £8,748 million; 2009 - £9,153 million).

(2) This shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

	Bank											
		Loans and advances			Securities							
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Total												
Central and local government	2,247	5,863	505	6,368	82,888	3	82,891	5,410	548	97,464	478	96,986
Finance	64,447	50,568	1,650	52,218	25,443	3,112	28,555	491,895	67,090	704,205	518,191	186,014
Residential mortgages	—	34,665	1,423	36,088	—	—	—	45	—	36,133	—	36,133
Personal lending	—	3,225	113	3,338	—	—	—	2	—	3,340	7	3,333
Property	—	14,868	17,021	31,889	1,106	101	1,207	3,637	1	36,734	360	36,374
Construction	—	2,373	1,409	3,782	21	28	49	856	—	4,687	173	4,514
Manufacturing	254	7,606	3,615	11,221	340	1,918	2,258	3,223	306	17,262	734	16,528
Service industries and business activities												
- retail, wholesale and repairs	—	3,972	1,390	5,362	311	2,403	2,714	936	—	9,012	268	8,744
- transport and storage	436	11,668	4,497	16,165	128	68	196	3,343	—	20,140	38	20,102
- health, education and recreation	—	3,560	942	4,502	45	—	45	576	—	5,123	166	4,957
- hotels and restaurants	—	2,881	508	3,389	14	2	16	585	—	3,990	69	3,921
- utilities	—	2,985	1,583	4,568	328	265	593	3,172	—	8,333	13	8,320
- other	23	11,427	1,335	12,762	655	2,628	3,283	5,064	375	21,507	175	21,332
Agriculture, forestry and fishing	—	612	19	631	1	10	11	23	—	665	41	624
Finance leases and instalment credit	—	94	78	172	127	—	127	73	—	372	16	356
Interest accruals	51	102	42	144	478	—	478	—	—	673	—	673
Total third-party	67,458	156,469	36,130	192,599	111,885	10,538	122,423	518,840	68,320	969,640	520,729	448,811
Amounts due from holding company and subsidiaries	—	201,276	3,453	204,729	70,147	—	70,147	18,457	—	293,333	—	293,333
Total gross of provisions	67,458	357,745	39,583	397,328	182,032	10,538	192,570	537,297	68,320	1,262,973	520,729	742,244
Provisions	—	(1,519)	(3,104)	(4,623)	(572)	(52)	(624)	—	—	(5,247)	n/a	(5,247)
Total	67,458	356,226	36,479	392,705	181,460	10,486	191,946	537,297	68,320	1,257,726	520,729	736,997

Comprising:	
Repurchase agreements	9,867
Derivative balances	477,226
Derivative collateral	30,345
Other	3,291
	520,729

For the notes relating to this table refer to page 91.

2010	Bank											
		Loans and advances			Securities							
	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Total												
Central and local government	626	3,891	647	4,538	78,575	—	78,575	7,223	173	91,135	2,684	88,451
Finance	57,440	54,313	3,643	57,956	30,458	666	31,124	384,949	47,868	579,337	387,416	191,921
Residential mortgages	—	42,430	1,665	44,095	—	—	—	2	—	44,097	13	44,084
Personal lending	—	5,260	419	5,679	—	—	—	7	—	5,686	10	5,676
Property	—	18,242	24,089	42,331	3,201	109	3,310	3,233	28	48,902	427	48,475
Construction	—	3,898	1,512	5,410	39	—	39	716	—	6,165	433	5,732
Manufacturing	389	8,626	4,917	13,543	288	14	302	2,749	—	16,983	554	16,429
Service industries and business activities												
- retail, wholesale and repairs	—	4,869	1,701	6,570	278	11	289	947	—	7,806	597	7,209
- transport and storage	—	10,852	6,174	17,026	259	1	260	2,541	—	19,827	77	19,750
- health, education and recreation	—	7,416	1,197	8,613	156	3	159	930	—	9,702	159	9,543
- hotels and restaurants	—	3,642	781	4,423	172	—	172	460	—	5,055	120	4,935
- utilities	—	3,697	1,798	5,495	496	2	498	2,003	2	7,998	10	7,988
- other	124	10,202	1,894	12,096	502	253	755	2,923	379	16,277	79	16,198
Agriculture, forestry and fishing	—	696	27	723	—	—	—	30	—	753	36	717
Finance leases and instalment credit	—	262	105	367	10	—	10	14	—	391	42	349
Interest accruals	48	223	66	289	516	—	516	—	—	853	—	853
Total third-party	58,627	178,519	50,635	229,154	114,950	1,059	116,009	408,727	48,450	860,967	392,657	468,310
Amounts due from holding company and subsidiaries	—	160,957	6,987	167,944	74,726	—	74,726	24,085	—	266,755	—	266,755
Total gross of provisions	58,627	339,476	57,622	397,098	189,676	1,059	190,735	432,812	48,450	1,127,722	392,657	735,065
Provisions	—	(2,118)	(3,463)	(5,581)	(468)	(43)	(511)	—	—	(6,092)	n/a	(6,092)
Total	58,627	337,358	54,159	391,517	189,208	1,016	190,224	432,812	48,450	1,121,630	392,657	728,973

Comprising:	
Repurchase agreements	3,293
Derivative balances	357,192
Derivative collateral	28,245
Other	3,927
	392,657

For the notes relating to this table refer to page 91.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

	Bank											
		Loans and advances			Securities							
2009	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Total												
Central and local government	129	3,287	767	4,054	84,588	—	84,588	6,922	8	95,701	465	95,236
Finance	42,360	41,172	4,062	45,234	39,235	940	40,175	387,902	25,204	540,875	364,293	176,582
Residential mortgages	—	41,874	1,895	43,769	—	—	—	3	—	43,772	7	43,765
Personal lending	—	6,293	686	6,979	—	—	—	29	—	7,008	20	6,988
Property	—	19,667	30,152	49,819	4,541	100	4,641	3,668	1	58,129	356	57,773
Construction	—	4,090	2,510	6,600	42	114	156	858	45	7,659	477	7,182
Manufacturing	182	11,367	7,440	18,807	374	3	377	2,747	—	22,113	1,377	20,736
Service industries and business activities												
- retail, wholesale and repairs	—	5,854	2,123	7,977	369	7	376	867	—	9,220	602	8,618
- transport and storage	—	12,475	7,040	19,515	355	1	356	1,776	—	21,647	72	21,575
- health, education and recreation	22	8,855	1,926	10,781	297	—	297	1,106	—	12,206	129	12,077
- hotels and restaurants	—	4,844	1,070	5,914	313	—	313	780	—	7,007	114	6,893
- utilities	—	3,938	2,569	6,507	459	—	459	2,528	—	9,494	11	9,483
- other	280	9,568	3,558	13,126	1,022	20	1,042	2,443	—	16,891	79	16,812
Agriculture, forestry and fishing	—	815	31	846	—	—	—	35	—	881	61	820
Finance leases and instalment credit	—	376	48	424	56	—	56	16	—	496	39	457
Interest accruals	60	569	146	715	451	—	451	—	—	1,226	—	1,226
Total third-party	43,033	175,044	66,023	241,067	132,102	1,185	133,287	411,680	25,258	854,325	368,102	486,223
Amounts due from holding company and subsidiaries	—	125,736	10,727	136,463	83,010	—	83,010	39,233	—	258,706	—	258,706
Total gross of provisions	43,033	300,780	76,750	377,530	215,112	1,185	216,297	450,913	25,258	1,113,031	368,102	744,929
Provisions	—	(1,881)	(2,769)	(4,650)	(514)	(160)	(674)	—	—	(5,324)	n/a	(5,324)
Total	43,033	298,899	73,981	372,880	214,598	1,025	215,623	450,913	25,258	1,107,707	368,102	739,605

For the notes relating to this table refer to page 91.

Loans and advances to banks and customers by geographical region

The table below analyses loans and advances, including reverse repos, gross of provisions by geographical region (location of office).

	Bank		
	2011 £m	2010 £m	2009 £m
Loans and advances to banks (1)			
- UK	47,230	57,861	40,766
- US	37	257	409
- Europe	143	1,086	255
- RoW	2,734	1,713	2,405
Total third-party	50,144	60,917	43,835
Amounts due from subsidiaries	58,972	40,127	33,610
Total loans and advances to banks	109,116	101,044	77,445
Loans and advances to customers			
- UK	181,904	193,651	196,247
- US	8,528	7,897	11,522
- Europe	14,608	16,933	21,936
- RoW	4,873	8,383	10,560
Total third-party	209,913	226,864	240,265
Amounts due from holding company and subsidiaries	145,757	127,817	102,853
Total loans and advances to banks	355,670	354,681	343,118
	464,786	455,725	420,563

Note:

(1) Loans and advances to banks includes £74 million of accrued interest (2010 - £42 million; 2009 - £106 million).

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

The tables on pages 86 to 91 analyse total financial assets by industry sector and geography for the Bank.

	Bank											
		Loans and advances			Securities							
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
UK												
Central and local government	2,130	5,767	17	5,784	76,347	—	76,347	5,190	548	89,999	478	89,521
Finance	63,453	46,020	1,145	47,165	21,887	3,075	24,962	298,344	41,331	475,255	327,825	147,430
Residential mortgages	—	34,284	1,423	35,707	—	—	—	45	—	35,752	—	35,752
Personal lending	—	3,221	113	3,334	—	—	—	1	—	3,335	7	3,328
Property	—	14,240	14,532	28,772	837	67	904	3,539	—	33,215	360	32,855
Construction	—	2,070	1,078	3,148	20	26	46	843	—	4,037	173	3,864
Manufacturing	254	4,754	531	5,285	336	1,908	2,244	1,993	—	9,776	734	9,042
Service industries and business activities												
- retail, wholesale and repairs	—	3,146	1,232	4,378	307	2,403	2,710	798	—	7,886	268	7,618
- transport and storage	436	6,734	2,879	9,613	51	67	118	2,112	—	12,279	38	12,241
- health, education and recreation	—	2,628	466	3,094	45	—	45	454	—	3,593	166	3,427
- hotels and restaurants	—	2,669	403	3,072	14	—	14	584	—	3,670	69	3,601
- utilities	—	1,847	887	2,734	324	265	589	2,809	—	6,132	13	6,119
- other	—	8,940	1,028	9,968	605	2,625	3,230	3,820	375	17,393	175	17,218
Agriculture, forestry and fishing	—	573	19	592	1	10	11	14	—	617	41	576
Finance leases and instalment credit	—	32	52	84	—	—	—	73	—	157	16	141
Interest accruals	51	80	—	80	450	—	450	—	—	581	—	581
Total third-party	66,324	137,005	25,805	162,810	101,224	10,446	111,670	320,619	42,254	703,677	330,363	373,314
Amounts due from holding company and subsidiaries	—	193,673	1,550	195,223	69,531	—	69,531	14,888	—	279,642	—	279,642
Total gross of provisions	66,324	330,678	27,355	358,033	170,755	10,446	181,201	335,507	42,254	983,319	330,363	652,956
US												
Central and local government	—	44	—	44	2,162	—	2,162	9	—	2,215	—	2,215
Finance	14	1,642	198	1,840	1,435	22	1,457	165,279	23,357	191,947	162,627	29,320
Property	—	117	104	221	—	20	20	38	—	279	—	279
Construction	—	124	16	140	—	2	2	11	—	153	—	153
Manufacturing	—	1,821	—	1,821	—	10	10	452	—	2,283	—	2,283
Service industries and business activities												
- retail, wholesale and repairs	—	278	—	278	1	—	1	63	—	342	—	342
- transport and storage	—	460	921	1,381	11	1	12	1,084	—	2,477	—	2,477
- health, education and recreation	—	288	34	322	—	—	—	90	—	412	—	412
- hotels and restaurants	—	177	—	177	—	2	2	1	—	180	—	180
- utilities	—	362	8	370	4	—	4	295	—	669	—	669
- other	23	1,828	38	1,866	46	3	49	580	—	2,518	—	2,518
Agriculture, forestry and fishing	—	—	—	—	—	—	—	6	—	6	—	6
Finance leases and instalment credit	—	51	—	51	—	—	—	—	—	51	—	51
Interest accruals	—	11	6	17	21	—	21	—	—	38	—	38
Total third-party	37	7,203	1,325	8,528	3,680	60	3,740	167,908	23,357	203,570	162,627	40,943
Amounts due from holding company and subsidiaries	—	2,640	14	2,654	—	—	—	2,141	—	4,795	—	4,795
Total gross of provisions	37	9,843	1,339	11,182	3,680	60	3,740	170,049	23,357	208,365	162,627	45,738

For the notes relating to this table refer to page 91.

2011	Bank											
		Loans and advances			Securities							
	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Europe												
Central and local government	—	17	444	461	—	3	3	21	—	485	—	485
Finance	—	552	271	823	—	15	15	—	281	1,119	—	1,119
Residential mortgages	—	1	—	1	—	—	—	—	—	1	—	1
Personal lending	—	3	—	3	—	—	—	—	—	3	—	3
Property	—	309	1,897	2,206	—	—	—	—	—	2,206	—	2,206
Construction	—	179	307	486	—	—	—	—	—	486	—	486
Manufacturing	—	650	3,053	3,703	—	—	—	—	—	3,703	—	3,703
Service industries and business activities												
- retail, wholesale and repairs	—	286	132	418	—	—	—	—	—	418	—	418
- transport and storage	—	4,260	514	4,774	—	—	—	—	—	4,774	—	4,774
- health, education and recreation	—	288	217	505	—	—	—	—	—	505	—	505
- hotels and restaurants	—	21	105	126	—	—	—	—	—	126	—	126
- utilities	—	405	415	820	—	—	—	—	—	820	—	820
- other	—	133	245	378	—	—	—	—	—	378	—	378
Agriculture, forestry and fishing	—	—	—	—	—	—	—	—	—	—	—	—
Finance leases and instalment credit	—	—	—	—	—	—	—	—	—	—	—	—
Interest accruals	—	11	36	47	—	—	—	—	—	47	—	47
Total third-party	—	7,115	7,636	14,751	—	18	18	21	281	15,071	—	15,071
Amounts due from holding company and subsidiaries	—	4	1,720	1,724	—	—	—	—	—	1,724	—	1,724
Total gross of provisions	—	7,119	9,356	16,475	—	18	18	21	281	16,795	—	16,795
RoW												
Central and local government	117	35	44	79	4,379	—	4,379	190	—	4,765	—	4,765
Finance	980	2,354	36	2,390	2,121	—	2,121	28,272	2,121	35,884	27,739	8,145
Residential mortgages	—	380	—	380	—	—	—	—	—	380	—	380
Personal lending	—	1	—	1	—	—	—	1	—	2	—	2
Property	—	202	488	690	269	14	283	60	1	1,034	—	1,034
Construction	—	—	8	8	1	—	1	2	—	11	—	11
Manufacturing	—	381	31	412	4	—	4	778	306	1,500	—	1,500
Service industries and business activities												
- retail, wholesale and repairs	—	262	26	288	3	—	3	75	—	366	—	366
- transport and storage	—	214	183	397	66	—	66	147	—	610	—	610
- health, education and recreation	—	356	225	581	—	—	—	32	—	613	—	613
- hotels and restaurants	—	14	—	14	—	—	—	—	—	14	—	14
- utilities	—	371	273	644	—	—	—	68	—	712	—	712
- other	—	526	24	550	4	—	4	664	—	1,218	—	1,218
Agriculture, forestry and fishing	—	39	—	39	—	—	—	3	—	42	—	42
Finance leases and instalment credit	—	11	26	37	127	—	127	—	—	164	—	164
Interest accruals	—	—	—	—	7	—	7	—	—	7	—	7
Total third-party	1,097	5,146	1,364	6,510	6,981	14	6,995	30,292	2,428	47,322	27,739	19,583
Amounts due from holding company and subsidiaries	—	4,959	169	5,128	616	—	616	1,428	—	7,172	—	7,172
Total gross of provisions	1,097	10,105	1,533	11,638	7,597	14	7,611	31,720	2,428	54,494	27,739	26,755

For the notes relating to this table refer to page 91.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

2010	Bank: Reverse repos £m	Loans and advances: Core £m	Loans and advances: Non-Core £m	Loans and advances: Total £m	Securities: Debt £m	Securities: Equity £m	Securities: Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
UK												
Central and local government	611	3,368	140	3,508	69,649	—	69,649	6,977	173	80,918	2,684	78,234
Finance	56,693	49,531	2,333	51,864	23,553	594	24,147	237,975	28,488	399,167	249,773	149,394
Residential mortgages	—	42,017	1,665	43,682	—	—	—	2	—	43,684	13	43,671
Personal lending	—	5,257	419	5,676	—	—	—	1	—	5,677	10	5,667
Property	—	17,214	20,277	37,491	2,901	105	3,006	3,142	28	43,667	427	43,240
Construction	—	3,451	1,164	4,615	39	—	39	700	—	5,354	433	4,921
Manufacturing	389	6,039	1,193	7,232	274	—	274	1,956	—	9,851	554	9,297
Service industries and business activities												
- retail, wholesale and repairs	—	3,884	1,433	5,317	258	11	269	748	—	6,334	597	5,737
- transport and storage	—	5,983	3,559	9,542	195	—	195	1,442	—	11,179	77	11,102
- health, education and recreation	—	6,795	671	7,466	156	—	156	611	—	8,233	159	8,074
- hotels and restaurants	—	3,393	592	3,985	172	—	172	454	—	4,611	120	4,491
- utilities	—	2,035	1,011	3,046	488	—	488	1,713	2	5,249	10	5,239
- other	—	8,015	1,115	9,130	430	251	681	1,805	336	11,952	79	11,873
Agriculture, forestry and fishing	—	692	27	719	—	—	—	25	—	744	36	708
Finance leases and instalment credit	—	201	105	306	10	—	10	14	—	330	42	288
Interest accruals	48	192	—	192	475	—	475	—	—	715	—	715
Total third-party	57,741	158,067	35,704	193,771	98,600	961	99,561	257,565	29,027	637,665	255,014	382,651
Amounts due from holding company and subsidiaries	—	151,816	5,061	156,877	74,726	—	74,726	19,291	—	250,894	—	250,894
Total gross of provisions	57,741	309,883	40,765	350,648	173,326	961	174,287	276,856	29,027	888,559	255,014	633,545
US												
Central and local government	—	47	—	47	2,900	—	2,900	5	—	2,952	—	2,952
Finance	14	680	591	1,271	3,110	46	3,156	121,555	14,694	140,690	115,223	25,467
Property	—	191	132	323	—	1	1	23	—	347	—	347
Construction	—	133	7	140	—	—	—	16	—	156	—	156
Manufacturing	—	1,297	64	1,361	14	14	28	583	—	1,972	—	1,972
Service industries and business activities												
- retail, wholesale and repairs	—	413	—	413	11	—	11	68	—	492	—	492
- transport and storage	—	514	1,385	1,899	8	1	9	929	—	2,837	—	2,837
- health, education and recreation	—	156	235	391	—	3	3	292	—	686	—	686
- hotels and restaurants	—	72	63	135	—	—	—	3	—	138	—	138
- utilities	—	484	6	490	3	2	5	244	—	739	—	739
- other	124	1,359	110	1,469	69	2	71	503	43	2,210	—	2,210
Agriculture, forestry and fishing	—	—	—	—	—	—	—	3	—	3	—	3
Finance leases and instalment credit	—	56	—	56	—	—	—	—	—	56	—	56
Interest accruals	—	7	14	21	26	—	26	—	—	47	—	47
Total third-party	138	5,409	2,607	8,016	6,141	69	6,210	124,224	14,737	153,325	115,223	38,102
Amounts due from holding company and subsidiaries	—	3,596	131	3,727	—	—	—	2,758	—	6,485	—	6,485
Total gross of provisions	138	9,005	2,738	11,743	6,141	69	6,210	126,982	14,737	159,810	115,223	44,587

For the notes relating to this table refer to page 91.

Bank

2010	Reverse repos £m	Loans and advances: Core £m	Loans and advances: Non-Core £m	Loans and advances: Total £m	Securities: Debt £m	Securities: Equity £m	Securities: Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Europe												
Central and local government	—	110	507	617	—	—	—	64	—	681	—	681
Finance	—	1,500	359	1,859	43	26	69	—	3,536	5,464	—	5,464
Residential mortgages	—	4	—	4	—	—	—	—	—	4	—	4
Personal lending	—	1	—	1	—	—	—	—	—	1	—	1
Property	—	297	2,526	2,823	—	—	—	—	—	2,823	—	2,823
Construction	—	235	301	536	—	—	—	—	—	536	—	536
Manufacturing	—	1,095	3,424	4,519	—	—	—	—	—	4,519	—	4,519
Service industries and business activities												
- retail, wholesale and repairs	—	322	183	505	—	—	—	—	—	505	—	505
- transport and storage	—	4,158	897	5,055	—	—	—	—	—	5,055	—	5,055
- health, education and recreation	—	337	275	612	—	—	—	—	—	612	—	612
- hotels and restaurants	—	112	126	238	—	—	—	—	—	238	—	238
- utilities	—	362	507	869	—	—	—	—	—	869	—	869
- other	—	233	80	313	—	—	—	—	—	313	—	313
Agriculture, forestry and fishing	—	1	—	1	—	—	—	—	—	1	—	1
Finance leases and instalment credit	—	5	—	5	—	—	—	—	—	5	—	5
Interest accruals	—	11	51	62	—	—	—	—	—	62	—	62
Total third-party	—	8,783	9,236	18,019	43	26	69	64	3,536	21,688	—	21,688
Amounts due from holding company and subsidiaries	—	17	1,462	1,479	—	—	—	—	—	1,479	—	1,479
Total gross of provisions	—	8,800	10,698	19,498	43	26	69	64	3,536	23,167	—	23,167
RoW												
Central and local government	15	366	—	366	6,026	—	6,026	177	—	6,584	—	6,584
Finance	733	2,602	360	2,962	3,752	—	3,752	25,419	1,150	34,016	22,420	11,596
Residential mortgages	—	409	—	409	—	—	—	—	—	409	—	409
Personal lending	—	2	—	2	—	—	—	6	—	8	—	8
Property	—	540	1,154	1,694	300	3	303	68	—	2,065	—	2,065
Construction	—	79	40	119	—	—	—	—	—	119	—	119
Manufacturing	—	195	236	431	—	—	—	210	—	641	—	641
Service industries and business activities												
- retail, wholesale and repairs	—	250	85	335	9	—	9	131	—	475	—	475
- transport and storage	—	197	333	530	56	—	56	170	—	756	—	756
- health, education and recreation	—	128	16	144	—	—	—	27	—	171	—	171
- hotels and restaurants	—	65	—	65	—	—	—	3	—	68	—	68
- utilities	—	816	274	1,090	5	—	5	46	—	1,141	—	1,141
- other	—	595	589	1,184	3	—	3	615	—	1,802	—	1,802
Agriculture, forestry and fishing	—	3	—	3	—	—	—	2	—	5	—	5
Finance leases and instalment credit	—	—	—	—	—	—	—	—	—	—	—	—
Interest accruals	—	13	1	14	15	—	15	—	—	29	—	29
Total third-party	748	6,260	3,088	9,348	10,166	3	10,169	26,874	1,150	48,289	22,420	25,869
Amounts due from holding company and subsidiaries	—	5,528	333	5,861	—	—	—	2,036	—	7,897	—	7,897
Total gross of provisions	748	11,788	3,421	15,209	10,166	3	10,169	28,910	1,150	56,186	22,420	33,766

For the notes relating to this table refer to page 91.

Risk management: Credit risk continued

Balance sheet analysis: Sector and geographical region continued

	Bank											
		Loans and advances			Securities							
2009	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
UK												
Central and local government	129	2,128	192	2,320	79,263	—	79,263	6,712	4	88,428	465	87,963
Finance	41,997	35,404	1,561	36,965	30,532	928	31,460	239,768	22,110	372,300	232,267	140,033
Residential mortgages	—	41,480	1,895	43,375	—	—	—	3	—	43,378	7	43,371
Personal lending	—	6,290	686	6,976	—	—	—	—	—	6,976	20	6,956
Property	—	18,653	23,406	42,059	3,870	100	3,970	3,588	1	49,618	356	49,262
Construction	—	3,475	1,929	5,404	42	113	155	799	45	6,403	477	5,926
Manufacturing	182	7,584	2,452	10,036	345	—	345	2,112	—	12,675	1,377	11,298
Service industries and business activities												
- retail, wholesale and repairs	—	4,636	1,753	6,389	355	7	362	708	—	7,459	602	6,857
- transport and storage	—	8,201	4,262	12,463	306	—	306	952	—	13,721	72	13,649
- health, education and recreation	22	8,474	699	9,173	297	—	297	811	—	10,303	129	10,174
- hotels and restaurants	—	4,206	782	4,988	313	—	313	772	—	6,073	114	5,959
- utilities	—	2,022	1,599	3,621	445	—	445	2,257	—	6,323	11	6,312
- other	—	6,998	2,043	9,041	963	18	981	1,737	—	11,759	79	11,680
Agriculture, forestry and fishing	—	812	31	843	—	—	—	30	—	873	61	812
Finance leases and instalment credit	—	340	29	369	56	—	56	16	—	441	39	402
Interest accruals	60	537	64	601	420	—	420	—	—	1,081	—	1,081
Total third-party	42,390	151,240	43,383	194,623	117,207	1,166	118,373	260,265	22,160	637,811	236,076	401,735
Amounts due from holding company and subsidiaries	—	118,235	10,351	128,586	83,010	—	83,010	31,783	—	243,379	—	243,379
Total gross of provisions	42,390	269,475	53,734	323,209	200,217	1,166	201,383	292,048	22,160	881,190	236,076	645,114
US												
Central and local government	—	48	—	48	2,273	—	2,273	9	1	2,331	—	2,331
Finance	192	595	1,449	2,044	6,215	5	6,220	125,413	2,463	136,332	112,301	24,031
Property	—	505	222	727	2	—	2	30	—	759	—	759
Construction	—	141	13	154	—	1	1	50	—	205	—	205
Manufacturing	—	1,881	206	2,087	29	3	32	580	—	2,699	—	2,699
Service industries and business activities												
- retail, wholesale and repairs	—	456	16	472	14	—	14	108	—	594	—	594
- transport and storage	—	474	1,496	1,970	—	1	1	737	—	2,708	—	2,708
- health, education and recreation	—	—	863	863	—	—	—	272	—	1,135	—	1,135
- hotels and restaurants	—	382	14	396	—	—	—	7	—	403	—	403
- utilities	—	553	6	559	2	—	2	204	—	765	—	765
- other	280	1,433	655	2,088	40	2	42	540	—	2,950	—	2,950
Agriculture, forestry and fishing	—	—	—	—	—	—	—	2	—	2	—	2
Finance leases and instalment credit	—	25	—	25	—	—	—	—	—	25	—	25
Interest accruals	—	10	16	26	30	—	30	—	—	56	—	56
Total third-party	472	6,503	4,956	11,459	8,605	12	8,617	127,952	2,464	150,964	112,301	38,663
Amounts due from holding company and subsidiaries	—	4,327	59	4,386	—	—	—	4,353	—	8,739	—	8,739
Total gross of provisions	472	10,830	5,015	15,845	8,605	12	8,617	132,305	2,464	159,703	112,301	47,402

For the notes relating to this table refer to page 91.

2009	Reverse repos £m	Loans and advances Core £m	Loans and advances Non-Core £m	Loans and advances Total £m	Securities Debt £m	Securities Equity £m	Securities Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	Net £m
Europe												
Central and local government	—	22	575	597	—	—	—	33	—	630	—	630
Finance	—	547	576	1,123	44	7	51	—	116	1,290	—	1,290
Residential mortgages	—	4	—	4	—	—	—	—	—	4	—	4
Personal lending	—	1	—	1	—	—	—	—	—	1	—	1
Property	—	308	4,795	5,103	—	—	—	—	—	5,103	—	5,103
Construction	—	461	354	815	—	—	—	—	—	815	—	815
Manufacturing	—	1,637	4,402	6,039	—	—	—	—	—	6,039	—	6,039
Service industries and business activities												
- retail, wholesale and repairs	—	699	270	969	—	—	—	—	—	969	—	969
- transport and storage	—	3,589	919	4,508	—	—	—	—	—	4,508	—	4,508
- health, education and recreation	—	173	338	511	—	—	—	—	—	511	—	511
- hotels and restaurants	—	134	274	408	—	—	—	—	—	408	—	408
- utilities	—	844	602	1,446	—	—	—	—	—	1,446	—	1,446
- other	—	527	68	595	1	—	1	—	—	596	—	596
Finance leases and instalment credit	—	11	—	11	—	—	—	—	—	11	—	11
Interest accruals	—	11	50	61	—	—	—	—	—	61	—	61
Total third-party	—	8,968	13,223	22,191	45	7	52	33	116	22,392	—	22,392
Amounts due from holding company and subsidiaries	—	2	162	164	—	—	—	—	—	164	—	164
Total gross of provisions	—	8,970	13,385	22,355	45	7	52	33	116	22,556	—	22,556
RoW												
Central and local government	—	1,089	—	1,089	3,052	—	3,052	168	3	4,312	—	4,312
Finance	171	4,626	476	5,102	2,444	—	2,444	22,721	515	30,953	19,725	11,228
Residential mortgages	—	390	—	390	—	—	—	—	—	390	—	390
Personal lending	—	2	—	2	—	—	—	29	—	31	—	31
Property	—	201	1,729	1,930	669	—	669	50	—	2,649	—	2,649
Construction	—	13	214	227	—	—	—	9	—	236	—	236
Manufacturing	—	265	380	645	—	—	—	55	—	700	—	700
Service industries and business activities												
- retail, wholesale and repairs	—	63	84	147	—	—	—	51	—	198	—	198
- transport and storage	—	211	363	574	49	—	49	87	—	710	—	710
- health, education and recreation	—	208	26	234	—	—	—	23	—	257	—	257
- hotels and restaurants	—	122	—	122	—	—	—	1	—	123	—	123
- utilities	—	519	362	881	12	—	12	67	—	960	—	960
- other	—	610	792	1,402	18	—	18	166	—	1,586	—	1,586
Agriculture, forestry and fishing	—	3	—	3	—	—	—	3	—	6	—	6
Finance leases and instalment credit	—	—	19	19	—	—	—	—	—	19	—	19
Interest accruals	—	11	16	27	1	—	1	—	—	28	—	28
Total third-party	171	8,333	4,461	12,794	6,245	—	6,245	23,430	518	43,158	19,725	23,433
Amounts due from holding company and subsidiaries	—	3,172	155	3,327	—	—	—	3,097	—	6,424	—	6,424
Total gross of provisions	171	11,505	4,616	16,121	6,245	—	6,245	26,527	518	49,582	19,725	29,857

Bank

Notes:

(1) Includes cash and balances at central banks of £64,261 million (2010 - £44,921 milion; 2009 - £21,099 million) and settlement balances of £4,059 million (2010 - £3,529 million; 2009 - £4,159 million).

(2) This shows the amount by which the Bank's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Bank a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

Risk management: Credit risk continued

Balance sheet analysis: Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the Group's cross border exposures greater than 0.5% of the Group's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

	2011						2010					
	Government £m	Banks £m	Other £m	Total £m	Short positions £m	Net of short positions £m	Government £m	Banks £m	Other £m	Total £m	Short positions £m	Net of short positions £m
US	17,933	6,668	30,574	55,175	13,329	41,846	19,214	12,944	22,730	54,888	14,240	40,648
Germany	30,766	4,457	9,370	44,593	2,947	41,646	17,213	4,553	7,699	29,465	4,675	24,790
France	10,263	14,276	7,093	31,632	5,904	25,728	14,903	15,383	3,377	33,663	4,285	29,378
Japan	8,349	7,423	3,330	19,102	3,141	15,961	7,585	1,665	668	9,918	3,246	6,672
Netherlands	4,466	1,921	9,124	15,511	910	14,601	2,874	1,905	6,664	11,443	951	10,492
Spain	308	1,245	6,153	7,706	973	6,733	1,315	1,753	6,755	9,823	1,381	8,442
Republic of Ireland	26	3,649	2,566	6,241	68	6,173	102	3,519	1,108	4,729	139	4,590
Italy	4,495	526	1,199	6,220	4,823	1,397	5,532	547	922	7,001	3,199	3,802
Cayman Islands	—	4	3,640	3,644	2	3,642	—	—	4,935	4,935	44	4,891

Asset quality

The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings agencies and are therefore excluded from the following table and are set out on pages 100 to 102.

Asset quality band	Probability of default range
AQ1	0% - 0.034%
AQ2	0.034% - 0.048%
AQ3	0.048% - 0.095%
AQ4	0.095% - 0.381%
AQ5	0.381% - 1.076%
AQ6	1.076% - 2.153%
AQ7	2.153% - 6.089%
AQ8	6.089% - 17.222%
AQ9	17.222% - 100%
AQ10	100%

2011	Group Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Total									
AQ1	68,367	62,658	106,743	4,277	477,729	25	68,155	6,888	794,842
AQ2	10	1,601	13,468	93	7,265	—	20,758	1,027	44,222
AQ3	23	1,641	29,148	32	9,863	—	21,048	2,041	63,796
AQ4	19	1,272	97,569	753	13,738	—	36,958	3,208	153,517
AQ5	44	844	109,173	41	6,129	—	33,513	2,741	152,485
AQ6	9	117	46,165	46	2,169	—	16,833	1,324	66,663
AQ7	8	113	29,751	12	2,309	—	18,868	603	51,664
AQ8	1	14	11,568	19	1,055	—	4,142	253	17,052
AQ9	5	7	15,301	4	1,147	7	1,570	104	18,145
AQ10	1	162	391	2	1,023	—	2,123	199	3,901
Balances with holding company and fellow subsidiaries	—	27,232	792	—	10,380	—	7	5,753	44,164
Past due	—	—	10,779	1,623	—	—	—	—	12,402
Impaired	—	94	37,020	—	—	—	—	—	37,114
Impairment provision	—	(85)	(18,469)	—	—	—	—	—	(18,554)
	68,487	95,670	489,399	6,902	532,807	32	223,975	24,141	1,441,413
2010									
AQ1	49,827	78,328	117,727	4,079	397,967	23	67,271	6,959	722,181
AQ2	1	90	11,007	1,166	1,413	—	23,005	931	37,613
AQ3	2	1,563	22,105	147	2,334	—	22,137	2,020	50,308
AQ4	1	152	87,275	571	2,182	—	34,470	2,974	127,625
AQ5	3	165	108,049	60	4,046	—	35,105	3,655	151,083
AQ6	3	13	62,948	33	1,003	—	25,177	1,993	91,170
AQ7	1	65	43,511	1	659	—	17,779	969	62,985
AQ8	—	15	15,890	14	289	—	7,456	245	23,909
AQ9	—	13	13,115	2	284	7	3,614	494	17,529
AQ10	—	278	4,470	—	1,359	—	2,203	260	8,570
Balances with holding company and fellow subsidiaries	—	4,848	1,946	—	17,469	—	39	12,479	36,781
Past due	—	7	13,267	2,675	—	—	—	—	15,949
Impaired	—	98	33,693	—	—	—	—	—	33,791
Impairment provision	—	(88)	(16,682)	—	—	—	—	—	(16,770)
	49,838	85,547	518,321	8,748	429,005	30	238,256	32,979	1,362,724

For the note relating to this table refer to page 96.

Risk management: Credit risk continued

Balance sheet analysis: Asset quality continued

	Group								
2009	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Total									
AQ1	27,033	56,548	98,079	3,721	372,642	26	56,560	6,617	621,226
AQ2	—	897	8,631	306	10,574	—	22,770	1,134	44,312
AQ3	1	1,932	26,617	199	10,287	—	23,500	2,671	65,207
AQ4	23	860	88,922	605	5,697	—	37,342	4,302	137,751
AQ5	2	48	109,383	149	5,895	7	38,399	3,987	157,870
AQ6	1	96	90,661	40	2,286	—	29,758	1,682	124,524
AQ7	—	37	43,128	33	1,931	—	25,410	1,429	71,968
AQ8	—	13	19,179	—	1,247	—	11,330	180	31,949
AQ9	—	—	12,181	—	1,788	—	3,691	260	17,920
AQ10	—	216	7,975	3	1,946	—	3,135	167	13,442
Balances with holding company and fellow subsidiaries	—	5,274	1,949	—	32,020	—	42	20,680	59,965
Past due	—	36	13,979	3,910	40	—	—	—	17,965
Impaired	—	100	27,415	187	—	—	—	—	27,702
Impairment provision	—	(90)	(11,930)	—	—	—	—	—	(12,020)
	27,060	65,967	536,169	9,153	446,353	33	251,937	43,109	1,379,781

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Core									
AQ1	68,317	62,614	89,622	4,271	473,991	25	62,330	6,254	767,424
AQ2	10	1,601	12,051	91	6,740	—	19,834	1,024	41,351
AQ3	22	1,641	26,518	32	9,406	—	19,960	1,997	59,576
AQ4	18	1,272	92,385	752	12,795	—	35,885	3,083	146,190
AQ5	44	844	102,666	41	4,701	—	32,380	2,573	143,249
AQ6	9	117	40,438	46	1,936	—	15,950	1,322	59,818
AQ7	8	113	25,964	12	712	—	17,285	530	44,624
AQ8	1	14	9,730	19	584	—	4,057	216	14,621
AQ9	5	7	10,999	4	589	7	1,416	80	13,107
AQ10	1	162	229	2	315	—	1,193	163	2,065
Balances with holding company and fellow subsidiaries	—	27,196	764	—	10,084	—	7	5,753	43,804
Past due	—	—	9,299	1,623	—	—	—	—	10,922
Impaired	—	94	14,497	—	—	—	—	—	14,591
Impairment provision	—	(85)	(7,666)	—	—	—	—	—	(7,751)
	68,435	95,590	427,496	6,893	521,853	32	210,297	22,995	1,353,591

For the note relating to this table refer to page 96.

2010	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
	Group								
Core									
AQ1	49,827	78,204	96,644	4,079	387,531	23	60,386	6,851	683,545
AQ2	1	89	8,372	1,166	1,051	—	21,980	914	33,573
AQ3	2	1,561	19,029	146	2,149	—	20,104	1,954	44,945
AQ4	1	150	78,569	571	1,813	—	30,882	2,867	114,853
AQ5	3	163	94,885	60	3,617	—	32,259	3,530	134,517
AQ6	3	12	52,095	33	742	—	23,315	1,931	78,131
AQ7	1	64	36,976	1	403	—	16,884	911	55,240
AQ8	—	15	12,859	14	174	—	7,281	244	20,587
AQ9	—	13	9,309	2	121	7	3,173	466	13,091
AQ10	—	277	2,298	—	316	—	1,292	225	4,408
Balances with holding company and fellow subsidiaries	—	4,736	1,888	—	14,434	—	39	12,479	33,576
Past due	—	—	10,664	2,625	—	—	—	—	13,289
Impaired	—	98	12,819	—	—	—	—	—	12,917
Impairment provision	—	(88)	(7,260)	—	—	—	—	—	(7,348)
	49,838	85,294	429,147	8,697	412,351	30	217,595	32,372	1,235,324

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Non-Core									
AQ1	50	44	17,121	6	3,738	—	5,825	634	27,418
AQ2	—	—	1,417	2	525	—	924	3	2,871
AQ3	1	—	2,630	—	457	—	1,088	44	4,220
AQ4	1	—	5,184	1	943	—	1,073	125	7,327
AQ5	—	—	6,507	—	1,428	—	1,133	168	9,236
AQ6	—	—	5,727	—	233	—	883	2	6,845
AQ7	—	—	3,787	—	1,597	—	1,583	73	7,040
AQ8	—	—	1,838	—	471	—	85	37	2,431
AQ9	—	—	4,302	—	558	—	154	24	5,038
AQ10	—	—	162	—	708	—	930	36	1,836
Balances with holding company and fellow subsidiaries	—	36	28	—	296	—	—	—	360
Past due	—	—	1,480	—	—	—	—	—	1,480
Impaired	—	—	22,523	—	—	—	—	—	22,523
Impairment provision	—	—	(10,803)	—	—	—	—	—	(10,803)
	52	80	61,903	9	10,954	—	13,678	1,146	87,822

For the note relating to this table refer to page 96.

Risk management: Credit risk continued

Balance sheet analysis: Asset quality continued

2010	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
	Group								
Non-Core									
AQ1	—	124	21,083	—	10,436	—	6,885	108	38,636
AQ2	—	1	2,635	—	362	—	1,025	17	4,040
AQ3	—	2	3,076	1	185	—	2,033	66	5,363
AQ4	—	2	8,706	—	369	—	3,588	107	12,772
AQ5	—	2	13,164	—	429	—	2,846	125	16,566
AQ6	—	1	10,853	—	261	—	1,862	62	13,039
AQ7	—	1	6,535	—	256	—	895	58	7,745
AQ8	—	—	3,031	—	115	—	175	1	3,322
AQ9	—	—	3,806	—	163	—	441	28	4,438
AQ10	—	1	2,172	—	1,043	—	911	35	4,162
Balances with holding company and fellow subsidiaries	—	112	58	—	3,035	—	—	—	3,205
Past due	—	7	2,603	50	—	—	—	—	2,660
Impaired	—	—	20,874	—	—	—	—	—	20,874
Impairment provision	—	—	(9,422)	—	—	—	—	—	(9,422)
	—	253	89,174	51	16,654	—	20,661	607	127,400

Note:
(1) Excluding items in the course of collection of £1,470 million (2010 - £1,958 million; 2009 - £2,474 million).

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
	Bank							
Total								
AQ1	64,147	44,919	58,622	3,227	476,718	49,260	6,089	702,982
AQ2	9	1,123	6,738	43	7,085	19,358	747	35,103
AQ3	23	1,521	18,716	9	9,798	17,272	1,631	48,970
AQ4	18	1,163	35,037	722	13,432	19,993	1,223	71,588
AQ5	43	649	46,090	22	5,335	12,829	1,108	66,076
AQ6	8	106	14,489	3	1,678	5,728	357	22,369
AQ7	7	87	7,424	11	2,053	8,427	234	18,243
AQ8	1	9	3,073	19	865	1,206	59	5,232
AQ9	5	7	5,899	3	977	630	38	7,559
AQ10	—	159	136	—	899	1,093	30	2,317
Balances with holding company and subsidiaries	—	58,972	145,757	—	18,457	9,735	5,753	238,674
Past due	—	—	1,474	—	—	—	—	1,474
Impaired	—	85	12,215	—	—	—	—	12,300
Impairment provision	—	(76)	(4,547)	—	—	—	—	(4,623)
	64,261	108,724	351,123	4,059	537,297	145,531	17,269	1,228,264

For the note relating to this table refer to page 99.

	Bank							
2010	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
AQ1	44,916	58,880	64,861	2,237	396,558	46,075	5,600	619,127
AQ2	1	62	5,632	205	1,346	20,809	785	28,840
AQ3	1	869	12,448	75	2,299	17,092	1,671	34,455
AQ4	1	116	35,648	121	2,098	20,297	1,383	59,664
AQ5	1	122	48,142	19	3,702	16,594	1,582	70,162
AQ6	1	6	21,629	24	668	10,470	868	33,666
AQ7	—	21	12,405	1	463	7,543	337	20,770
AQ8	—	8	4,333	14	187	2,727	40	7,309
AQ9	—	9	4,833	2	169	1,964	298	7,275
AQ10	—	272	1,828	—	1,237	1,296	128	4,761
Balances with holding company and subsidiaries	—	40,127	127,817	—	24,085	533	12,479	205,041
Past due	—	—	2,521	831	—	—	—	3,352
Impaired	—	89	12,584	—	—	—	—	12,673
Impairment provision	—	(79)	(5,502)	—	—	—	—	(5,581)
	44,921	100,502	349,179	3,529	432,812	145,400	25,171	1,101,514
2009								
AQ1	21,099	39,939	45,138	2,656	371,762	45,312	5,443	531,349
AQ2	—	888	5,019	42	10,456	21,579	911	38,895
AQ3	—	1,492	16,075	—	10,196	20,316	2,205	50,284
AQ4	—	623	41,900	50	5,389	25,436	2,349	75,747
AQ5	—	36	50,851	35	5,399	17,115	2,255	75,691
AQ6	—	93	35,739	40	1,922	10,969	446	49,209
AQ7	—	23	14,182	33	1,746	10,594	592	27,170
AQ8	—	9	5,350	—	1,168	3,753	20	10,300
AQ9	—	—	6,177	—	1,753	1,621	108	9,659
AQ10	—	216	4,707	3	1,850	2,015	92	8,883
Balances with holding company and subsidiaries	—	33,610	102,853	—	39,233	329	20,680	196,705
Past due	—	—	3,431	1,113	39	—	—	4,583
Impaired	—	90	11,696	187	—	—	—	11,973
Impairment provision	—	(80)	(4,570)	—	—	—	—	(4,650)
	21,099	76,939	338,548	4,159	450,913	159,039	35,101	1,085,798

For the note relating to this table refer to page 99.

Risk management: Credit risk continued

Balance sheet analysis: Asset quality continued

	Bank							
2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
Core								
AQ1	64,147	44,917	49,951	3,221	473,118	47,511	5,469	688,334
AQ2	9	1,123	6,026	41	6,564	18,508	744	33,015
AQ3	23	1,521	17,670	9	9,341	16,796	1,589	46,949
AQ4	18	1,163	31,544	721	12,552	19,149	1,099	66,246
AQ5	43	649	41,667	22	3,964	11,950	943	59,238
AQ6	8	106	10,748	3	1,457	5,008	356	17,686
AQ7	7	87	5,187	11	460	7,032	165	12,949
AQ8	1	9	2,651	19	477	1,171	22	4,350
AQ9	5	7	3,482	3	496	519	29	4,541
AQ10	—	159	—	—	227	511	21	918
Balances with holding company and subsidiaries	—	58,947	142,331	—	18,119	9,735	5,753	234,885
Past due	—	—	1,349	—	—	—	—	1,349
Impaired	—	85	3,396	—	—	—	—	3,481
Impairment provision	—	(76)	(1,443)	—	—	—	—	(1,519)
	64,261	108,697	314,559	4,050	526,775	137,890	16,190	1,172,422
2010								
AQ1	44,916	58,796	56,914	2,237	386,212	43,307	5,520	597,902
AQ2	1	61	4,220	205	984	19,819	768	26,058
AQ3	1	867	10,614	74	2,114	15,492	1,608	30,770
AQ4	1	115	30,282	121	1,732	17,251	1,277	50,779
AQ5	1	120	38,736	19	3,279	14,403	1,461	58,019
AQ6	1	5	14,436	24	465	9,207	806	24,944
AQ7	—	21	9,140	1	210	6,883	279	16,534
AQ8	—	8	3,589	14	87	2,632	39	6,369
AQ9	—	9	3,068	2	56	1,602	271	5,008
AQ10	—	271	955	—	278	574	93	2,171
Balances with holding company and subsidiaries	—	40,006	120,952	—	20,680	533	12,479	194,650
Past due	—	—	2,038	781	—	—	—	2,819
Impaired	—	89	3,877	—	—	—	—	3,966
Impairment provision	—	(79)	(2,038)	—	—	—	—	(2,117)
	44,921	100,289	296,783	3,478	416,097	131,703	24,601	1,017,872

For the note relating to this table refer to page 99.

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
	Bank							
Non-Core								
AQ1	—	2	8,671	6	3,600	1,749	620	14,648
AQ2	—	—	712	2	521	850	3	2,088
AQ3	—	—	1,046	—	457	476	42	2,021
AQ4	—	—	3,493	1	880	844	124	5,342
AQ5	—	—	4,423	—	1,371	879	165	6,838
AQ6	—	—	3,741	—	221	720	1	4,683
AQ7	—	—	2,237	—	1,593	1,395	69	5,294
AQ8	—	—	422	—	388	35	37	882
AQ9	—	—	2,417	—	481	111	9	3,018
AQ10	—	—	136	—	672	582	9	1,399
Balances with holding company and subsidiaries	—	25	3,426	—	338	—	—	3,789
Past due	—	—	125	—	—	—	—	125
Impaired	—	—	8,819	—	—	—	—	8,819
Impairment provision	—	—	(3,104)	—	—	—	—	(3,104)
	—	27	36,564	9	10,522	7,641	1,079	55,842
2010								
AQ1	—	84	7,947	—	10,346	2,768	80	21,225
AQ2	—	1	1,412	—	362	990	17	2,782
AQ3	—	2	1,834	1	185	1,600	63	3,685
AQ4	—	1	5,366	—	366	3,046	106	8,885
AQ5	—	2	9,406	—	423	2,191	121	12,143
AQ6	—	1	7,193	—	203	1,263	62	8,722
AQ7	—	—	3,265	—	253	660	58	4,236
AQ8	—	—	744	—	100	95	1	940
AQ9	—	—	1,765	—	113	362	27	2,267
AQ10	—	1	873	—	959	722	35	2,590
Balances with holding company and subsidiaries	—	121	6,865	—	3,405	—	—	10,391
Past due	—	—	483	50	—	—	—	533
Impaired	—	—	8,707	—	—	—	—	8,707
Impairment provision	—	—	(3,464)	—	—	—	—	(3,464)
	—	213	52,396	51	16,715	13,697	570	83,642

Note:
(1) Excluding items in the course of collection of £316 million (2010 - £463 million; 2009 - £426 million).

Risk management: Credit risk continued

Balance sheet analysis: Debt securities

The table below analyses debt securities by issuer and external ratings. Ratings are based on the lower of S&P, Moody's and Fitch.

	Group								
	Central and local government				Other financial				Of which
	UK	US	Other	Banks	institutions	Corporate	Total	% of total (1)	ABS (2)
2011	£m	£m	£m	£m	£m	£m	£m	%	£m
Total									
AAA	19,669	45	27,638	2,221	9,828	165	59,566	35	9,549
AA to AA+	—	37,490	375	1,060	29,011	319	68,255	41	31,560
A to AA-	—	1	20,803	3,822	3,599	419	28,644	17	3,113
BBB- to A-	—	—	66	337	2,490	1,127	4,020	2	2,467
Non-investment grade	—	—	251	157	4,671	1,104	6,183	4	4,362
Unrated	—	3	—	47	1,347	274	1,671	1	1,235
	19,669	37,539	49,133	7,644	50,946	3,408	168,339	100	52,286
Issued by holding company and fellow subsidiaries	—	—	—	714	88	—	802		—
	19,669	37,539	49,133	8,358	51,034	3,408	169,141		52,286
Core									
AAA	19,669	45	27,638	1,799	7,246	165	56,562	36	6,967
AA to AA+	—	37,490	375	1,060	26,734	286	65,945	42	29,283
A to AA-	—	1	20,803	3,815	1,993	419	27,031	17	1,522
BBB- to A-	—	—	66	337	1,301	926	2,630	2	1,174
Non-investment grade	—	—	251	157	2,504	953	3,865	2	2,422
Unrated	—	3	—	45	798	241	1,087	1	784
	19,669	37,539	49,133	7,213	40,576	2,990	157,120	100	42,152
Non-Core									
AAA	—	—	—	422	2,582	—	3,004	27	2,582
AA to AA+	—	—	—	—	2,277	33	2,310	21	2,277
A to AA-	—	—	—	7	1,606	—	1,613	14	1,591
BBB- to A-	—	—	—	—	1,189	201	1,390	12	1,293
Non-investment grade	—	—	—	—	2,167	151	2,318	21	1,940
Unrated	—	—	—	2	549	33	584	5	451
	—	—	—	431	10,370	418	11,219	100	10,134
2010									
Total									
AAA	10,755	36,002	30,836	4,533	32,140	413	114,679	69	38,281
AA to AA+	—	—	17,214	1,724	3,718	265	22,921	14	3,753
A to AA-	—	—	5,876	3,248	2,489	545	12,158	7	2,513
BBB- to A-	—	—	232	666	3,366	1,874	6,138	4	3,317
Non-investment grade	—	—	320	111	5,134	1,076	6,641	4	4,913
Unrated	—	—	53	415	2,365	648	3,481	2	1,645
	10,755	36,002	54,531	10,697	49,212	4,821	166,018	100	54,422
Issued by fellow subsidiaries	—	—	—	—	11	—	11		—
	10,755	36,002	54,531	10,697	49,223	4,821	166,029		54,422
Core									
AAA	10,755	35,707	30,836	4,533	28,427	413	110,671	73	34,570
AA to AA+	—	—	17,214	1,724	1,039	265	20,242	13	1,074
A to AA-	—	—	5,876	3,217	1,126	544	10,763	7	1,150
BBB- to A-	—	—	232	644	1,132	1,803	3,811	2	1,040
Non-investment grade	—	—	320	111	3,255	830	4,516	3	3,042
Unrated	—	—	53	414	1,341	632	2,440	2	921
	10,755	35,707	54,531	10,643	36,320	4,487	152,443	100	41,797

For the notes relating to this table refer to page 102.

	Group								
	Central and local government								
	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	% of total (1) £m	Of which ABS (2) £m
Non-Core									
AAA	—	295	—	—	3,713	—	4,008	29	3,711
AA to AA+	—	—	—	—	2,679	—	2,679	20	2,679
A to AA-	—	—	—	31	1,363	1	1.395	10	1,363
BBB- to A-	—	—	—	22	2,234	71	2,327	17	2,277
Non-investment grade	—	—	—	—	1,879	246	2,125	16	1,871
Unrated	—	—	—	1	1,024	16	1,041	8	724
	—	295	—	54	12,892	334	13,575	100	12,625
2009									
Total									
AAA	25,208	24,275	29,171	2,900	37,393	3,299	122,246	66	44,099
AA to AA+	—	—	18,890	2,812	7,810	994	30,506	17	8,099
A to AA-	—	—	7,472	2,265	3,677	621	14,035	8	3,794
BBB- to A-	—	—	822	699	4,557	1,626	7,704	4	4,174
Non-investment grade	—	—	181	146	3,551	1,329	5,207	3	3,468
Unrated	—	—	47	230	3,362	971	4,610	2	2,021
	25,208	24,275	56,583	9,052	60,350	8,840	184,308	100	65,655
Issued by fellow subsidiaries	—	—	—	—	873	—	873		—
	25,208	24,275	56,583	9,052	61,223	8,840	185,181		65,655

	Bank								
	Central and local government								
2011	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	% of total (1)	Of which ABS (2) £m
AAA	19,664	—	27,238	1,521	8,500	160	57,083	51	8,167
AA to AA+	—	18,317	367	1,030	3,067	193	22,974	21	3,147
A to AA-	—	—	16,992	3,542	3,028	289	23,851	21	2,523
BBB- to A-	—	—	61	112	1,863	738	2,774	3	1,850
Non-investment grade	—	—	249	140	2,435	799	3,623	3	2,465
Unrated	—	—	—	11	855	142	1,008	1	535
	19,664	18,317	44,907	6,356	19,748	2,321	111,313	100	18,687
Issued by holding company and subsidiairies	—	—	—	953	69,194	—	70,147		68,785
	19,664	18,317	44,907	7,309	88,942	2,321	181,460		87,472
2010									
AAA	10,754	18,368	30,043	4,424	8,712	381	72,682	64	10,902
AA to AA+	—	—	13,650	1,459	4,231	187	19,527	17	3,555
A to AA-	—	—	5,870	3,046	1,572	285	10,773	10	1,646
BBB- to A-	—	—	144	625	1,992	821	3,582	3	2,031
Non-investment grade	—	—	285	120	2,893	698	3,996	3	2,746
Unrated	—	—	53	648	2,002	1,219	3,922	2	1,606
	10,754	18,368	50,045	10,322	21,402	3,591	114,482	100	22,486
Issued by subsidiaries	—	—	—	—	74,726	—	74,726		74,252
	10,754	18,368	50,045	10,322	96,128	3,591	189,208		96,738

For the notes relating to this table refer to page 102.

Risk management: Credit risk continued

Balance sheet analysis: Debt securities continued

2009	Central and local government UK £m	US £m	Other £m	Bank Banks £m	Other financial institutions £m	Corporate £m	Total £m	% of total (1)	Of which ABS (2) £m
AAA	25,206	9,564	28,425	2,433	11,033	3,235	79,896	61	13,710
AA to AA+	—	—	13,842	2,512	7,826	756	24,936	19	7,850
A to AA-	—	—	7,472	2,087	2,348	497	12,404	9	2,558
BBB- to A-	—	—	806	669	2,954	1,153	5,582	4	2,766
Non-investment grade	—	—	160	170	2,304	1,016	3,650	3	2,304
Unrated	—	—	37	229	3,277	1,577	5,120	4	2,004
	25,206	9,564	50,742	8,100	29,742	8,234	131,588	100	31,192
Issued by subsidiairies	—	—	—	—	83,010	—	83,010		81,492
	25,206	9,564	50,742	8,100	112,752	8,234	214,598		112,684

Notes:

(1) Percentage calculated before balances with Group companies.

(2) Asset-backed securities.

Key points

- The decrease in AAA rated debt securities relates to the downgrading of US government and agencies to AA+ by S&P during the year.
- The proportion of debt securities rated A to AA- increased to 17% in the Group and 21% in the Bank, principally reflecting the Japanese government downgrade in 2011.

The table below analyses debt securities by issuer and measurement classification. The categorisation of debt securities has been revised to include asset-backed securities (ABS) by class of issuer. The main changes are to US central and local government which includes US federal agencies, and financial institutions which now includes US government sponsored agencies and securitisation entities. 2010 and 2009 data are presented on the revised basis.

2011	Central and local government UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS £m
Held-for-trading (HFT)	9,004	18,770	35,146	3,649	22,577	2,615	91,761	20,815
Designated as at fair value through profit or loss	1	—	—	53	457	9	520	418
Available-for-sale	10,654	18,769	13,987	4,624	22,907	451	71,392	25,996
Loans and receivables	10	—	—	32	5,093	333	5,468	5,057
	19,669	37,539	49,133	8,358	51,034	3,408	169,141	52,286
Total of which US agencies	—	4,896	—	—	25,924	—	30,820	28,558
Available-for-sale								
Gross unrealised gains	1,312	967	700	3	874	9	3,865	952
Gross unrealised losses	—	—	—	(32)	(326)	(12)	(370)	(336)
2010								
Held-for-trading	5,092	15,619	39,971	3,657	23,086	4,346	91,771	21,988
Designated as at fair value through profit or loss	1	117	1	4	8	10	141	119
Available-for-sale	5,651	20,266	14,559	7,033	19,752	176	67,437	26,296
Loans and receivables	11	—	—	3	6,377	289	6,680	6,019
	10,755	36,002	54,531	10,697	49,223	4,821	166,029	54,422
Total of which US agencies	—	6,811	—	—	21,686	—	28,497	25,375
Available-for-sale								
Gross unrealised gains	244	293	145	58	798	2	1,540	998
Gross unrealised losses	—	(2)	—	(13)	(317)	(43)	(375)	(334)

2009	Central and local government UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS £m
Held-for-trading	8,120	9,147	47,022	5,404	28,779	4,667	103,139	26,246
Designated as at fair value through profit or loss	1	205	—	3	30	10	249	207
Available-for-sale	17,086	14,923	9,561	3,645	24,850	1,437	71,502	31,640
Loans and receivables	1	—	—	—	7,564	2,726	10,291	7,562
	25,208	24,275	56,583	9,052	61,223	8,840	185,181	65,655
Total of which US agencies	—	8,817	—	—	23,834	—	32,651	28,422
Available-for-sale								
Gross unrealised gains	72	217	32	8	491	11	831	674
Gross unrealised losses	(50)	(98)	(24)	(2)	(977)	(197)	(1,348)	(1,162)

Asset-backed securities

The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets. The carrying value of the Group's debt securities is detailed below.

	2011 £bn	2010 £bn	2009 £bn
Securities issued by central and local governments	106.3	101.3	106.1
Securities issued by corporates	3.4	4.8	8.8
Securities issued by banks and other financial institutions	59.4	59.9	70.3
	169.1	166.0	185.2
Asset-backed securities	52.3	54.4	65.7

The Group's credit market activities gave rise to risk concentrations in asset-backed securities (ABS). The Group has exposures to ABS which are predominantly debt securities, but can also be held in derivative form. ABS have an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed onto investors by the issue of securities with varying seniority, by a special purpose entity.

Debt securities include residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and other ABS. In many cases the risk associated with these assets is hedged by way of credit derivative protection, purchased over the specific asset or relevant ABS indices. The counterparty to some of these hedge transactions are monoline insurers.

The following tables summarise the gross and net exposures and carrying values of these securities by geography of the underlying assets at 31 December 2011, 2010 and 2009. Gross exposures represent the principal amounts relating to ABS. Government sponsored or similar RMBS comprises securities that are: (a) guaranteed or effectively guaranteed by the US government, by way of its support for US federal agencies and government sponsored enterprises or (b) guaranteed by the Dutch government. Net exposures represent the carrying value after taking account of the hedge protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

Risk management: Credit risk continued

Balance sheet analysis: Asset-backed securities by geography and measurement classification

The tables below summarise ABS carrying values and net exposures by geography and measurement classification for the Group.

2011	US £m	UK £m	Other Europe £m	RoW (1) £m	Total £m	FVTPL (2) HFT (3) £m	FVTPL (2) DFV (4) £m	AFS (5) £m	LAR (6) £m
Gross exposure									
RMBS: G10 government	27,549	—	—	2	27,551	15,032	—	12,519	—
RMBS: prime	1,201	3,251	1,520	484	6,456	1,090	428	4,929	9
RMBS: non-conforming	1,220	2,197	74	—	3,491	717	—	1,402	1,372
RMBS: sub-prime	1,847	424	94	2	2,367	2,183	—	22	162
CMBS	1,623	1,551	841	1	4,016	2,001	—	862	1,153
CDOs	7,889	72	315	—	8,276	4,454	—	3,732	90
CLOs	5,019	156	740	—	5,915	1,294	—	4,420	201
ABS	2,085	1,792	1,627	971	6,475	1,966	17	2,211	2,281
	48,433	9,443	5,211	1,460	64,547	28,737	445	30,097	5,268
Carrying value									
RMBS: G10 government	28,022	—	—	2	28,024	15,132	—	12,892	—
RMBS: prime	1,035	2,802	1,186	466	5,489	870	418	4,199	2
RMBS: non-conforming	708	1,897	74	—	2,679	326	—	981	1,372
RMBS: sub-prime	686	141	72	2	901	737	—	9	155
CMBS	1,502	1,241	592	1	3,336	1,511	—	717	1,108
CDOs	1,632	31	156	—	1,819	315	—	1,417	87
CLOs	4,524	98	443	—	5,065	884	—	4,004	177
ABS	1,715	894	1,420	944	4,973	1,040	—	1,777	2,156
	39,824	7,104	3,943	1,415	52,286	20,815	418	25,996	5,057
Net exposure									
RMBS: G10 government	28,022	—	—	2	28,024	15,132	—	12,892	—
RMBS: prime	825	3,223	985	458	5,491	447	418	4,624	2
RMBS: non-conforming	677	2,225	74	—	2,976	284	—	1,320	1,372
RMBS: sub-prime	385	135	67	2	589	434	—	—	155
CMBS	860	1,241	500	1	2,602	777	—	717	1,108
CDOs	1,030	31	156	—	1,217	304	—	826	87
CLOs	1,367	98	436	—	1,901	827	—	896	178
ABS	1,456	789	1,420	782	4,447	617	—	1,774	2,056
	34,622	7,742	3,638	1,245	47,247	18,822	418	23,049	4,958

For the notes relating to this table refer to page 106.

2010	US £m	UK £m	Other Europe £m	RoW (1) £m	Total £m	FVTPL (2) HFT (3) £m	FVTPL (2) DFV (4) £m	AFS (5) £m	LAR (6) £m
Gross exposure									
RMBS: G10 government	24,206	16	—	—	24,222	13,839	—	10,383	—
RMBS: prime	1,773	3,039	1,096	192	6,100	1,606	1	4,446	47
RMBS: non-conforming	1,249	2,107	92	—	3,448	708	—	1,313	1,427
RMBS: sub-prime	792	362	139	221	1,514	818	—	497	199
CMBS	3,086	1,427	850	45	5,408	2,646	121	1,408	1,233
CDOs	12,152	128	313	—	12,593	7,943	1	4,550	99
CLOs	6,038	134	876	9	7,057	1,062	—	5,572	423
ABS	3,104	1,066	936	1,679	6,785	1,534	—	2,505	2,746
	52,400	8,279	4,302	2,146	67,127	30,156	123	30,674	6,174
Carrying value									
RMBS: G10 government	24,391	15	—	—	24,406	13,765	—	10,641	—
RMBS: prime	1,613	2,664	910	192	5,379	1,383	1	3,957	38
RMBS: non-conforming	1,084	1,959	92	—	3,135	605	—	1,102	1,428
RMBS: sub-prime	638	252	120	205	1,215	681	—	344	190
CMBS	2,937	1,314	581	38	4,870	2,263	117	1,282	1,208
CDOs	3,135	69	128	—	3,332	1,340	1	1,895	96
CLOs	5,333	102	632	3	6,070	691	—	4,958	421
ABS	2,780	865	729	1,641	6,015	1,260	—	2,117	2,638
	41,911	7,240	3,192	2,079	54,422	21,988	119	26,296	6,019
Net exposure									
RMBS: G10 government	24,391	15	—	—	24,406	13,765	—	10,641	—
RMBS: prime	1,513	2,613	576	191	4,893	897	1	3,957	38
RMBS: non-conforming	1,081	1,959	92	—	3,132	602	—	1,102	1,428
RMBS: sub-prime	289	249	112	176	826	304	—	332	190
CMBS	1,823	1,312	402	38	3,575	1,188	10	1,230	1,147
CDOs	1,085	39	119	—	1,243	742	1	404	96
CLOs	1,387	102	625	—	2,114	672	—	1,021	421
ABS	2,294	668	722	1,634	5,318	691	—	2,109	2,518
	33,863	6,957	2,648	2,039	45,507	18,861	12	20,796	5,838
2009									
Gross exposure									
RMBS: G10 government	26,645	17	—	—	26,662	13,443	—	13,219	—
RMBS: prime	2,958	4,496	1,737	219	9,410	3,296	1	5,355	758
RMBS: non-conforming	1,341	2,137	128	—	3,606	635	—	1,497	1,474
RMBS: sub-prime	1,668	699	195	553	3,115	1,632	—	1,012	471
CMBS	3,422	1,741	1,345	590	7,098	3,450	200	1,844	1,604
CDOs	12,378	198	358	27	12,961	9,073	1	3,715	172
CLOs	9,092	166	2,160	1,172	12,590	5,346	—	6,586	658
ABS	3,587	1,794	2,421	1,544	9,346	2,531	—	2,918	3,897
	61,091	11,248	8,344	4,105	84,788	39,406	202	36,146	9,034
Carrying value									
RMBS: G10 government	26,985	15	—	—	27,000	13,363	—	13,637	—
RMBS: prime	2,689	3,847	1,459	209	8,204	2,449	1	5,259	495
RMBS: non-conforming	958	1,957	128	—	3,043	389	—	1,180	1,474
RMBS: sub-prime	977	289	146	379	1,791	779	—	696	316
CMBS	3,237	1,264	849	203	5,553	2,438	205	1,639	1,271
CDOs	3,275	114	220	27	3,636	2,063	1	1,423	149
CLOs	6,736	112	1,460	999	9,307	3,298	—	5,505	504
ABS	2,886	947	2,127	1,161	7,121	1,467	—	2,301	3,353
	47,743	8,545	6,389	2,978	65,655	26,246	207	31,640	7,562

For the notes relating to this table refer to page 106.

Risk management: Credit risk continued

Balance sheet analysis: Asset-backed securities by geography and measurement classification continued

2009	US £m	UK £m	Other Europe £m	RoW (1) £m	Total £m	FVTPL (2) HFT (3) £m	FVTPL (2) DFV (4) £m	AFS (5) £m	LAR (6) £m
Net exposure									
RMBS: G10 government	26,985	15	—	—	27,000	13,363	—	13,637	—
RMBS: prime	2,428	3,013	468	168	6,077	484	1	5,097	495
RMBS: non-conforming	948	1,957	128	—	3,033	379	—	1,180	1,474
RMBS: sub-prime	565	280	137	282	1,264	530	—	419	315
CMBS	2,245	1,187	520	44	3,996	976	194	1,556	1,270
CDOs	743	72	203	26	1,044	521	1	373	149
CLOs	1,636	86	1,094	39	2,855	673	—	1,678	504
ABS	2,117	661	2,089	1,119	5,986	466	—	2,300	3,220
	37,667	7,271	4,639	1,678	51,255	17,392	196	26,240	7,427

Notes:
(1) Rest of the world.
(2) Fair value through profit or loss.
(3) Held-for-trading.
(4) Designated as at fair value.
(5) Available-for-sale.
(6) Loans and receivables.

The table below summarises the rating levels of ABS carrying values of the Group. Credit ratings are based on those from rating agencies S&P, Moody's and Fitch and have been mapped onto the S&P scale.

	RMBS								
2011	Government sponsored or similar £m	Prime £m	Non-conforming £m	Sub-prime £m	CMBS £m	CDOS £m	CLOS £m	ABS £m	Total £m
AAA	5	3,431	1,488	105	647	135	2,106	1,632	9,549
AA to AA+	28,019	605	106	57	695	35	1,503	540	31,560
A to AA-	—	499	110	104	1,195	142	516	547	3,113
BBB- to A-	—	22	288	93	333	71	341	1,319	2,467
Non-investment grade	—	784	658	396	410	1,266	176	672	4,362
Unrated	—	148	29	146	56	170	423	263	1,235
	28,024	5,489	2,679	901	3,336	1,819	5,065	4,973	52,286
2010									
AAA	24,406	4,012	1,754	313	2,732	444	2,488	2,132	38,281
AA to AA+	—	142	144	116	392	567	1,784	608	3,753
A to AA-	—	52	60	212	973	186	343	687	2,513
BBB- to A-	—	79	316	39	482	187	527	1,687	3,317
Non-investment grade	—	900	809	458	291	1,863	332	260	4,913
Unrated	—	194	52	77	—	85	596	641	1,645
	24,406	5,379	3,135	1,215	4,870	3,332	6,070	6,015	54,422
2009									
AAA	27,000	5,941	1,980	545	3,367	437	2,718	2,111	44,099
AA to AA+	—	659	198	121	589	943	4,364	1,225	8,099
A to AA-	—	501	109	306	1,021	254	607	996	3,794
BBB- to A-	—	544	160	87	273	943	252	1,915	4,174
Non-investment grade	—	558	594	579	152	797	636	152	3,468
Unrated	—	1	2	153	151	262	730	722	2,021
	27,000	8,204	3,043	1,791	5,553	3,636	9,307	7,121	65,655

Non-investment grade and unrated ABS

The table below summarises the carrying values by accounting classification of non-investment grade or not publicly rated ABS.

	Non-investment grade				Unrated			
2011	HFT £m	AFS £m	LAR £m	Total £m	HFT £m	AFS £m	LAR £m	Total £m
RMBS: prime	312	417	54	783	148	—	—	148
RMBS: non-conforming	279	372	7	658	28	—	—	28
RMBS: sub-prime	387	9	—	396	146	—	—	146
CMBS	307	10	93	410	56	—	—	56
CDOs	116	1,111	40	1,267	130	40	—	170
CLOs	131	—	44	175	285	139	—	424
ABS	150	12	511	673	12	70	181	263
	1,682	1,931	749	4,362	805	249	181	1,235
2010								
RMBS: prime	355	534	11	900	194	—	—	194
RMBS: non-conforming	388	415	6	809	52	—	—	52
RMBS: sub-prime	437	21	—	458	77	—	—	77
CMBS	198	17	76	291	—	—	—	—
CDOs	691	1,151	21	1,863	85	—	—	85
CLOs	239	5	88	332	267	329	—	596
ABS	147	13	100	260	192	104	345	641
	2,455	2,156	302	4,913	867	433	345	1,645
2009								
RMBS: prime	120	430	8	558	—	1	—	1
RMBS: non-conforming	253	341	—	594	—	2	—	2
RMBS: sub-prime	339	240	—	579	153	—	—	153
CMBS	100	3	49	152	150	—	1	151
CDOs	487	300	10	797	143	119	—	262
CLOs	269	359	8	636	207	523	—	730
ABS	78	63	11	152	253	134	335	722
	1,646	1,736	86	3,468	906	779	336	2,021

Risk management: Credit risk continued

Balance sheet analysis: Residential mortgage-backed securities

RMBS are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The risk of the RMBS will vary primarily depending on the quality and geographic region of the underlying mortgage assets and the credit enhancement of the securitisation structure. Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes, including guarantees over the value of the exposures, often provided by monoline insurers.

The main categories of mortgages that serve as collateral to RMBS held by the Group with related vintages are set out below and described in the glossary on pages 297 to 304. The US market has more established definitions of differing underlying mortgage quality and these are used as the basis for the Group's RMBS categorisation.

The Group classifies RMBS as sub-prime or Alt-A based on industry standard criteria, including Fair Isaac Corporation scores (FICO), level of documentation and loan-to-value (LTV) ratios of the underlying mortgage loans. RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 95%. The FICO score is the determining factor in the classification of the Group's RMBS as sub-prime or Alt-A.

The table below analyses the vintage of the Group's carrying value of RMBS portfolios by geography and classification.

	By geography					By classification			
2011	US £m	UK £m	Other Europe £m	RoW £m	Total £m	Government sponsored £m	Prime £m	Non-conforming £m	Sub-prime £m
2004 and earlier	2,435	38	80	42	2,595	1,993	410	79	113
2005	1,661	125	182	26	1,994	905	502	384	203
2006	575	1,303	305	97	2,280	317	1,118	629	216
2007	1,404	2,392	144	36	3,976	821	1,457	1,482	216
2008	1,154	24	74	127	1,379	1,128	174	75	2
2009	1,364	58	7	1	1,430	1,209	163	7	51
2010 and later	21,858	900	540	141	23,439	21,651	1,665	23	100
	30,451	4,840	1,332	470	37,093	28,024	5,489	2,679	901
2010									
2004 and earlier	4,395	95	56	50	4,596	3,789	587	90	130
2005	2,579	123	173	28	2,903	1,527	580	568	228
2006	1,082	2,131	530	121	3,864	631	2,010	736	487
2007	2,434	2,065	154	33	4,686	1,811	1,167	1,476	232
2008	2,314	58	92	155	2,619	2,288	223	104	4
2009 and later	14,922	418	117	10	15,467	14,360	812	161	134
	27,726	4,890	1,122	397	34,135	24,406	5,379	3,135	1,215
2009									
2004 and earlier	8,504	186	150	33	8,873	7,558	893	98	324
2005	4,221	667	338	74	5,300	2,779	1,750	511	260
2006	1,847	2,822	655	182	5,506	885	3,344	690	587
2007	1,788	2,424	452	50	4,714	1,064	1,708	1,529	413
2008 and later	15,249	9	138	249	15,645	14,714	509	215	207
	31,609	6,108	1,733	588	40,038	27,000	8,204	3,043	1,791

Balance sheet analysis: Derivatives

The following table shows the notional amounts and fair values of the Group's derivatives.

	2011			2010			2009		
Contract type	Notional £bn	Asset £m	Liabilities £m	Notional £bn	Asset £m	Liabilities £m	Notional £bn	Asset £m	Liabilities £m
Interest rate	38,569	418,971	403,391	39,492	304,402	292,547	42,604	311,620	296,553
Exchange rate	4,364	71,465	78,138	4,669	80,318	86,465	3,598	61,928	58,798
Credit derivatives	1,047	26,739	26,417	1,316	25,169	24,130	1,568	39,324	36,837
Equity and commodities	114	5,252	8,513	35	1,647	3,572	69	1,461	3,012
		522,427	516,459		411,536	406,714		414,333	395,200
Balances with Group companies	231	10,380	11,377	365	17,469	14,255	863	32,020	29,344
		532,807	527,836		429,005	420,969		446,353	424,544

The table below analyses the Group's third party derivative assets by internal asset quality rating and residual maturity. Master netting agreements in respect of mark-to-market (mtm) values and collateral do not result in a net presentation in the Group's balance sheet under IFRS.

	2011						2010						
	0-3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m	0-3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m	2009 Total £m
AQ1	23,965	10,429	16,669	124,805	301,861	477,729	29,333	10,386	16,053	130,859	211,336	397,967	372,642
AQ2	285	216	389	1,707	4,668	7,265	253	99	149	713	199	1,413	10,574
AQ3	877	251	361	2,702	5,672	9,863	1,121	337	549	185	142	2,334	10,287
AQ4	1,367	727	628	4,004	7,012	13,738	532	111	145	1,222	172	2,182	5,697
AQ5	802	75	166	1,575	3,511	6,129	553	70	163	1,272	1,988	4,046	5,895
AQ6	111	26	73	782	1,177	2,169	122	42	63	615	161	1,003	2,286
AQ7	84	20	40	1,655	510	2,309	138	13	36	270	202	659	1,931
AQ8	16	21	11	138	869	1,055	2	1	5	87	194	289	1,247
AQ9	5	8	6	252	876	1,147	14	5	38	72	155	284	1,788
AQ10	9	18	35	641	320	1,023	13	11	43	324	968	1,359	1,946
Accruing past due	—	—	—	—	—	—	—	—	—	—	—	—	40
	27,521	11,791	18,378	138,261	326,476	522,427	32,081	11,075	17,244	135,619	215,517	411,536	414,333
Counterparty mtm netting						(440,947)						(327,725)	(352,492)
Cash collateral held against derivative exposures (1)						(36,358)						(29,556)	(28,454)
Net exposure						45,122						54,255	33,387

For the note relating to this table refer to page 110.

Risk management: Credit risk continued

Balance sheet analysis: Derivatives continued

The tables below analyse the Group's third party derivative assets by contract type and residual maturity and the effect of position netting and collateral.

	Group							
2011	0 - 3 months £m	3 - 6 months £m	6 - 12 months £m	1 - 5 years £m	Over 5 years £m	Gross assets £m	Counterparty mtm netting £m	Net exposure £m
Exchange rate	23,122	7,967	9,322	18,517	12,537	71,465	(57,471)	13,994
Interest rate	3,860	3,133	7,434	101,024	303,520	418,971	(355,841)	63,130
Credit derivatives	124	330	619	15,673	9,993	26,739	(23,957)	2,782
Equity and commodity	415	361	1,003	3,047	426	5,252	(3,678)	1,574
	27,521	11,791	18,378	138,261	326,476	522,427	(440,947)	81,480
Cash collateral held against derivative exposures (1)								(36,358)
Net exposure								45,122
2010								
Exchange rate	28,081	7,516	9,018	22,318	13,385	80,318	(68,972)	11,346
Interest rate	3,855	3,423	7,703	99,972	189,449	304,402	(235,306)	69,096
Credit derivatives	56	98	290	12,133	12,592	25,169	(21,800)	3,369
Equity and commodity	89	38	233	1,196	91	1,647	(1,647)	—
	32,081	11,075	17,244	135,619	215,517	411,536	(327,725)	83,811
Cash collateral held against derivative exposures (1)								(29,556)
Net exposure								54,255
2009								
Exchange rate	17,617	5,431	6,974	21,300	10,606	61,928	(46,268)	15,660
Interest rate	8,445	8,384	16,273	104,611	173,907	311,620	(269,466)	42,154
Credit derivatives	79	113	388	19,156	19,588	39,324	(35,297)	4,027
Equity and commodity	38	65	295	800	263	1,461	(1,461)	—
	26,179	13,993	23,930	145,867	204,364	414,333	(352,492)	61,841
Cash collateral held against derivative exposures (1)								(28,454)
Net exposure								33,387

Note:
(1) As at 31 December 2011, in addition to cash collateral the Group holds collateral in the form of securities of £5.3 billion (2010 - £2.9 billion; 2009 - £3.6 billion) against derivative positions.

Credit derivatives

The Group trades credit derivatives as part of its client led business and to mitigate credit risk. The Group's credit derivative exposures relating to proprietary trading are minimal. The table below analyses the Group's bought and sold protection.

	2011				2010			
	Notional		Fair value		Notional		Fair value	
	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn
Client-led trading and residual risk	400.3	390.4	17.0	16.5	383.9	362.5	8.4	6.7
Credit hedging - banking book (1)	14.8	4.3	0.1	0.1	8.4	4.3	0.1	—
Credit hedging - trading book								
- Rates	21.0	17.1	0.9	1.7	21.6	10.3	(0.9)	0.2
- Credit and mortgage markets	40.7	25.7	2.1	1.3	159.3	169.5	1.7	2.0
- Other	0.9	0.1	—	—	0.7	0.1	—	—
Total excluding APS	477.7	437.6	20.1	19.6	573.9	546.7	9.3	8.9
APS	131.8	—	(0.2)	—	195.8	—	0.6	—
	609.5	437.6	19.9	19.6	769.7	546.7	9.9	8.9

For the note relating to this table refer to page 111.

*unaudited

Core	2011 Notional Bought £bn	2011 Notional Sold £bn	2011 Fair value Bought £bn	2011 Fair value Sold £bn	2010 Notional Bought £bn	2010 Notional Sold £bn	2010 Fair value Bought £bn	2010 Fair value Sold £bn
Client-led trading	370.5	369.4	14.6	14.0	344.8	343.0	5.2	4.4
Credit hedging - banking book (1)	2.2	0.9	—	0.1	1.0	1.0	—	—
Credit hedging - trading book								
- Rates	19.7	16.2	0.9	1.7	21.4	10.2	(0.8)	0.2
- Credit and mortgage markets	3.9	3.1	0.2	0.1	4.1	4.0	0.3	0.5
- Other	0.8	0.1	—	—	0.6	0.1	—	—
	397.1	389.7	15.7	15.9	371.9	358.3	4.7	5.1
Non-Core								
Residual risk	29.8	21.0	2.4	2.5	39.1	19.5	3.2	2.3
Credit hedging - banking book (1)	12.6	3.4	0.1	—	7.4	3.3	0.1	—
Credit hedging - trading book								
- Rates	1.3	0.9	—	—	0.2	0.1	(0.1)	—
- Credit and mortgage markets	36.8	22.6	1.9	1.2	155.2	165.5	1.4	1.5
- Other	0.1	—	—	—	0.1	—	—	—
	80.6	47.9	4.4	3.7	202.0	188.4	4.6	3.8

Analysis by counterparty:

Counterparty	2011 Notional Bought £bn	2011 Notional Sold £bn	2011 Fair value Bought £bn	2011 Fair value Sold £bn	2010 Notional Bought £bn	2010 Notional Sold £bn	2010 Fair value Bought £bn	2010 Fair value Sold £bn
Central and local government - APS	131.8	—	(0.2)	—	195.8	—	0.6	—
Monoline insurers	8.0	—	0.6	—	9.3	—	0.9	—
CDPCs	24.5	—	0.9	—	25.0	—	0.8	—
Banks	203.5	200.5	8.5	9.9	365.0	358.9	5.0	5.4
Other financial institutions	232.9	230.6	10.2	9.5	171.4	186.5	3.6	3.5
Corporates	8.8	6.5	(0.1)	0.2	3.2	1.3	(1.0)	—
	609.5	437.6	19.9	19.6	769.7	546.7	9.9	8.9

Note:
(1) Credit hedging in the banking book principally relates to portfolio management in Non-Core.

Monoline insurers

The table below summaries the Group's exposures to monolines all of which are in Non-Core.

	2011 £m	2010 £m	2009 £m
Gross exposure to monolines	1,668	1,781	3,582
Hedges with financial institutions	(71)	(71)	(512)
Credit valuation adjustment	(1,012)	(800)	(1,925)
Net exposure to monolines	585	910	1,145
Credit valuation adjustment as a % of gross exposure	61%	45%	54%
Counterparty and credit risk RWAs*	£3.5bn	£2.8bn	£13.1bn

The net income statement effect relating to monoline exposures is shown below.

	2011 £m	2010 £m	2009 £m
Credit valuation adjustment at 1 January	(800)	(1,925)	(3,289)
Credit valuation adjustment at 31 December	(1,012)	(800)	(1,925)
(Increase)/decrease in credit valuation adjustment	(212)	1,125	1,364
Net debit relating to realisations, hedges, foreign exchange and other movements	(416)	(702)	(1,478)
Net credit/(debit) relating to reclassified debt securities	197	(310)	(1,740)
Net (debit)/credit to income statement	(431)	113	(1,854)

Risk management: Credit risk continued

Balance sheet analysis: Monoline Insurers continued

The table below summarises monoline exposures by rating for the Group. Credit ratings are based on those from ratings agencies S&P and Moody's. Where the ratings differ, the lower of the two is taken.

2011	Notional: protected assets £m	Fair value: reference protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Hedges £m	Net exposure £m
A to AA-	4,550	3,891	659	236	—	423
Non-investment grade	3,414	2,405	1,009	776	71	162
	7,964	6,296	1,668	1,012	71	585
Of which:						
CMBS	830	559	271	247		
CDOs	291	32	259	182		
CLOs	4,616	4,166	450	177		
Other ABS	1,725	1,217	508	317		
Other	502	322	180	89		
	7,964	6,296	1,668	1,012		
2010						
A to AA-	5,890	5,110	780	254	—	526
Non-investment grade	3,375	2,374	1,001	546	71	384
	9,265	7,484	1,781	800	71	910
Of which:						
CMBS	712	524	188	131		
CDOs	292	56	236	106		
CLOs	5,661	5,075	586	193		
Other ABS	2,108	1,541	567	277		
Other	492	288	204	93		
	9,265	7,484	1,781	800		
2009						
A to AA-	6,560	5,355	1,205	361	—	844
Non-investment grade	7,279	4,902	2,377	1,564	512	301
	13,839	10,257	3,582	1,925	512	1,145
Of which						
CMBS	719	328	391	247		
CDOs	1,454	624	830	566		
CLOs	8,844	7,435	1,409	628		
Other ABS	2,386	1,612	774	397		
Other	436	258	178	87		
	13,839	10,257	3,582	1,925		

*unaudited

Credit derivative product companies (CDPCs)

A summary of the group exposures to CDPCs, all of which are in Non-Core, is detailed below.

	2011 £m	2010 £m	2009 £m
Gross exposure to CDPCs	1,896	1,244	1,264
Credit valuation adjustment	(1,034)	(490)	(495)
Net exposure to CDPCs	862	754	769
CVA as % of gross exposure	55%	39%	39%
Counterparty and credit risk RWAs*	£8.4bn	£7.2bn	£7.5bn
Capital deductions*	£245m	£280m	£347m

The table below details the Group's CDPC exposures by rating.

2011	Notional: protected assets £m	Fair value: reference protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Net exposure £m
AAA	213	212	1	—	1
A to AA-	646	632	14	3	11
Non-investment grade	19,671	18,151	1,520	788	732
Unrated	3,974	3,613	361	243	118
	24,504	22,608	1,896	1,034	862
2010					
AAA	213	212	1	—	1
BBB- to A-	644	629	15	4	11
Non-investment grade	20,066	19,050	1,016	401	615
Unrated	4,165	3,953	212	85	127
	25,088	23,844	1,244	490	754
2009					
AAA	1,658	1,637	21	5	16
AA to AA+	1,070	1,043	27	9	18
A to AA-	17,080	16,137	943	373	570
BBB- to A-	3,926	3,653	273	108	165
	23,734	22,470	1,264	495	769

The table below details the net income statement effect arising from the Group's CDPC exposures.

	2011 £m	2010 £m	2009 £m
Credit valuation adjustment at 1 January	(490)	(495)	(746)
Credit valuation adjustment at 31 December	(1,034)	(490)	(495)
(Increase)/decrease in credit valuation adjustment	(544)	5	251
Novations from RBS N.V.	—	4	449
Net credit/(debit) relating to realisations, hedges, foreign exchange and other movements	459	(150)	(1,764)
Loss from trading activities	(85)	(141)	(1,064)

Risk management: Credit risk continued

Balance sheet analysis: Other counterparties

The net income statement effect arising from the change in level of credit valuation adjustment for all other counterparties and related trades for the Group is shown in the table below.

	2011 £m	2010 £m	2009 £m
Credit valuation adjustment at 1 January	(1,609)	(1,401)	(1,089)
Credit valuation adjustment at 31 December	(2,069)	(1,609)	(1,401)
Increase in credit valuation adjustment	(460)	(208)	(312)
Novations from RBS N.V.	—	—	90
Net credit/(debit) relating to realisations, hedges, foreign exchange and other movements	286	5	(390)
Loss from trading activities	(174)	(203)	(612)

REIL, provisions and reserves

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest.

Impaired loans are all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Loans are classified as accruing loans past due 90 days or more where they are past due 90 days but where no impairment provision is recognised. This category is used for fully collateralised non-revolving credit facilities.

	2011			2010			2009
	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m	Group £m
Impaired loans							
UK	8,291	7,253	15,544	8,564	7,731	16,295	13,401
Overseas	6,300	15,270	21,570	4,353	13,143	17,496	14,114
	14,591	22,523	37,114	12,917	20,874	33,791	27,515
Accruing loans past due 90 days or more							
UK	1,192	508	1,700	1,436	939	2,375	2,237
Overseas	229	29	258	216	248	464	832
	1,421	537	1,958	1,652	1,187	2,839	3,069
Total REIL	16,012	23,060	39,072	14,569	22,061	36,630	30,584
REIL as a % of gross loans to customers (1)	4.4%	31.8%	8.7%	3.8%	21.9%	7.5%	5.9%
Closing provision for impairment as a % of total REIL	49%	47%	48%	50%	43%	46%	39%

Note:
(1) Includes gross loans and REIL in disposal groups but excludes reverse repos and intercompany loans.

Potential problem loans

Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment provision is required. This category is used for fully collateralised advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

	2011 £m	2010 £m	2009 £m
Potential problem loans	553	512	430

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

REIL by division

The tables below analyse the Group's loans and advances (excluding reverse repos and disposal groups) and related REIL, provisions, impairments, amounts written-off and coverage ratios by division.

	Group							
2011	Gross loans to banks £m	Gross loans to customers £m	REIL £m	Provisions £m	REIL as a % of gross customer loans %	Provisions as a % of REIL %	Impairment charge £m	Amounts written-off £m
UK Retail	628	103,377	4,087	2,344	4.0	57	788	823
UK Corporate	672	96,514	3,972	1,608	4.1	40	782	653
Wealth	2,422	16,913	211	81	1.2	38	25	11
Global Transaction Services	2,291	7,827	27	42	0.3	156	11	63
Ulster Bank	2,079	34,052	5,523	2,749	16.2	50	1,384	124
US Retail & Commercial	208	51,436	1,006	451	2.0	45	247	371
Retail & Commercial	8,300	310,119	14,826	7,275	4.8	49	3,237	2,045
Global Banking & Markets	23,534	63,123	1,186	476	1.9	40	(45)	40
Other	355	11	—	—	—	—	—	—
Core	32,189	373,253	16,012	7,751	4.3	48	3,192	2,085
Non-Core	44	72,566	23,060	10,803	31.8	47	3,777	2,098
Total third-party	32,233	445,819	39,072	18,554	8.8	47	6,969	4,183
Amounts due from fellow subsidiaries	27,232	792	—	—	—	—	—	—
	59,465	446,611	39,072	18,554	8.7	47	6,969	4,183
2010								
UK Retail	407	108,405	4,620	2,741	4.3	59	1,160	1,135
UK Corporate	72	111,431	3,967	1,732	3.6	44	761	349
Wealth	2,220	16,130	223	66	1.4	30	18	9
Global Transaction Services	1,445	6,725	78	91	1.2	117	14	16
Ulster Bank	2,928	36,858	3,619	1,633	9.8	45	1,161	48
US Retail & Commercial	145	48,516	913	505	1.9	55	483	547
Retail & Commercial	7,217	328,065	13,420	6,768	4.1	50	3,597	2,104
Global Banking & Markets	34,986	57,986	1,149	581	2.0	51	284	16
Other	(129)	(452)	—	—	—	—	—	—
Core	42,074	385,599	14,569	7,349	3.8	50	3,881	2,120
Non-Core	141	98,298	22,061	9,421	22.4	43	5,418	2,255
Total third-party	42,215	483,897	36,630	16,770	7.6	46	9,299	4,375
Amounts due from holding company and fellow subsidiaries	4,848	1,946	—	—	—	—	—	—
	47,063	485,843	36,630	16,770	7.5	46	9,299	4,375
2009								
UK Retail	500	102,994	4,641	2,677	4.5	58	1,679	1,150
UK Corporate	90	111,206	2,330	1,271	2.1	55	923	352
Wealth	1,841	13,684	218	55	1.6	25	33	12
Global Transaction Services	1,186	6,136	85	92	1.4	108	16	22
Ulster Bank	2,637	39,707	2,260	962	5.7	43	649	34
US Retail & Commercial	29	48,907	643	478	1.3	74	702	546
Retail & Commercial	6,283	322,634	10,177	5,535	3.2	54	4,002	2,116
Global Banking & Markets	25,914	63,308	1,032	532	1.6	52	220	58
Other	(75)	(448)	—	—	—	—	—	—
Core	32,122	385,494	11,209	6,067	2.9	54	4,222	2,174
Non-Core	305	126,844	19,375	5,953	15.3	31	7,151	3,542
Total third-party	32,427	512,338	30,584	12,020	6.0	39	11,373	5,716
Amounts due from holding company and fellow subsidiaries	5,274	1,949	—	—	—	—	—	—
	37,701	514,287	30,584	12,020	5.9	39	11,373	5,716

Risk management: Credit risk continued

Balance sheet analysis: Movement in REIL

The table below details the movement in REIL for the year ended 31 December 2011.

	Group								
	Impaired loans			Other loans (1)			Total		
	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m
At 1 January 2011	12,917	20,874	33,791	1,652	1,187	2,839	14,569	22,061	36,630
Transfer to disposal groups	(1,287)	—	(1,287)	(238)	—	(238)	(1,525)	—	(1,525)
Transfers from fellow subsidiaries	4	—	4	—	—	—	4	—	4
Intra-group transfers	300	(300)	—	149	(149)	—	449	(449)	—
Currency translation and other adjustments	(126)	(408)	(534)	(12)	—	(12)	(138)	(408)	(546)
Additions	8,015	8,510	16,525	2,517	871	3,388	10,532	9,381	19,913
Transfers	688	377	1,065	(509)	(302)	(811)	179	75	254
Disposals and restructurings	(404)	(1,389)	(1,793)	(9)	(97)	(106)	(413)	(1,486)	(1,899)
Repayments	(3,431)	(3,043)	(6,474)	(2,129)	(973)	(3,102)	(5,560)	(4,016)	(9,576)
Amounts written-off	(2,085)	(2,098)	(4,183)	—	—	—	(2,085)	(2,098)	(4,183)
At 31 December 2011	14,591	22,523	37,114	1,421	537	1,958	16,012	23,060	39,072

Note:
(1) Accruing loans past due 90 days or more (see table below).

Key points

- REIL increased by £2.4 billion in the year. REIL at 31 December 2011 excludes £1.5 billion (impaired loans £1.3 billion; accruing loans £0.2 billion) in relation to the UK branch-based businesses being sold to Santander UK plc, of which £1.0 billion was in UK Corporate and £0.5 billion in UK Retail.
- Ulster Bank Group's non-performing loans increased significantly by £3.5 billion (Core - £1.9 billion; Non-Core - £1.6 billion). This principally related to residential mortgages (£0.6 billion, 39% increase) and commercial real estate (£2.4 billion, 25% increase), reflecting the continued deterioration in the property sectors in Ireland. The Non-Core REIL increase related to Ulster Bank was partially offset by run-off in other Non-Core donating divisions in the year.

Past due analysis

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

	2011			2010			2009
	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m	Group £m
Past due 1-29 days	5,502	682	6,184	6,391	788	7,179	6,272
Past due 30-59 days	1,472	161	1,633	1,710	377	2,087	2,252
Past due 60-89 days	904	100	1,004	911	251	1,162	2,386
Past due 90 days or more	1,421	537	1,958	1,652	1,187	2,839	3,069
	9,299	1,480	10,779	10,664	2,603	13,267	13,979

Loans, REIL and impairments by sector and geographical region

The tables below analyse gross loans and advances to customers (excluding reverse repos and disposal groups), REIL, provisions, impairment charges and amounts written-off relating to these loans, by industry and geography (by location of office) for the Group.

	Group							
2011	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Total								
Central and local government	8,854	—	—	—	—	—	—	—
Finance								
- banks	32,233	94	85	0.3	90	0.3	—	—
- other	45,070	432	238	1.0	55	0.5	(121)	50
Residential mortgages	142,676	5,000	1,313	3.5	26	0.9	1,046	516
Personal lending	31,481	2,668	2,114	8.5	79	6.7	749	1,182
Property	76,003	21,563	8,781	28.4	41	11.6	3,702	1,171
Construction	8,681	1,749	693	20.1	40	8.0	139	244
Manufacturing	22,065	542	298	2.5	55	1.4	210	179
Service industries and business activities								
- Retail, wholesale and repairs	20,175	950	468	4.7	49	2.3	175	151
- Transport and storage	20,251	552	122	2.7	22	0.6	76	43
- Health, education and recreation	14,542	1,048	432	7.2	41	3.0	304	98
- Hotels and restaurants	8,229	1,437	643	17.5	45	7.8	334	131
- Utilities	6,586	52	9	0.8	17	0.1	3	3
- Other	22,610	2,046	903	9.0	44	4.0	744	227
Agriculture, forestry and fishing	3,498	145	63	4.1	43	1.8	(7)	18
Finance leases and instalment credit	14,414	794	508	5.5	64	3.5	112	170
Interest accruals	684	—	—	—	—	—	—	—
Latent	—	—	1,884	—	—	—	(497)	—
Total third-party	478,052	39,072	18,554	8.2	47	3.9	6,969	4,183
Amounts due from holding company and fellow subsidiaries	28,024	—	—	—	—	—	—	—
	506,076	39,072	18,554	7.7	47	3.7	6,969	4,183
of which:								
UK								
- Residential mortgages	100,725	2,076	397	2.1	19	0.4	180	25
- Personal lending	19,345	2,384	1,925	12.3	81	10.0	645	1,007
- Property	55,727	7,854	2,852	14.1	36	5.1	1,407	490
- Other	156,207	4,930	3,036	3.2	62	1.9	726	886
Europe								
- Residential mortgages	18,334	2,121	664	11.6	31	3.6	437	10
- Personal lending	2,188	140	122	6.4	87	5.6	(8)	22
- Property	15,771	13,007	5,696	82.5	44	36.1	2,334	508
- Other	25,499	4,184	2,343	16.4	56	9.2	937	239
US								
- Residential mortgages	23,237	770	240	3.3	31	1.0	426	481
- Personal lending	8,441	143	66	1.7	46	0.8	112	153
- Property	3,777	329	92	8.7	28	2.4	(2)	138
- Other	37,311	514	831	1.4	162	2.2	(184)	183
RoW								
- Residential mortgages	380	33	12	8.7	36	3.2	3	—
- Personal lending	1,507	1	1	0.1	100	0.1	—	—
- Property	728	373	141	51.2	38	19.4	(37)	35
- Other	8,875	213	136	2.4	64	1.5	(7)	6
Total third-party	478,052	39,072	18,554	8.2	47	3.9	6,969	4,183
Amounts due from holding company and fellow subsidiaries	28,024	—	—	—	—	—	—	—
	506,076	39,072	18,554	7.7	47	3.7	6,969	4,183

Risk management: Credit risk continued

Balance sheet analysis: Loans, REIL and impairments by sector and geographic region continued

	Group							
2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Total								
Central and local government	7,140	—	—	—	—	—	—	—
Finance								
- banks	42,163	98	88	0.2	90	0.2	—	—
- other	46,740	637	278	1.4	44	0.6	147	102
Residential mortgages	145,677	4,230	854	2.9	20	0.6	1,008	668
Personal lending	36,004	3,340	2,733	9.3	82	7.6	1,244	1,442
Property	89,015	19,487	6,677	21.9	34	7.5	4,658	1,011
Construction	11,255	2,457	867	21.8	35	7.7	527	144
Manufacturing	24,740	836	276	3.4	33	1.1	105	149
Service industries and business activities								
- Retail, wholesale and repairs	21,186	963	483	4.5	50	2.3	313	135
- Transport and storage	21,745	213	96	1.0	45	0.4	66	39
- Health, education and recreation	19,004	968	272	5.1	28	1.4	146	199
- Hotels and restaurants	9,621	1,269	504	13.2	40	5.2	321	106
- Utilities	7,845	55	11	0.7	20	0.1	8	—
- Other	22,458	1,090	492	4.9	45	2.2	361	261
Agriculture, forestry and fishing	3,751	140	84	3.7	60	2.2	30	6
Finance leases and instalment credit	16,803	847	555	5.0	66	3.3	252	113
Interest accruals	965	—	—	—	—	—	—	—
Latent	—	—	2,500	—	—	—	113	—
Total third-party	526,112	36,630	16,770	7.0	46	3.2	9,299	4,375
Amounts due from fellow subsidiaries	6,794	—	—	—	—	—	—	—
	532,906	36,630	16,770	6.9	46	3.1	9,299	4,375
of which:								
UK								
- Residential mortgages	101,592	2,062	312	2.0	15	0.3	169	16
- Personal lending	22,529	3,081	2,512	13.7	82	11.2	1,041	1,153
- Property	65,462	7,958	2,215	12.2	28	3.4	1,546	399
- Other	179,063	5,569	3,549	3.1	64	2.0	1,313	696
Europe								
- Residential mortgages	19,475	1,505	280	7.7	19	1.4	219	6
- Personal lending	2,503	202	165	8.1	82	6.6	43	19
- Property	16,916	10,465	4,161	61.9	40	24.6	2,804	210
- Other	30,206	3,022	1,737	10.0	57	5.8	1,003	70
US								
- Residential mortgages	24,201	640	253	2.6	40	1.0	615	645
- Personal lending	9,520	55	55	0.6	100	0.6	160	270
- Property	4,913	765	202	15.6	26	4.1	321	220
- Other	35,318	735	1,057	2.1	144	3.0	(24)	471
RoW								
- Residential mortgages	409	23	9	5.6	39	2.2	5	1
- Personal lending	1,452	2	1	0.1	50	0.1	—	—
- Property	1,724	299	99	17.3	33	5.7	(13)	182
- Other	10,829	247	163	2.3	66	1.5	97	17
Total third-party	526,112	36,630	16,770	7.0	46	3.2	9,299	4,375
Amounts due from fellow subsidiaries	6,794	—	—	—	—	—	—	—
	532,906	36,630	16,770	6.9	46	3.1	9,299	4,375

2011	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
	Group							
Core								
Central and local government	8,337	—	—	—	—	—	—	—
Finance								
- banks	32,189	94	85	0.3	90	0.3	—	—
- other	42,155	239	167	0.6	70	0.4	(8)	30
Residential mortgages	138,321	4,704	1,182	3.4	25	0.9	776	198
Personal lending	30,151	2,624	2,077	8.7	79	6.9	715	935
Property	38,310	3,681	998	9.6	27	2.6	470	167
Construction	6,169	653	221	10.6	34	3.6	178	143
Manufacturing	18,030	277	128	1.5	46	0.7	97	104
Service industries and business activities								
- Retail, wholesale and repairs	18,175	586	279	3.2	48	1.5	196	113
- Transport and storage	15,675	325	52	2.1	16	0.3	47	29
- Health, education and recreation	13,171	572	213	4.3	37	1.6	170	55
- Hotels and restaurants	7,118	952	354	13.4	37	5.0	209	60
- Utilities	4,959	22	1	0.4	5	—	—	—
- Other	20,354	1,013	567	5.0	56	2.8	544	178
Agriculture, forestry and fishing	3,374	98	36	2.9	37	1.1	(15)	5
Finance leases and instalment credit	8,355	172	110	2.1	64	1.3	31	68
Interest accruals	599	—	—	—	—	—	—	—
Latent	—	—	1,281	—	—	—	(218)	—
Total third-party	405,442	16,012	7,751	3.9	48	1.9	3,192	2,085
Amounts due from holding company and fellow subsidiaries	27,960	—	—	—	—	—	—	—
	433,402	16,012	7,751	3.7	48	1.8	3,192	2,085
of which:								
UK								
- Residential mortgages	99,302	2,024	386	2.0	19	0.4	174	24
- Personal lending	19,218	2,347	1,895	12.2	81	9.9	657	828
- Property	31,142	2,475	568	7.9	23	1.8	379	113
- Other	137,453	2,637	1,536	1.9	58	1.1	530	537
Europe								
- Residential mortgages	18,328	2,121	664	11.6	31	3.6	437	10
- Personal lending	1,921	140	122	7.3	87	6.4	(8)	22
- Property	4,559	1,033	364	22.7	35	8.0	162	11
- Other	17,845	1,855	1,295	10.4	70	7.3	697	146
US								
- Residential mortgages	20,311	526	120	2.6	23	0.6	162	164
- Personal lending	7,505	136	59	1.8	43	0.8	66	85
- Property	2,407	111	24	4.6	22	1.0	16	43
- Other	35,363	397	560	1.1	141	1.6	15	96
RoW								
- Residential mortgages	380	33	12	8.7	36	3.2	3	—
- Personal lending	1,507	1	1	0.1	100	0.1	—	—
- Property	202	62	42	30.7	68	20.8	(87)	—
- Other	7,999	114	103	1.4	90	1.3	(11)	6
Total third-party	405,442	16,012	7,751	3.9	48	1.9	3,192	2,085
Amounts due from holding company and fellow subsidiaries	27,960	—	—	—	—	—	—	—
	433,402	16,012	7,751	3.7	48	1.8	3,192	2,085

Risk management: Credit risk continued

Balance sheet analysis: Loans, REIL and impairments by sector and geographic region continued

	Group							
2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Central and local government	6,473	—	—	—	—	—	—	—
Finance								
- banks	42,022	98	88	0.2	90	0.2	—	—
- other	39,619	304	210	0.8	69	0.5	119	21
Residential mortgages	140,351	3,998	691	2.8	17	0.5	578	242
Personal lending	32,552	3,126	2,535	9.6	81	7.8	1,147	1,272
Property	41,934	3,278	813	7.8	25	1.9	743	99
Construction	8,163	603	213	7.4	35	2.6	190	39
Manufacturing	19,271	370	147	1.9	40	0.8	119	67
Service industries and business activities								
- Retail, wholesale and repairs	18,635	529	227	2.8	43	1.2	199	94
- Transport and storage	14,972	112	40	0.7	36	0.3	40	35
- Health, education and recreation	17,267	505	131	2.9	26	0.8	142	64
- Hotels and restaurants	8,149	741	236	9.1	32	2.9	165	49
- Utilities	6,038	22	3	0.4	14	—	1	—
- Other	19,591	555	266	2.8	48	1.4	173	91
Agriculture, forestry and fishing	3,618	84	49	2.3	58	1.4	24	5
Finance leases and instalment credit	8,273	244	141	2.9	58	1.7	63	42
Interest accruals	745	—	—	—	—	—	—	—
Latent	—	—	1,559	—	—	—	178	—
Total third-party	427,673	14,569	7,349	3.4	50	1.7	3,881	2,120
Amounts due from fellow subsidiaries	6,624	—	—	—	—	—	—	—
	434,297	14,569	7,349	3.4	50	1.7	3,881	2,120
of which:								
UK								
- Residential mortgages	99,927	2,010	305	—	15	—	164	15
- Personal lending	22,101	2,888	2,335	13.1	81	10.6	1,027	1,142
- Property	34,970	2,454	500	7.0	20	1.4	394	44
- Other	150,954	2,648	1,739	1.8	66	1.2	690	319
Europe								
- Residential mortgages	19,467	1,505	280	7.7	19	1.4	184	6
- Personal lending	2,183	201	164	9.2	82	7.5	43	19
- Property	4,829	622	235	12.9	38	4.9	245	1
- Other	21,049	1,054	804	5.0	76	3.8	542	19
US								
- Residential mortgages	20,548	460	97	2.2	21	0.5	225	221
- Personal lending	6,816	35	35	0.5	100	0.5	77	111
- Property	1,595	144	43	9.0	30	2.7	84	54
- Other	31,957	362	647	1.1	179	2.0	71	164
RoW								
- Residential mortgages	409	23	9	5.6	39	2.2	5	—
- Personal lending	1,452	2	1	—	50	—	—	—
- Property	540	58	35	10.7	60	6.5	20	—
- Other	8,876	103	120	1.2	117	1.4	110	5
Total third-party	427,673	14,569	7,349	3.4	50	1.7	3,881	2,120
Amounts due from fellow subsidiaries	6,624	—	—	—	—	—	—	—
	434,297	14,569	7,349	3.4	50	1.7	3,881	2,120

2011	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
	Group							
Non-Core								
Central and local government	517	—	—	—	—	—	—	—
Finance								
- banks	44	—	—	—	—	—	—	—
- other	2,915	193	71	6.6	37	2.4	(113)	20
Residential mortgages	4,355	296	131	6.8	44	3.0	270	318
Personal lending	1,330	44	37	3.3	84	2.8	34	247
Property	37,693	17,882	7,783	47.4	44	20.6	3,232	1,004
Construction	2,512	1,096	472	43.6	43	18.8	(39)	101
Manufacturing	4,035	265	170	6.6	64	4.2	113	75
Service industries and business activities								
- Retail, wholesale and repairs	2,000	364	189	18.2	52	9.5	(21)	38
- Transport and storage	4,576	227	70	5.0	31	1.5	29	14
- Health, education and recreation	1,371	476	219	34.7	46	16.0	134	43
- Hotels and restaurants	1,111	485	289	43.7	60	26.0	125	71
- Utilities	1,627	30	8	1.8	27	0.5	3	3
- Other	2,256	1,033	336	45.8	33	14.9	200	49
Agriculture, forestry and fishing	124	47	27	37.9	57	21.8	8	13
Finance leases and instalment credit	6,059	622	398	10.3	64	6.6	81	102
Interest accruals	85	—	—	—	—	—	—	—
Latent	—	—	603	—	—	—	(279)	—
Total third-party	72,610	23,060	10,803	31.8	47	14.9	3,777	2,098
Amounts due from holding company and fellow subsidiaries	64	—	—	—	—	—	—	—
	72,674	23,060	10,803	31.7	47	14.9	3,777	2,098
of which:								
UK								
- Residential mortgages	1,423	52	11	3.7	21	0.8	6	1
- Personal lending	127	37	30	29.1	81	23.6	(12)	179
- Property	24,585	5,379	2,284	21.9	42	9.3	1,028	377
- Other	18,754	2,293	1,500	12.2	65	8.0	196	349
Europe								
- Residential mortgages	6	—	—	—	—	—	—	—
- Personal lending	267	—	—	—	—	—	—	—
- Property	11,212	11,974	5,332	106.8	45	47.6	2,172	497
- Other	7,654	2,329	1,048	30.4	45	13.7	240	93
US								
- Residential mortgages	2,926	244	120	8.3	49	4.1	264	317
- Personal lending	936	7	7	0.7	100	0.7	46	68
- Property	1,370	218	68	15.9	31	5.0	(18)	95
- Other	1,948	117	271	6.0	232	13.9	(199)	87
RoW								
- Property	526	311	99	59.1	32	18.8	50	35
- Other	876	99	33	11.3	33	3.8	4	—
Total third-party	72,610	23,060	10,803	31.8	47	14.9	3,777	2,098
Amounts due from holding company and fellow subsidiaries	64	—	—	—	—	—	—	—
	72,674	23,060	10,803	31.7	47	14.9	3,777	2,098

Risk management: Credit risk continued

Balance sheet analysis: Loans, REIL and impairments by sector and geographic region continued

	Group							
2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Non-Core								
Central and local government	667	—	—	—	—	—	—	—
Finance								
- banks	141	—	—	—	—	—	—	—
- other	7,121	333	68	4.7	20	1.0	28	81
Residential mortgages	5,326	232	163	4.4	70	3.1	430	426
Personal lending	3,452	214	198	6.2	93	5.7	97	170
Property	47,081	16,209	5,864	34.4	36	12.5	3,915	912
Construction	3,092	1,854	654	60.0	35	21.2	337	105
Manufacturing	5,469	466	129	8.5	28	2.4	(14)	82
Service industries and business activities								
- Retail, wholesale and repairs	2,551	434	256	17.0	59	10.0	114	41
- Transport and storage	6,773	101	56	1.5	55	0.8	26	4
- Health, education and recreation	1,737	463	141	26.7	30	8.1	4	135
- Hotels and restaurants	1,472	528	268	35.9	51	18.2	156	57
- Utilities	1,807	33	8	1.8	24	0.4	7	—
- Other	2,867	535	226	18.7	42	7.9	188	170
Agriculture, forestry and fishing	133	56	35	42.1	63	26.3	6	1
Finance leases and instalment credit	8,530	603	414	7.1	69	4.9	189	71
Interest accruals	220	—	—	—	—	—	—	—
Latent	—	—	941	—	—	—	(65)	—
Total third-party	98,439	22,061	9,421	22.4	43	9.6	5,418	2,255
Amounts due from fellow subsidiaries	170	—	—	—	—	—	—	—
	98,609	22,061	9,421	22.4	43	9.6	5,418	2,255
of which:								
UK								
- Residential mortgages	1,665	52	7	3.1	13	0.4	5	1
- Personal lending	428	193	177	45.1	92	41.4	14	11
- Property	30,492	5,504	1,715	18.1	31	5.6	1,152	355
- Other	28,109	2,921	1,810	10.4	62	6.4	623	377
Europe								
- Residential mortgages	8	—	—	—	—	—	35	—
- Personal lending	320	1	1	0.3	100	0.3	—	—
- Property	12,087	9,843	3,926	81.4	40	32.5	2,559	209
- Other	9,157	1,968	933	21.5	47	10.2	461	51
US								
- Residential mortgages	3,653	180	156	4.9	87	4.3	390	424
- Personal lending	2,704	20	20	0.7	100	0.7	83	159
- Property	3,318	621	159	18.7	26	4.8	237	166
- Other	3,361	373	410	11.1	110	12.2	(95)	307
RoW								
- Residential mortgages	—	—	—	—	—	—	—	1
- Personal lending	—	—	—	—	—	—	—	—
- Property	1,184	241	64	20.4	27	5.4	(33)	182
- Other	1,953	144	43	7.4	30	2.2	(13)	12
Total third-party	98,439	22,061	9,421	22.4	43	9.6	5,418	2,255
Amounts due from fellow subsidiaries	170	—	—	—	—	—	—	—
	98,609	22,061	9,421	22.4	43	9.6	5,418	2,255

Impairment loss provision methodology

A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

For retail loans, which are segmented into collective, homogenous portfolios, time-based measures, such as days past due, are typically used as evidence of impairment. For these portfolios, the RBS Group recognises an impairment at 90 days past due.

For corporate portfolios, given their complexity and nature, the RBS Group relies not only on time-based measures but also on management judgement to identify evidence of impairment. Other factors considered may include: significant financial difficulty of the borrower; a breach of contract; a loan restructuring; a probable bankruptcy; and any observable data indicating a measurable decrease in estimated future cash flows.

Depending on various factors as explained below, the RBS Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

- *Individually assessed provisions -* provisions required for individually significant impaired assets which are assessed on a case by case basis, taking into account the financial condition of the counterparty and any guarantee and other collateral held after being stressed for downside risk. This incorporates an estimate of the discounted value of any recoveries and realisation of security or collateral. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.

  This assessment takes into account the benefit of any guarantee or other collateral held. The value and timing of cash flow receipts are based on available estimates in conjunction with facts available at that time. Timings and amounts of cash flows are reviewed on subsequent assessment dates, as new information becomes available. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.

- *Collectively assessed provisions -* provisions on impaired credits below an agreed threshold are assessed on a portfolio basis to reflect the homogeneous nature of the assets. The Group segments impaired credits in its collectively assessed portfolios according to asset type, such as credit cards, personal loans, mortgages and smaller homogenous wholesale portfolios, such as business or commercial banking. A further distinction is made between those impaired assets in collections and those in recoveries (see 'Problem debt management' on page 57 for a discussion of the collections and recoveries functions).

  The provision is determined based on a quantitative review of the relevant portfolio, taking account of the level of arrears, the value of any security, historical and projected cash recovery trends over the recovery period. The provision also incorporates any adjustments that may be deemed appropriate given current economic and credit conditions. Such adjustments may be determined based on: a review of the current cash collections profile performance against historical trends; updates to metric inputs - including model recalibrations; and monitoring of operational processes used in managing exposures - including the time taken to process non-performing exposures.

- *Latent loss provisions -* a separate approach is taken for provisions held against impairments in the performing portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

  The Group's methodologies to estimate latent loss provisions reflect:
  - the probability that the performing customer will default;
  - historical loss experience, adjusted, where appropriate, given current economic and credit conditions; and
  - the emergence period, defined as the period between an impairment event occurring and a loan being identified and reported as impaired.

  Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as the repayment terms and the duration of the loss mitigation and recovery processes. They are based on internal systems and processes within the particular portfolio and are reviewed regularly.

  As with collectively assessed impaired portfolios, the Group segments its performing portfolio according to asset type.

Risk management: Credit risk continued

Balance sheet analysis: Provisions and AFS reserves

The Group's consumer portfolios, which consist of high volume, small value credits, have highly efficient largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery methods. Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements.

Provisions are assessed on a case by case basis by experienced specialists with input from professional valuers and accountants. The Group operates a transparent provisions governance framework, setting thresholds to trigger enhanced oversight and challenge.

Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs and are subsequently measured at fair value with changes in fair value reported in owners' equity until disposal, at which stage the cumulative gain or loss is recognised in profit or loss. When there is objective evidence that an available-for-sale financial asset is impaired, any decline in its fair value below original cost is removed from equity and recognised in profit or loss.

The Group reviews its portfolios of available-for-sale financial assets for evidence of impairment, which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgment. The unrecognised losses on the Group's available-for-sale debt securities are concentrated in its portfolios of mortgage-backed securities. The losses reflect the widening of credit spreads as a result of the reduced market liquidity in these securities and the current uncertain macroeconomic outlook in the US and Europe. The underlying securities remain unimpaired.

The analysis of AFS debt securities and related AFS reserves is set out on page 126.

Movement in loan impairment provisions

The movement in provisions balance by division is shown in the table below.

2011	UK Retail £m	UK Corporate £m	Wealth £m	GTS (1) £m	Ulster Bank £m	US R&C (2) £m	Total R&C (2) £m	GBM (3) £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,741	1,732	66	91	1,633	505	6,768	581	7,349	9,421	16,770
Intra-group transfers	—	177	—	—	—	—	177	—	177	(177)	—
Transfers to disposal groups	(335)	(436)	—	(2)	—	—	(773)	—	(773)	—	(773)
Currency translation and other adjustments	—	25	3	5	(79)	(6)	(52)	(13)	(65)	(196)	(261)
Transfers from fellow subsidiaries	—	—	—	—	—	—	—	3	3	—	3
Amounts written-off	(823)	(653)	(11)	(63)	(124)	(371)	(2,045)	(40)	(2,085)	(2,098)	(4,183)
Recoveries of amounts previously written-off	69	17	—	—	1	76	163	3	166	342	508
Charged to the income statement	788	782	25	11	1,384	247	3,237	(45)	3,192	3,777	6,969
Unwind of discount (4)	(96)	(36)	(2)	—	(66)	—	(200)	(13)	(213)	(266)	(479)
At 31 December	2,344	1,608	81	42	2,749	451	7,275	476	7,751	10,803	18,554
Individually assessed											
- banks	—	—	2	7	—	—	9	76	85	—	85
- customers	—	679	70	3	991	73	1,816	291	2,107	9,440	11,547
Collectively assessed	2,157	662	—	15	1,282	161	4,277	—	4,277	760	5,037
Latent	187	267	9	17	476	217	1,173	109	1,282	603	1,885
	2,344	1,608	81	42	2,749	451	7,275	476	7,751	10,803	18,554

2010	UK Retail £m	UK Corporate £m	Wealth £m	GTS (1) £m	Ulster Bank £m	US R&C (2) £m	Total R&C (2) £m	GBM (3) £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,677	1,271	55	92	962	478	5,535	532	6,067	5,953	12,020
Intra-group transfers	—	—	—	—	(351)	—	(351)	(217)	(568)	568	—
Transfers to disposal groups	—	—	—	—	—	—	—	—	—	(72)	(72)
Currency translation and other adjustments	—	71	4	—	(22)	19	72	2	74	(79)	(5)
Disposal of subsidiaries	—	—	—	—	—	—	—	—	—	(13)	(13)
Amounts written-off	(1,135)	(349)	(9)	(16)	(48)	(547)	(2,104)	(16)	(2,120)	(2,255)	(4,375)
Recoveries of amounts previously written-off	128	8	—	1	1	72	210	2	212	148	360
Charged to the income statement	1,160	761	18	14	1,161	483	3,597	284	3,881	5,418	9,299
Unwind of discount (4)	(89)	(30)	(2)	—	(70)	—	(191)	(6)	(197)	(247)	(444)
At 31 December	2,741	1,732	66	91	1,633	505	6,768	581	7,349	9,421	16,770
Individually assessed											
- banks	—	—	2	7	—	—	9	79	88	—	88
- customers	—	546	57	55	502	56	1,216	348	1,564	7,453	9,017
Collectively assessed	2,526	689	—	14	733	177	4,139	—	4,139	1,027	5,166
Latent	215	497	7	15	398	272	1,404	154	1,558	941	2,499
	2,741	1,732	66	91	1,633	505	6,768	581	7,349	9,421	16,770

2009	UK Retail £m	UK Corporate £m	Wealth £m	GTS (1) £m	Ulster Bank £m	US R&C (2) £m	Total R&C (2) £m	GBM (3) £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,086	696	34	43	491	298	3,648	431	4,079	2,576	6,655
Currency translation and other adjustments	67	5	1	53	(109)	(34)	(17)	(61)	(78)	(165)	(243)
Amounts written-off	(1,150)	(352)	(12)	(22)	(34)	(546)	(2,116)	(58)	(2,174)	(3,542)	(5,716)
Recoveries of amounts previously written-off	97	20	—	2	1	58	178	2	180	127	307
Charged to the income statement	1,679	923	33	16	649	702	4,002	220	4,222	7,151	11,373
Unwind of discount (4)	(102)	(21)	(1)	—	(36)	—	(160)	(2)	(162)	(194)	(356)
At 31 December	2,677	1,271	55	92	962	478	5,535	532	6,067	5,953	12,020
Individually assessed											
- banks	—	—	2	8	—	—	10	80	90	—	90
- customers	—	205	44	59	280	14	602	207	809	4,106	4,915
Collectively assessed	2,475	475	—	17	412	130	3,509	—	3,509	1,145	4,654
Latent	202	591	9	8	270	334	1,414	245	1,659	702	2,361
	2,677	1,271	55	92	962	478	5,535	532	6,067	5,953	12,020

Notes:
(1) Global Transaction Services.
(2) Retail & Commercial.
(3) Global Banking & Markets.
(4) Recognised in interest income.

Risk management: Credit risk continued

Balance sheet analysis: Analysis of loan impairment charge

The following table analyses impairment losses.

	2011 £m	2010 £m	2009 £m
Latent loss	(497)	113	1,110
Collectively assessed	2,570	2,983	3,921
Individually assessed	4,896	6,203	6,334
Loans to customers	6,969	9,299	11,365
Loans to banks	—	—	8
Securities	207	101	801
Charge to income statement	7,176	9,400	12,174
Charge relating to customer loans as a % of gross customer loans (1)	1.5%	1.9%	2.2%

Note:
(1) Gross of provisions, including gross loans relating to disposal groups and excluding reverse repurchase agreements and intercompany loans.

	2011			2010			2009
	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m	Group £m
Loan impairment losses							
- customers	3,192	3,777	6,969	3,881	5,418	9,299	11,365
- banks	—	—	—	—	—	—	8
	3,192	3,777	6,969	3,881	5,418	9,299	11,373
Impairment losses on securities							
- debt securities	111	61	172	40	31	71	603
- equity shares	4	31	35	3	27	30	198
	115	92	207	43	58	101	801
Charge to income statement	3,307	3,869	7,176	3,924	5,476	9,400	12,174

Available-for-sale debt securities and reserves

The table below analyses available-for-sale debt securities and related reserves, gross of tax.

	2011				2010			
	US £m	UK £m	Other (1) £m	Total £m	US £m	UK £m	Other (1) £m	Total £m
Central and local government	18,769	10,654	13,987	43,410	20,266	5,651	14,559	40,476
Banks	41	640	3,943	4,624	183	3,076	3,774	7,033
Other financial institutions	17,453	3,079	2,375	22,907	15,963	1,480	2,309	19,752
Corporate	5	45	401	451	4	17	155	176
Total	36,268	14,418	20,706	71,392	36,416	10,224	20,797	67,437
Of which ABS	20,102	3,153	2,741	25,996	20,720	3,444	2,132	26,296
AFS reserves (gross)	1,537	773	550	2,860	908	221	34	1,163

Note:
(1) Includes eurozone countries as detailed on pages 130 to 143.

*unaudited

Risk management: Country risk

All disclosures in this section (pages 127 to 143) are audited unless otherwise indicated by an asterisk (*)

Introduction*

Country risk is the risk of material losses arising from significant country-specific events such as sovereign events (default or restructuring); economic events (contagion of sovereign default to other parts of the economy, cyclical economic shock); political events (transfer or convertibility restrictions and expropriation or nationalisation); and natural disaster or conflict. Such events have the potential to affect elements of the Group's credit portfolio that are directly or indirectly linked to the country in question and can also give rise to market, liquidity, operational and franchise risk related losses.

External risk environment*

2011 was another year of heightened country risks. However, trends were divergent, with conditions deteriorating among vulnerable eurozone countries facing growth impediments and higher public debt burdens, while many emerging markets continued to enjoy relative stability, seeing net inflows of capital for the full year and lower spreads despite some risk aversion in the second half. In the US, notwithstanding a more challenging political environment and a sovereign downgrade from a rating agency, a deal was secured to increase the sovereign debt ceiling, and yields on government debt remain low.

Eurozone risks

Europe was at the centre of rising global risks, owing to a combination of slower growth among some of its major economies and a further deepening of the ongoing sovereign crisis, which in turn harmed financial sector health. Risks in Greece rose as a deeper than expected contraction in GDP impacted the fiscal adjustment programme and hit debt sustainability. Negotiations on a voluntary restructuring of public debt held by the private sector commenced in the first half and a deal was finalised in March 2012, resulting in a contained default event. This in turn led to an agreement by eurozone leaders on a further borrowing programme for the Greek government.

In May 2011, Portugal's new government agreed a borrowing programme with the EU-IMF after a sharp deterioration in sovereign liquidity. Ireland's performance under its EU-IMF programme was good and the announcement of a bank restructuring deal without defaults on senior debt obligations helped improve market confidence. This was reflected in a compression in bond spreads in the second half of the year.

Despite the announcement of significant new support proposals by eurozone leaders in July 2011, investor worries over risks to their implementation rose and market conditions worsened markedly as a result. Risk aversion towards Spanish and Italian assets picked up and despite a policy response by both countries, yields remained elevated, prompting the ECB to intervene to support their bonds in secondary markets for the first time. Contagion affected bank stocks and asset prices.

Eurozone leaders responded by stepping up anti-crisis efforts, focusing largely on agreeing fiscal reform, bolstering bank capital and strengthening capacity to offer financing support to sovereigns losing market access. The ECB continued to buy sovereign debt in the secondary market and increased liquidity support to banks with the introduction of an emergency three-year long-term refinancing operation in December. This helped ease interbank funding tensions somewhat and may have contributed to some relief in sovereign debt markets late in the year, as yields on new issuance by Spain and Italy dropped.

Emerging markets

Emerging markets continued to perform relatively well. In Asia, despite slowing growth, China and India continued to post strong overall expansion, while generally large external savings levels reinforced balance of payments stability. In China specifically, measures to curb house price growth began to have a more noticeable impact, with real estate prices falling in many cities. Efforts are underway to address some bank asset quality concerns linked to rapid lending growth in 2009.

In emerging Europe, Russia experienced some contagion into asset markets from weaker commodity prospects and a challenging investment climate, but the sovereign balance sheet remained quite robust. Foreign exchange debts remained a risk factor in a number of Eastern European economies. Elsewhere, Turkey's economy cooled in the second half of 2011, helping to narrow the current account deficit sharply, though external vulnerabilities persisted.

The Middle East and North Africa witnessed political instability in a number of the relatively lower-income countries. The path of any transition has yet to become fully clear in most cases. Excluding Bahrain, pressures for change were more contained in the Gulf Co-Operation Council countries.

Latin America remained characterised by relative stability owing to balance sheet repair by a number of countries following crises in previous decades. Capital inflows contributed to currency appreciation, but overheating pressures have so far proven contained, including in Brazil where credit growth slowed from high levels.

Outlook

Overall, the outlook for 2012 remains challenging with risks likely to remain elevated but divergent. Much will depend on the success of EU efforts to contain contagion from the sovereign crisis (where downside risks are high) and whether growth headwinds in larger advanced economies persist. Emerging market balance sheet risks remain lower, despite ongoing structural and political constraints, but these economies will continue to be affected by events elsewhere through financial markets and trade channels.

Governance*

All country exposures are covered by the RBS Group's country risk framework. In this framework, a limited number of advanced countries are under monitoring only, with all other countries placed under limit control using the RBS Group's country risk watchlist process either when these have been identified as exhibiting signs of stress, or when it is otherwise considered appropriate. Granular portfolio reviews are undertaken to align country risk profiles to the RBS Group's country risk appetite in light of evolving economic and political developments.

Risk management: Country risk continued

The framework for the RBS Group's appetite for country risk is set by the Executive Risk Forum (ERF) in the form of country risk appetite ceilings by sovereign risk grade for both total and medium-term exposure. Authority is delegated to the RBS Group Country Risk Committee to manage exposures within the framework, with escalation where needed to ERF.

Total and medium-term exposure limits are set for individual countries based on a risk assessment taking into account the country's economic situation and outlook as well as the RBS Group's franchise and business mix in that country. Additional limitations (for example, on foreign-currency exposure and product types with higher potential for loss in case of country events) may be established to address specific vulnerabilities in the context of a country's outlook and/or the RBS Group's business strategy in a particular country.

Monitoring, management and mitigation*

A country watchlist framework is in place to proactively monitor emerging issues and facilitate the development of mitigation strategies.

Management of country risk was further strengthened in 2011 with intensified stress testing, portfolio actions on a number of countries and enhancements to risk appetite setting and management systems, contributing inter alia to a reduction in exposures to a range of countries.

During 2011, the RBS Group conducted an analysis of its country risk profile, encompassing all divisions, in the context of various broad eurozone scenarios. The outcome of this analysis was used to define more specific scenarios to be used as trigger events in stress testing - on an ongoing basis - at both RBS Group and divisional levels. Such scenarios include a major balance sheet deleveraging across Europe, a default of a eurozone sovereign, or one or more stressed member states exiting the eurozone and undergoing currency redenomination, with subsequent contagion effects.

The situation remains very uncertain and the results of stress tests are sensitive to input assumptions. As a result, estimates of the potential impact on the RBS Group of various developments are wide-ranging. If a single country exits the eurozone, the impact could be limited. If several do, the impact is likely to be significant. Depending on the circumstances, the generally negative effect on the RBS Group of devaluations could be offset by the impact of revaluations. Nonetheless, the extent of market disruption is very difficult to predict and could be substantial.

From mid-2011, the RBS Group began implementing risk-mitigating actions at divisional level aimed at preparing for a wide variety of potential eurozone stress scenarios, with a particular focus on counterparty credit risk, settlement risk and funding risk. It also carried out a detailed assessment of the potential impact of such scenarios on RBS Group systems to ensure broad readiness.

*unaudited

In a few specific cases, management of the RBS Group's exposure was temporarily handed over to a cross-divisional country crisis team. Risk mitigation actions typically included taking guarantees or insurance, updating collateral agreements, credit documentation reviews and specified credit referral processes.

Risk appetite setting was strengthened by various measures. In addition to Greece, Ireland and Portugal, the RBS Group brought Italy and Spain under country limit control. Belgium and Japan followed in January 2012, with other advanced countries scheduled for review in this process throughout the year. Benchmark ratios systematically guided the setting of medium-term country exposure limits.

The RBS Group's regular, comprehensive and detailed country exposure reviews were further enhanced by intensified counterparty monitoring.

All of this, in combination with customers own efforts to reduce their debt levels, contributed to reductions in exposure to a range of countries including the vulnerable eurozone countries, Japan and countries in political transition in North Africa and the Middle East. Exposure reductions were implemented selectively, often retaining some credit lines for strategic clients and in cases of sufficient risk mitigation. Due to their nature, medium-term exposures cannot be adjusted as rapidly as short-term exposures.

Further strategic enhancements to portfolio management systems included the introduction of a comprehensive country risk management and reporting application, comprising banking and trading book exposures across the RBS Group on a consistent basis, and taking account of country risk transfers given guarantees, insurance and collateral taken. This system supports analysing and managing the exposures to countries in the eurozone and elsewhere, by tenor bucket, currency type, sector and product type, as well as by individual counterparty names and facilities. In addition, developments in trading book management systems played a role in actual exposure reductions in trading on a number of countries.

Internal rating systems were also further developed, contributing to more accurate calculations of country-specific default probabilities and expected loss-given-default rates, which are determinants in the calculation of risk-weighted assets and economic capital.

Other developments in country risk management in 2011 included the development of the regional and country risk view in the RBS Group's economic capital model and in integrated stress testing.

Going forward, the RBS Group continues to extend country limit control to other countries within and outside the eurozone and will continue to manage medium-term exposure closer to its medium-term benchmark ratios. In addition, work is continued on the determination of actual appetite per country, on the country risk reporting systems and their integration with credit, treasury and finance systems, on the representation of country risk aspects in rating models, economic capital models and integrated stress testing, and on the combination with actual and expected returns. All of this should help the RBS Group determine and steer its risk profile and further optimise its global portfolio management.

Credit default swap (CDS) contracts are used for a number of purposes including hedging of the credit trading portfolio, management of counterparty credit exposure, including credit valuation adjustment, and the mitigation of wrong-way risk. The RBS Group generally uses CDS contracts to manage exposure on a portfolio basis rather than a specific exposure basis. This may give rise to maturity mismatches between the underlying exposure and the CDS contract as well as between bought and sold CDS contracts on the same reference entity.

The terms of the RBS Group's CDS contracts are covered by standard ISDA documentation, which determines if a contract is triggered due to a credit event. Such events may include bankruptcy or restructuring of the reference entity or a failure of the reference entity to repay its debt. Under the terms of a CDS contract, one of the regional ISDA Credit Derivatives Determinations Committees is empowered to decide whether or not a credit event has occurred.

Country risk analysis

All the data tables and related definitions in this section are audited.

The following tables show the Group's exposure by country of incorporation of the counterparty at 31 December 2011. Countries shown are those where the Group's balance sheet exposure to counterparties incorporated in the country exceeded £1 billion and the country had an external rating of A+ or below from S&P, Moody's or Fitch at 31 December 2011, as well as selected eurozone countries. The numbers are stated before taking into account the impact of mitigating action, such as collateral, insurance or guarantees that may have been taken to reduce or eliminate exposure to country risk events. Exposures relating to ocean-going vessels are not included due to their multinational nature.

The following definitions apply to the tables on pages 130 to 143:

Lending comprises gross loans and advances to: central and local governments; central banks, including cash balances; other banks and financial institutions, incorporating overdraft and other short-term credit lines; corporations, in large part loans and leases; and individuals, comprising mortgages, personal loans and credit card balances. Lending includes impaired loans and loans where an impairment event has taken place, but no impairment provision is recognised.

Debt securities comprise securities classified as available-for-sale (AFS), loans and receivables (LAR), held-for-trading (HFT) and designated as at fair value through profit or loss (DFV). All debt securities other than LAR securities are carried at fair value with LAR debt securities are carried at amortised cost less impairment. HFT debt securities are presented as gross long positions (including DFV securities) and short positions per country. Impairment losses and exchange differences relating to AFS debt securities, together with interest, are recognised in the income statement; other changes in the fair value of AFS securities are reported within AFS reserves, which are presented gross of tax.

Derivatives comprise the mark-to-market (mtm) value of such contracts after the effect of enforceable netting agreements, but gross of collateral. Reverse repurchase agreements (repos) comprise the mtm value of counterparty exposure arising from repo transactions net of collateral.

Balance sheet exposures comprise lending exposures, debt securities and derivatives, and repo exposures.

Contingent liabilities and commitments comprise contingent liabilities, including guarantees and committed undrawn facilities.

Credit default swaps - under CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. The fair value, or mtm, represents the balance sheet carrying value. The mtm value of CDSs is included within derivatives against the counterparty of the trade, as opposed to the reference entity. The notional is the par amount of the credit protection bought or sold and is included against the reference entity of the CDS contract.

The column CDS notional less fair value represents the notional less fair value amounts arising from sold positions netted against those arising from bought positions, and represents the net change in exposure for a given reference entity should the CDS contract be triggered by a credit event, assuming there is a zero recovery rate. However, in most cases, the RBS Group expects the recovery rate to be greater than zero and the exposure change to be less than this amount.

The Group primarily transacts CDS contracts with investment-grade global financial institutions that are active participants in the CDS market. These transactions are subject to regular margining. For European peripheral sovereigns, credit protection has been purchased from a number of major European banks, predominantly outside the country of the reference entity. In a few cases where protection was bought from banks in the country of the reference entity, giving rise to wrong-way risk, this risk is mitigated through specific collateralisation. Due to their bespoke nature, exposures relating to CDPCs and related hedges have not been included, as they cannot be meaningfully attributed to a particular country or a reference entity. Exposures to CDPCs are disclosed on page 113.

The Group used CDS contracts throughout 2011 to manage both eurozone country and counterparty exposures. As shown in the individual country tables, this resulted in increases in both gross notional bought and sold eurozone CDS contracts, mainly on Italy, France and the Netherlands. The magnitude of the fair value of bought and sold CDS contracts increased over 2011 in line with the widening of eurozone CDS spreads.

'Other eurozone' comprises Austria, Cyprus, Estonia, Finland, Malta, Slovakia and Slovenia.

Risk management: Country risk continued

2011	Lending: Central and local government £m	Lending: Central banks £m	Lending: Other banks £m	Lending: Other financial institutions £m	Lending: Corporate £m	Lending: Personal £m	Lending: Total lending £m	Lending: Of which Non-Core £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Contingent liabilities and commitments £m	Total £m	CDS notional less fair value £m
Eurozone														
Ireland	45	1,460	123	336	18,868	18,858	39,690	10,090	427	2,777	42,894	2,568	45,462	(108)
Spain	9	—	203	153	5,095	362	5,822	3,677	(306)	2,388	7,904	1,313	9,217	(979)
Italy	—	70	217	216	1,332	23	1,858	941	326	1,729	3,913	2,374	6,287	(358)
Portugal	—	—	2	—	468	5	475	341	(34)	457	898	212	1,110	58
Greece	—	—	—	31	45	14	90	51	97	354	541	32	573	1
Germany	—	18,033	517	291	5,982	84	24,907	5,148	10,690	15,539	51,136	4,860	55,996	(2,285)
Netherlands	2,559	—	313	845	2,885	20	6,622	2,108	3,151	9,679	19,452	4,343	23,795	(1,179)
France	481	3	1,198	408	2,990	79	5,159	2,058	5,214	8,807	19,180	8,452	27,632	(2,633)
Luxembourg	—	—	101	1,717	1,966	2	3,786	1,404	159	2,403	6,348	1,736	8,084	(331)
Belgium	213	—	239	27	306	20	805	157	(87)	2,845	3,563	718	4,281	(89)
Other	121	—	14	97	1,145	26	1,403	237	89	1,946	3,438	1,029	4,467	(15)
	3,428	19,566	2,927	4,121	41,082	19,493	90,617	26,212	19,726	48,924	159,267	27,637	186,904	(7,918)
Other countries														
Brazil	—	—	936	—	42	4	982	—	100	19	1,101	308	1,409	(377)
Russia	—	—	633	—	273	62	968	6	10	43	1,021	101	1,122	(343)

For defintions refer to page 129.

*unaudited

2010	Lending: Central and local government £m	Central banks £m	Other banks £m	Other financial institutions £m	Corporate £m	Personal £m	Total lending £m	Of which Non-Core £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Contingent liabilities and commitments £m	Total £m	CDS notional less fair value £m
Eurozone														
Ireland	61	2,113	74	735	19,727	20,228	42,938	10,684	825	2,624	46,387	3,263	49,650	(40)
Spain	19	—	139	91	6,275	407	6,931	4,470	164	2,013	9,108	1,383	10,491	(475)
Italy	8	76	635	263	1,947	27	2,956	1,399	2,642	1,455	7,053	2,109	9,162	(509)
Portugal	86	—	47	—	584	6	723	315	42	345	1,110	407	1,517	56
Greece	—	13	1	32	74	16	136	74	79	224	439	42	481	182
Germany	—	10,847	912	391	6,751	84	18,985	6,158	7,348	14,132	40,465	5,353	45,818	(397)
Netherlands	914	—	(426)	673	3,046	22	4,229	2,466	2,877	7,521	14,627	5,875	20,502	(939)
France	511	3	961	451	3,588	102	5,616	2,496	10,816	7,260	23,692	8,699	32,391	(883)
Luxembourg	—	—	21	594	2,051	3	2,669	1,381	277	1,346	4,292	1,759	6,051	(371)
Belgium	102	—	154	4	512	21	793	179	35	2,169	2,997	646	3,643	72
Other	124	—	124	80	1,292	24	1,644	260	3	1,296	2,943	1,090	4,033	(54)
	1,825	13,052	2,642	3,314	45,847	20,940	87,620	29,882	25,108	40,385	153,113	30,626	183,739	(3,358)
Other countries														
Brazil	—	—	824	—	56	5	885	44	74	4	963	106	1,069	(355)
Russia	—	—	1	—	105	55	161	42	14	30	205	71	276	(121)

For definitions refer to page 129.

Key points*

Reported exposures are affected by currency movements. Over the year, sterling fell 0.3% against the US dollar and rose 3.1% against the euro.

- There were increases in certain country exposures and products reflecting the transfer of a substantial part of the UK activities of RBS N.V. to RBS plc in the fourth quarter of 2011 (hereafter “RBS N.V. transfers”).

- Exposure to most countries declined as the RBS Group maintained a cautious stance and many bank clients reduced debt levels. Decreases were seen in balance sheet and off-balance sheet exposures in many countries. Increases in derivatives and repos in a few countries were in line with the RBS Group’s strategy, driven partly by customer demand for hedging solutions and partly by market movements; risks are generally mitigated by active collateralisation.

- Russia - lending exposure increased by £0.8 billion, largely driven by RBS N.V. transfers and an increase in lending to banks.

- Eurozone periphery (Spain, Italy, Greece, Ireland and Portugal) - exposure decreased across most of the periphery, with derivatives (gross of collateral) and repos being the only component that still saw some increases year-on-year (partly an effect of market movements on existing positions). Much of the Group’s country risk exposure to the eurozone periphery countries arises from the activities of GBM and Ulster Bank (with respect to Ireland). The Group has some held-for-trading holdings of Italian bonds. GTS provides trade finance facilities to clients across Europe including the eurozone periphery.

- For more specific commentary on the Group’s exposure to each of the eurozone periphery countries, refer to pages 133 to 137. For commentary on the Group’s exposure to other eurozone countries, see page 143.

Risk management: Country risk continued

Eurozone

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	3,428	—	—	9,838	639	19,596	15,049	14,385	1,884	19,697	36,959	36,691	6,471	(6,369)
Central banks	19,566	—	—	—	—	—	—	—	5,482	25,048	—	—	—	—
Other banks	2,927	—	—	1,756	(16)	1,195	1,433	1,518	29,018	33,463	19,620	19,213	2,286	(2,223)
Other financial institutions	4,121	—	—	2,578	(78)	1,093	419	3,252	8,663	16,036	17,384	15,973	646	(582)
Corporate	41,082	13,379	6,676	102	2	528	59	571	3,876	45,529	76,397	70,032	2,219	(1,915)
Personal	19,493	2,258	1,048	—	—	—	—	—	1	19,494	—	—	—	—
	90,617	15,637	7,724	14,274	547	22,412	16,960	19,726	48,924	159,267	150,360	141,909	11,622	(11,089)
2010														
Central and local government	1,825	—	—	8,936	109	24,985	14,256	19,665	1,490	22,980	28,825	29,075	2,899	(2,843)
Central banks	13,052	—	—	—	—	7	—	7	6,187	19,246	—	—	—	—
Other banks	2,642	—	—	1,955	—	1,617	1,187	2,385	22,769	27,796	16,325	16,155	1,035	(1,027)
Other financial institutions	3,314	—	—	1,803	(62)	908	83	2,628	6,286	12,228	11,576	11,353	116	(128)
Corporate	45,847	11,769	4,920	52	—	631	260	423	3,652	49,922	66,415	62,956	(279)	471
Personal	20,940	1,638	534	—	—	—	—	—	1	20,941	—	—	—	—
	87,620	13,407	5,454	12,746	47	28,148	15,786	25,108	40,385	153,113	123,141	119,539	3,771	(3,527)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	67,548	5,581	1,085	131	145	14	—	—	68,778	5,726
Other financial institutions	79,028	5,553	313	51	2,094	278	147	14	81,582	5,896
Total	146,576	11,134	1,398	182	2,239	292	147	14	150,360	11,622

*unaudited

Ireland

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	45	—	—	—	—	20	19	1	92	138	2,145	2,223	466	(481)
Central banks	1,460	—	—	—	—	—	—	—	—	1,460	—	—	—	—
Other banks	123	—	—	—	—	195	14	181	1,424	1,728	110	107	21	(21)
Other financial institutions	336	—	—	29	—	116	35	110	852	1,298	362	308	63	(73)
Corporate	18,868	10,224	5,655	—	—	135	—	135	408	19,411	425	322	(11)	10
Personal	18,858	2,258	1,048	—	—	—	—	—	1	18,859	—	—	—	—
	39,690	12,482	6,703	29	—	466	68	427	2,777	42,894	3,042	2,960	539	(565)
2010														
Central and local government	61	—	—	4	—	93	88	9	20	90	1,872	2,014	360	(387)
Central banks	2,113	—	—	—	—	7	—	7	126	2,246	—	—	—	—
Other banks	74	—	—	264	(5)	96	45	315	1,289	1,678	317	312	103	(95)
Other financial institutions	735	—	—	152	(2)	205	—	357	837	1,929	242	269	34	(73)
Corporate	19,727	8,246	4,036	3	—	140	6	137	351	20,215	481	338	(20)	17
Personal	20,228	1,638	534	—	—	—	—	—	1	20,229	—	—	—	—
	42,938	9,884	4,570	423	(7)	541	139	825	2,624	46,387	2,912	2,933	477	(538)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	1,586	300	2	—	—	—	—	—	1,588	300
Other financial institutions	1,325	232	—	—	129	7	—	—	1,454	239
Total	2,911	532	2	—	129	7	—	—	3,042	539

Key points*

- The Group's exposure to Ireland is driven by Ulster Bank Group. The Group's total Irish portfolio primarily comprises personal lending of £18.9 billion (largely mortgages) and corporate lending of £18.9 billion (largely loans to the property sector). In addition, the Group has lending and derivatives exposure to the Central Bank of Ireland, financial institutions and large international clients with funding units based in Ireland.

- Exposure declined in most categories, with notable reductions in lending of £3.2 billion and in off-balance sheet items of £0.7 billion over the year, as a result of currency movements and de-risking in the portfolio.

Central and local government and central bank

- Exposure to the central bank fluctuates, driven by regulatory requirements and by deposits of excess liquidity as part of the Group's assets and liabilities management. Exposures fell by £0.7 billion over the year.

Financial institutions

- GBM and Ulster Bank account for the majority of the Group's exposure to financial institutions. Exposure to the financial sector fell by £1.1 billion during the year, caused by a £0.4 billion reduction in lending, a £0.4 billion reduction in debt securities and a £0.3 billion reduction in off-balance sheet exposure, partly offset by an increase in derivatives reflecting RBS N.V. transfers; these exposures are typically collateralised and fluctuate from period to period.

Corporate

- Corporate lending exposure fell approximately £0.9 billion over the year, driven by a combination of exchange rate movements and write-offs. At the end of 2011, lending exposure was highest in the property sector (£11.6 billion), which is also the sector that experienced the largest year-on-year reduction (£0.4 billion). REIL and impairment provisions rose by £2.0 billion and £1.6 billion respectively over the year.

Personal

- The Ulster Bank retail portfolio mainly consists of mortgages (approximately 95% of Ulster Bank personal lending at 31 December 2011), with the remainder comprising credit card and other personal lending. Overall personal lending exposure fell approximately £1.4 billion over the year as a result of exchange rate movements, amortisation, a small amount of write-offs and a lack of demand in the market.

Risk management: Country risk continued

Spain

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	CDP Notional Bought £m	CDP Notional Sold £m	CDP Fair value Bought £m	CDP Fair value Sold £m
Central and local government	9	—	—	—	—	360	751	(391)	35	(347)	5,151	5,155	538	(522)
Central banks	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other banks	203	—	—	8	(1)	162	214	(44)	1,618	1,777	1,965	1,937	154	(152)
Other financial institutions	153	—	—	45	—	65	8	102	281	536	2,411	2,199	157	(128)
Corporate	5,095	1,183	439	—	—	27	—	27	454	5,576	4,794	3,956	446	(398)
Personal	362	—	—	—	—	—	—	—	—	362	—	—	—	—
	5,822	1,183	439	53	(1)	614	973	(306)	2,388	7,904	14,321	13,247	1,295	(1,200)
2010														
Central and local government	19	—	—	49	2	1,172	1,248	(27)	53	45	3,820	3,923	436	(435)
Central banks	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other banks	139	—	—	38	—	142	118	62	1,454	1,655	2,087	2,159	133	(135)
Other financial institutions	91	—	—	67	(1)	34	7	94	22	207	1,569	1,354	71	(44)
Corporate	6,275	1,865	570	—	—	43	8	35	484	6,794	4,691	4,184	202	(156)
Personal	407	—	—	—	—	—	—	—	—	407	—	—	—	—
	6,931	1,865	570	154	1	1,391	1,381	164	2,013	9,108	12,167	11,620	842	(770)

CDP = Credit default protection (reference entity)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	6,595	499	68	5	32	4	—	—	6,695	508
Other financial institutions	7,195	734	162	3	269	50	—	—	7,626	787
Total	13,790	1,233	230	8	301	54	—	—	14,321	1,295

Key points*

- The Group maintains strong relationships with Spanish government entities, banks, other financial institutions and large corporate clients. The exposure to Spain is driven by corporate lending.
- Exposure fell in 2011 particularly in corporate lending, as a result of steps taken to de-risk the portfolio.

Central and local government and central bank

- The Group's exposure to the government was negative at 31 December 2011, reflecting net short held-for-trading debt securities.

Financial institutions

- Most of the Group's exposure to financial institutions consists of derivatives exposure to Spanish international banks and a few of the large regional banks, the majority of which is collateralised. This increased by £0.4 billion in 2011, due partly to market movements.

Corporate

- Lending exposure to corporate clients declined by 1.2 billion during 2011, with reductions in lending notably to the property sector and increases in the energy sector.

*unaudited

Italy

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	CDS Notional Bought £m	CDS Notional Sold £m	CDS Fair value Bought £m	CDS Fair value Sold £m
Central and local government	—	—	—	—	—	4,336	4,725	(389)	90	(299)	12,046	12,192	1,736	(1,704)
Central banks	70	—	—	—	—	—	—	—	—	70	—	—	—	—
Other banks	217	—	—	—	—	65	85	(20)	1,023	1,220	6,033	5,933	1,209	(1,186)
Other financial institutions	216	—	—	643	(6)	39	13	669	155	1,040	879	762	60	(51)
Corporate	1,332	318	86	8	—	58	—	66	461	1,859	4,711	4,293	347	(280)
Personal	23	—	—	—	—	—	—	—	—	23	—	—	—	—
	1,858	318	86	651	(6)	4,498	4,823	326	1,729	3,913	23,669	23,180	3,352	(3,221)
2010														
Central and local government	8	—	—	—	—	5,113	3,175	1,938	70	2,016	8,998	8,519	641	(552)
Central banks	76	—	—	—	—	—	—	—	—	76	—	—	—	—
Other banks	635	—	—	63	1	61	16	108	734	1,477	4,335	4,418	420	(409)
Other financial institutions	263	—	—	532	(1)	49	—	581	238	1,082	704	696	19	(13)
Corporate	1,947	179	30	8	—	15	8	15	413	2,375	4,203	3,937	143	(88)
Personal	27	—	—	—	—	—	—	—	—	27	—	—	—	—
	2,956	179	30	603	—	5,238	3,199	2,642	1,455	7,053	18,240	17,570	1,223	(1,062)

Credit default protection (reference entity)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	12,884	1,673	487	94	8	1	—	—	13,379	1,768
Other financial institutions	10,063	1,539	8	2	219	43	—	—	10,290	1,584
Total	22,947	3,212	495	96	227	44	—	—	23,669	3,352

Key points*

- The Group maintains strong relationships with Italian government entities, banks, other financial institutions and large corporate clients. Since the start of 2011, the Group has taken steps to reduce its risks through strategic exits where appropriate, or to mitigate these risks through increased collateral requirements, in line with the RBS Group's evolving appetite for Italian risk. As a result, the Group reduced lending exposures to Italian counterparties by £1.1 billion over 2011 to £1.9 billion.

Central and local government and central bank

- The Group is an active market-maker in Italian government bonds, resulting in large gross long and short positions in held-for-trading securities.
- Over 2011, the total government debt securities position declined by £2.3 billion, reflecting a rebalancing of the trading portfolio. The Group left itself in £0.4 billion net short positions at 31 December 2011 to avoid being temporarily over-exposed as a result of its expected participation in the purchase of new government bonds being issued in January 2012.

Financial institutions

- The Group's product offering consists largely of collateralised trading products and, to a lesser extent, short-term uncommitted lending lines for liquidity purposes. Overall, exposure to banks and other financial institutions declined as a result of reductions in lending and debt securities.

Corporate

- Lending exposure decreased by £0.6 billion during 2011, driven by reductions in the commercial real estate and telecom sectors.

Risk management: Country risk continued

Portugal

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	—	—	—	—	—	36	152	(116)	19	(97)	3,304	3,413	997	(985)
Other banks	2	—	—	—	—	12	2	10	371	383	1,197	1,155	264	(260)
Other financial institutions	—	—	—	5	—	7	—	12	8	20	8	5	1	(1)
Corporate	468	—	—	42	—	18	—	60	59	587	363	321	68	(48)
Personal	5	—	—	—	—	—	—	—	—	5	—	—	—	—
	475	—	—	47	—	73	154	(34)	457	898	4,872	4,894	1,330	(1,294)
2010														
Central and local government	86	—	—	—	—	66	122	(56)	29	59	2,844	2,923	471	(460)
Other banks	47	—	—	—	—	46	2	44	272	363	1,085	1,107	231	(243)
Other financial institutions	—	—	—	47	—	7	—	54	7	61	9	6	(1)	—
Corporate	584	—	—	—	—	—	—	—	37	621	554	495	47	(28)
Personal	6	—	—	—	—	—	—	—	—	6	—	—	—	—
	723	—	—	47	—	119	124	42	345	1,110	4,492	4,531	748	(731)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	2,922	786	46	12	—	—	—	—	2,968	798
Other financial institutions	1,871	517	—	—	33	15	—	—	1,904	532
Total	4,793	1,303	46	12	33	15	—	—	4,872	1,330

Key points*

- Balance sheet exposures to entities in Portugal decreased by £0.2 billion, to £0.9 billion by 31 December 2011. Medium-term activity has ceased with the exception of that carried out under a Credit Support Annex.

Central and local government and central bank

- The Group's exposure to the Portuguese government was negative at 31 December 2011, reflecting net short held-for-trading debt securities.

Financial institutions

- The remaining exposure to financial institutions largely comprises derivatives exposure, which is generally collateralised.

Corporate

- Non-financial corporate exposure is to the transport and energy sectors.

*unaudited

Greece

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	CDS (reference entity) Notional Bought £m	CDS Notional Sold £m	CDS Fair value Bought £m	CDS Fair value Sold £m
Central and local government	—	—	—	—	—	102	5	97	—	97	3,158	3,165	2,228	(2,230)
Other banks	—	—	—	—	—	—	—	—	289	289	22	22	3	(3)
Other financial institutions	31	—	—	—	—	—	—	—	2	33	34	34	8	(8)
Corporate	45	—	—	—	—	—	—	—	63	108	434	428	144	(142)
Personal	14	—	—	—	—	—	—	—	—	14	—	—	—	—
	90	—	—	—	—	102	5	97	354	541	3,648	3,649	2,383	(2,383)
2010														
Central and local government	—	—	—	—	—	118	39	79	7	86	2,960	3,061	854	(871)
Central banks	13	—	—	—	—	—	—	—	—	13	—	—	—	—
Other banks	1	—	—	—	—	—	—	—	166	167	21	19	3	(3)
Other financial institutions	32	—	—	—	—	—	—	—	3	35	35	35	11	(11)
Corporate	74	—	—	—	—	—	—	—	48	122	511	616	44	(49)
Personal	16	—	—	—	—	—	—	—	—	16	—	—	—	—
	136	—	—	—	—	118	39	79	224	439	3,527	3,731	912	(934)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	2,001	1,345	1	1	—	—	—	—	2,002	1,346
Other financial institutions	1,507	945	63	45	76	47	—	—	1,646	1,037
Total	3,508	2,290	64	46	76	47	—	—	3,648	2,383

Key points*

- The Group continues to actively manage its exposure to the country, in line with the de-risking strategy that has been in place since early 2010. Much of the remaining exposure is collateralised or guaranteed.

Central and local government and central bank

- The only exposure to the Greek government at 31 December 2011 was approximately £0.1 billion of net held-for-trading debt securities.

Financial institutions

- Activity with Greek financial companies is under close scrutiny; exposure is minimal.
- Due to market movements, the gross derivatives exposure to banks increased by £0.1 billion. The portfolio is largely collateralised.

Corporate

- The Group's corporate exposure is steadily declining. The focus is now on short-term trade facilities to the domestic subsidiaries of international clients, increasingly supported by parental guarantees.

Risk management: Country risk continued

Germany

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	—	—	—	8,071	534	4,136	2,084	10,123	423	10,546	2,631	2,640	76	(67)
Central banks	18,033	—	—	—	—	—	—	—	5,437	23,470	—	—	—	—
Other banks	517	—	—	371	—	282	761	(108)	5,901	6,310	4,754	4,688	306	(310)
Other financial institutions	291	—	—	563	(29)	187	95	655	3,288	4,234	3,647	3,400	7	(2)
Corporate	5,982	191	80	13	1	14	7	20	490	6,492	20,304	18,292	147	(126)
Personal	84	—	—	—	—	—	—	—	—	84	—	—	—	—
	24,907	191	80	9,018	506	4,619	2,947	10,690	15,539	51,136	31,336	29,020	536	(505)
2010														
Central and local government	—	—	—	4,889	24	5,911	4,124	6,676	160	6,836	2,056	2,173	25	(19)
Central banks	10,847	—	—	—	—	—	—	—	6,038	16,885	—	—	—	—
Other banks	912	—	—	241	2	526	481	286	5,495	6,693	3,795	3,907	74	(88)
Other financial institutions	391	—	—	219	(40)	195	17	397	1,951	2,739	2,659	2,610	(16)	17
Corporate	6,751	146	28	14	—	28	53	(11)	488	7,228	19,487	18,927	(379)	369
Personal	84	—	—	—	—	—	—	—	—	84	—	—	—	—
	18,985	146	28	5,363	(14)	6,660	4,675	7,348	14,132	40,465	27,997	27,617	(296)	279

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	14,641	171	163	4	8	—	—	—	14,812	175
Other financial institutions	16,172	355	18	—	334	6	—	—	16,524	361
Total	30,813	526	181	4	342	6	—	—	31,336	536

Netherlands

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	2,559	—	—	823	68	848	591	1,080	—	3,639	1,206	1,189	31	(31)
Central banks	—	—	—	—	—	—	—	—	7	7	—	—	—	—
Other banks	313	—	—	574	(2)	302	212	664	7,484	8,461	962	995	41	(42)
Other financial institutions	845	—	—	1,133	(34)	251	102	1,282	1,497	3,624	5,439	5,244	101	(94)
Corporate	2,885	408	85	17	1	113	5	125	691	3,701	15,302	14,212	250	(166)
Personal	20	—	—	—	—	—	—	—	—	20	—	—	—	—
	6,622	408	85	2,547	33	1,514	910	3,151	9,679	19,452	22,909	21,640	423	(333)
2010														
Central and local government	914	—	—	425	2	1,425	607	1,243	—	2,157	1,195	999	(2)	(4)
Central banks	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Other banks	(426)	—	—	669	2	195	275	589	4,613	4,776	779	784	12	(10)
Other financial institutions	673	—	—	638	(14)	344	12	970	2,179	3,822	3,620	3,608	3	(2)
Corporate	3,046	203	—	15	—	117	57	75	729	3,850	11,750	10,907	(61)	171
Personal	22	—	—	—	—	—	—	—	—	22	—	—	—	—
	4,229	203	—	1,747	(10)	2,081	951	2,877	7,521	14,627	17,344	16,298	(48)	155

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	7,590	107	88	1	6	—	—	—	7,684	108
Other financial institutions	14,379	220	23	—	676	81	147	14	15,225	315
Total	21,969	327	111	1	682	81	147	14	22,909	423

Risk management: Country risk continued

France

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	481	—	—	934	37	8,705	5,669	3,970	357	4,808	3,425	2,859	225	(192)
Central banks	3	—	—	—	—	—	—	—	12	15	—	—	—	—
Other banks	1,198	—	—	795	(13)	157	75	877	7,055	9,130	4,190	3,990	274	(235)
Other financial institutions	408	—	—	111	(4)	325	126	310	673	1,391	2,544	2,051	133	(117)
Corporate	2,990	40	13	19	—	72	34	57	710	3,757	23,048	21,562	602	(578)
Personal	79	—	—	—	—	—	—	—	—	79	—	—	—	—
	5,159	40	13	1,859	20	9,259	5,904	5,214	8,807	19,180	33,207	30,462	1,234	(1,122)
2010														
Central and local government	511	—	—	3,559	81	10,266	3,968	9,857	362	10,730	2,225	2,287	87	(92)
Central banks	3	—	—	—	—	—	—	—	15	18	—	—	—	—
Other banks	961	—	—	618	(1)	398	204	812	5,949	7,722	3,501	3,041	57	(43)
Other financial institutions	451	—	—	54	(3)	42	23	73	302	826	1,567	1,597	(2)	(2)
Corporate	3,588	140	7	12	—	152	90	74	632	4,294	18,673	18,162	(172)	163
Personal	102	—	—	—	—	—	—	—	—	102	—	—	—	—
	5,616	140	7	4,243	77	10,858	4,285	10,816	7,260	23,692	25,966	25,087	(30)	26

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	13,321	452	162	13	79	8	—	—	13,562	473
Other financial institutions	19,367	738	24	1	254	22	—	—	19,645	761
Total	32,688	1,190	186	14	333	30	—	—	33,207	1,234

Luxembourg

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	CDP Notional Bought £m	CDP Notional Sold £m	CDP Fair value Bought £m	CDP Fair value Sold £m
Other banks	101	—	—	8	—	7	—	15	546	662	—	—	—	—
Other financial institutions	1,717	—	—	49	(5)	77	34	92	1,679	3,488	2,060	1,970	116	(108)
Corporate	1,966	834	263	—	—	58	6	52	178	2,196	2,414	2,136	145	(116)
Personal	2	—	—	—	—	—	—	—	—	2	—	—	—	—
	3,786	834	263	57	(5)	142	40	159	2,403	6,348	4,474	4,106	261	(224)
2010														
Central and local government	—	—	—	—	—	24	—	24	—	24	—	—	—	—
Other banks	21	—	—	28	—	35	—	63	495	579	—	—	—	—
Other financial institutions	594	—	—	94	(1)	32	19	107	636	1,337	1,171	1,178	(3)	—
Corporate	2,051	751	184	—	—	104	21	83	215	2,349	2,245	1,871	(16)	15
Personal	3	—	—	—	—	—	—	—	—	3	—	—	—	—
	2,669	751	184	122	(1)	195	40	277	1,346	4,292	3,416	3,049	(19)	15

CDP = Credit default protection (reference entity)

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	1,534	93	16	—	—	—	—	—	1,550	93
Other financial institutions	2,844	161	10	—	70	7	—	—	2,924	168
Total	4,378	254	26	—	70	7	—	—	4,474	261

Risk management: Country risk continued

Belgium

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	CDS Notional Bought £m	CDS Notional Sold £m	CDS Fair value Bought £m	CDS Fair value Sold £m
Central and local government	213	—	—	7	—	608	722	(107)	89	195	1,612	1,505	120	(110)
Central banks	—	—	—	—	—	—	—	—	3	3	—	—	—	—
Other banks	239	—	—	—	—	—	—	—	2,291	2,530	297	299	12	(13)
Other financial institutions	27	—	—	—	—	1	4	(3)	191	215	—	—	—	—
Corporate	306	—	—	3	—	20	—	23	271	600	562	569	12	(12)
Personal	20	—	—	—	—	—	—	—	—	20	—	—	—	—
	805	—	—	10	—	629	726	(87)	2,845	3,563	2,471	2,373	144	(135)
2010														
Central and local government	102	—	—	7	—	529	602	(66)	92	128	880	986	53	(57)
Central banks	—	—	—	—	—	—	—	—	7	7	—	—	—	—
Other banks	154	—	—	34	1	66	2	98	1,787	2,039	257	266	1	(1)
Other financial institutions	4	—	—	—	—	—	—	—	96	100	—	—	—	—
Corporate	512	—	—	—	—	5	2	3	187	702	627	588	(6)	6
Personal	21	—	—	—	—	—	—	—	—	21	—	—	—	—
	793	—	—	41	1	600	606	35	2,169	2,997	1,764	1,840	48	(52)

Note: the CDS columns are "Credit default protection (reference entity)".

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	1,597	97	2	—	12	1	—	—	1,611	98
Other financial institutions	855	46	1	—	4	—	—	—	860	46
Total	2,452	143	3	—	16	1	—	—	2,471	144

* unaudited

Rest of eurozone (1)

2011	Lending £m	REIL £m	Provisions £m	AFS and LAR debt securities £m	AFS reserves £m	HFT debt securities Long £m	HFT debt securities Short £m	Total debt securities £m	Derivatives (gross of collateral) and repos £m	Balance sheet exposures £m	Credit default protection (reference entity) Notional Bought £m	Notional Sold £m	Fair value Bought £m	Fair value Sold £m
Central and local government	121	—	—	3	—	445	331	117	779	1,017	2,281	2,350	54	(47)
Central banks	—	—	—	—	—	—	—	—	23	23	—	—	—	—
Other banks	14	—	—	—	—	13	70	(57)	1,016	973	90	87	2	(1)
Other financial institutions	97	—	—	—	—	25	2	23	37	157	—	—	—	—
Corporate	1,145	181	55	—	—	13	7	6	91	1,242	4,040	3,941	69	(59)
Personal	26	—	—	—	—	—	—	—	—	26	—	—	—	—
	1,403	181	55	3	—	496	410	89	1,946	3,438	6,411	6,378	125	(107)
2010														
Central and local government	124	—	—	3	—	268	283	(12)	697	809	1,975	2,190	(26)	34
Central banks	—	—	—	—	—	—	—	—	1	1	—	—	—	—
Other banks	124	—	—	—	—	52	44	8	515	647	148	142	1	—
Other financial institutions	80	—	—	—	—	—	5	(5)	15	90	—	—	—	—
Corporate	1,292	239	65	—	—	27	15	12	68	1,372	3,193	2,931	(61)	51
Personal	24	—	—	—	—	—	—	—	—	24	—	—	—	—
	1,644	239	65	3	—	347	347	3	1,296	2,943	5,316	5,263	(86)	85

CDS bought protection: counterparty analysis by internal asset quality band

2011	AQ1 Notional £m	AQ1 Fair value £m	AQ2-AQ3 Notional £m	AQ2-AQ3 Fair value £m	AQ4-AQ9 Notional £m	AQ4-AQ9 Fair value £m	AQ10 Notional £m	AQ10 Fair value £m	Total Notional £m	Total Fair value £m
Banks	2,877	58	50	1	—	—	—	—	2,927	59
Other financial institutions	3,450	66	4	—	30	—	—	—	3,484	66
Total	6,327	124	54	1	30	—	—	—	6,411	125

Note:
(1) Comprises Austria, Cyprus, Estonia, Finland, Malta, Slovakia and Slovenia.

Key points*

- Due to credit risk and capital considerations, the Group increased exposure to central banks by depositing with them higher levels of surplus liquidity on a short-term basis, given the limited alternative investment opportunities.
- During 2011, in anticipation of widening credit spreads and for reasons of general risk management, the Group reduced its holdings in French AFS sovereign bonds. The Group's holdings of German AFS sovereign debt concurrently increased, in line with internal liquidity and risk management strategies.
- Derivatives and repos generally increased, partly as a result of RBS N.V. transfers.

Central and local government and central bank

- Netherlands - lending to the Dutch government increased by £1.6 billion reflecting collateral relating to derivatives and repos.

Financial institutions

- France - most of the lending to banks is to the top three banks.
- Luxembourg - lending to non-bank financial institutions increased by £1.1 billion during 2011, reflecting collateral relating to derivatives and repos.

Corporate

- Corporate lending generally fell in eurozone non-periphery countries, driven by reductions in most sectors, with the largest decline seen in the property sector.

Risk management: Market risk

All the disclosures in this section (pages 144 to 158) are audited, unless indicated otherwise with an asterisk (*).

Market risk arises from changes in interest rates, foreign currency, credit spreads, equity prices and risk related factors such as market volatilities. The RBS Group manages market risk centrally within its trading and non-trading portfolios through a comprehensive market risk management framework. This control framework includes qualitative guidance in the form of comprehensive policy statements, dealing authorities, limits based on, but not limited to, value-at-risk (VaR), stress testing, positions and sensitivity analyses.

Governance

Business structure

The primary focus of the RBS Group's trading activities is to provide an extensive range of debt and equity financing, risk management and investment services to its customers, including major corporations and financial institutions around the world. The RBS Group undertakes these activities organised within the principal business lines: money markets, rates flow trading, currencies and commodities, equities, credit markets and portfolio management and origination.

Financial instruments held in the RBS Group's trading portfolios include, but are not limited to: debt securities, loans, deposits, equities, securities sale and repurchase agreements and derivative financial instruments.

The RBS Group undertakes transactions in financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide margin on a daily basis with cash or other security at the exchange.

The RBS Group also undertakes transactions in financial instruments that are traded over-the-counter (OTC) rather than on a recognised exchange. These instruments range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to meet customer requirements.

Assets and liabilities in the trading book are measured at their fair value. Fair value is the amount at which the instrument could be exchanged in a current transaction. The fair values are determined following IAS 39 guidance, which requires banks to use quoted market prices or, where this is not possible, valuation techniques (models) that make appropriate use of available observable inputs. When marking to market using a model, the valuation methodologies are approved by all stakeholders (trading, finance, market risk, model development and model review) prior to use for P&L and risk management purposes. Any profits or losses on the revaluation of positions are recognised in the daily profit and loss.

Organisation structure

Independent oversight and support is provided to the business by the Global Head of Market & Insurance Risk, assisted by the RBS Group and business Market Risk teams. The head of each business, assisted by a business market risk management team, is accountable for all market risks associated with its activities. The Global Market Risk Committee reviews and makes recommendations concerning the market risk profile across the RBS Group, including risk appetite, risk policy, models, methodology and market risk development issues. The committee meets monthly and is chaired by the Global Head of Market & Insurance Risk. Attendees include respective business market risk managers and Group Market Risk.

Risk management

Key principles

The RBS Group's qualitative market risk appetite is set out in policy statements, which outline the governance, responsibilities and requirements surrounding the identification, measurement, analysis, management and communication of market risk arising from the trading and non-trading investment activities of the RBS Group. All teams involved in the management and control of market risk are required to fully comply with the policy statements to ensure the RBS Group is not exposed to market risk beyond the qualitative and quantitative risk appetite. The control framework covers the following principles:

- Clearly defined responsibilities and authorities for the primary groups involved in market risk management in the RBS Group.
- An independent market risk management process.
- A market risk measurement methodology that captures correlation effects and allows aggregation of market risk across risk types, markets and business lines.
- Daily monitoring, analysis and reporting of market risk exposures against market risk limits.
- Clearly defined limit structure and escalation process in the event of a market risk limit excess.
- Use of VaR as a measure of the one-day market risk exposure of all trading positions.
- Use of non-VaR based limits and other controls.
- Use of stress testing and scenario analysis to support the market risk measurement and risk management process by assessing how portfolios and global business lines perform under extreme market conditions.
- Use of back-testing as a diagnostic tool to assess the accuracy of the VaR model and other risk management techniques.
- Adherence to the Risks Not In VaR (RNIV) framework to identify and quantify risks not captured within the VaR model.
- A new product approval process that requires market risk teams to assess and quantify market risk associated with proposed new products.

Quantitative risk appetite

The Executive Risk Forum (ERF) approves the quantitative market risk appetite for trading and non-trading activities. The Global Head of Market & Insurance Risk, under delegated authority from the ERF, sets and populates a limit framework, which is cascaded down through legal entity, division, business and desk level market risk limits.

At the RBS Group level, the risk appetite is expressed in the form of a combination of VaR, sensitivity and stress testing limits.

A daily report summarises the RBS Group's market risk exposures against the agreed limits. This daily report is sent to the Head of Restructuring & Risk, Global Head of Market & Insurance Risk, business Chief Risk Officers and appropriate business market risk managers.

Legal entities, divisions and lower levels in the business also have an appropriate market risk framework of controls and limits in place to cover all material market risk exposures.

The specific market risk metrics that are appropriate for controlling the positions of a desk will be more granular than the RBS Group level limits and tailored to the particular business.

In line with the overall business strategy to reduce risk exposures, the RBS Group's market risk limits were adjusted down during 2011.

The majority of the RBS Group's market risk exposure is in the GBM and Non-Core divisions and Group Treasury. The RBS Group is also exposed to market risk through interest rate risk on its non-trading activities. There are additional non-trading market risks in the Retail and Commercial businesses of the RBS Group, principally interest rate risk and foreign exchange risk. These aspects are discussed in more detail in Balance sheet management - Interest rate risk on page 47 and structural foreign exchange risk on page 48.

Risk models

VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at a given confidence level. For internal risk management purposes, the RBS Group's VaR assumes a time horizon of one trading day and a confidence level of 99%. The RBS Group's VaR model is based on a historical simulation model, utilising data from the previous two years.

The VaR model has been approved by the FSA to calculate regulatory capital for the trading book. The approval covers general market risk in interest rate, foreign exchange, equity and specified commodity products and specific risk in interest rate and equity products.

The VaR model is an important market risk measurement and control tool. It is used for determining a significant component of the market risk capital and, as such, it is regularly assessed. The main approach employed is the technique known as back-testing, which counts the number of days when a loss (as defined by the FSA) exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.

The FSA categorises a VaR model as green, amber or red. A green model status is consistent with a good working model and is achieved for models that have four or fewer back-testing exceptions in a 12-month period. For the Group's trading book, a green model status was maintained throughout 2011.

The RBS Group's VaR should be interpreted in light of the limitations of the methodology used, as follows:

- Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the two-year time series. Therefore, events that are more severe than those in the historical data series cannot be predicted.
- The use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.
- The RBS Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and, if so, intra-day profit and losses will be incurred.

These limitations mean that the RBS Group cannot guarantee that losses will not exceed the VaR.

The RNIV framework has been developed to quantify those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model, various non-VaR controls (for example, portfolio size limits, sensitivity limits, triggers or stress limits) are in place.

Risk models are developed both within business units and by RBS Group functions. Risk models are also subject to independent review and sign-off to the same standard as pricing models. Meetings are held with the FSA every quarter to discuss the traded market risk, including changes in models, management, back-testing results, risks not included in the VaR framework and other model performance statistics.

A number of VaR model and methodology enhancements were introduced during 2011. The quality of the market data time series used in the ABS mortgage trading business was improved, moving from interpolated weekly data to daily observed time series. This change has improved the accuracy of the correlation between the different time series in the daily data. Additionally, the basis modelling between cash and derivatives has been refined by introducing additional time series for the sub-prime and subordinated residential bonds, reducing the over-reliance on the commercial mortgage basis which was used as a conservative proxy.

Risk management: Market risk continued

A collateralised based discounting approach has been implemented for the vast majority of the collateralised positions in place of the previous LIBOR-based discounting approach.

Following the implementation of CRD III, three new models - for stressed VaR, incremental risk charge and all price risk (see more below) - have been fully approved by the UK regulator and form part of the capital and risk management framework from 31 December 2011 onwards.

Basel 2.5 (CRD III)*

The aim of CRD III is to improve the financial strength of institutions by increasing the financial resources required against certain risks in the trading book.

The Group is required to calculate: (i) an additional capital charge based on a stressed calibration of the VaR model - stressed VaR; (ii) an incremental risk charge to capture the default and migration risk for credit risk positions in the trading book; and (iii) an all price risk measure for correlation trading positions, subject to a capital floor that is based on standardised securitisation charges.

The capital charges associated with these new models as at 31 December 2011 are shown in the table below:

	Total £m
Stressed VaR	1,526
Incremental risk	329
All price risk	297

All other aspects of the CRD III rule changes have also been implemented.

Pricing models

Pricing models are developed and owned by the front office. Where pricing models are used as the basis of books and records valuations, they are subject to oversight and approval by Asset Level Modelled Product Review Committees (ALMPRCs). These committees prioritise models for independent validation by Group Risk Analytics (GRA) taking into consideration both the materiality of risk booked against the model and an assessment of the degree of model risk (i.e. valuation uncertainty arising from choice of modelling assumptions). The GRA review aims to quantify model risk by comparing model outputs against those of alternative independently developed models, the results of which are used by Market Risk to inform risk limits and by Finance to inform model reserves.

In 2011, updated RBS Group Standards for the development, testing and validation of derivative pricing models were agreed and implemented. Revisions to the model validation framework ensure that all new models and model changes are reviewed by Market Risk and Finance and, subject to materiality, independently validated by GRA. Model governance is through the ALMPRCs, which are newly established sub-committees of the overall GBM Modelled Product Review Committee (previously called the RBS Group Model Product Review Committee).

Stress testing

The RBS Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of the RBS Group's trading portfolios. The RBS Group calculates sensitivity analysis, historical stress tests and bottom-up stress testing.

Sensitivity analysis measures the sensitivity of the current portfolio of positions to defined market risk factor movements. These stresses are of a smaller magnitude compared to historical or bottom-up stress testing and are subject to the RBS Group Market Risk limit framework.

Historical stress tests calculate the changes in the portfolio valuations that would be generated if the market movements that occurred during historical market events were repeated.

Bottom-up stress testing is based on analysing the market risk exposures by risk factors and stressing each risk factor based on consultation with risk managers, economists and front office. The tests may be based on an economic scenario that is translated into risk factor shocks by an economist or by risk managers and front office as a means of assessing the vulnerabilities of their book.

The Global Market Risk Stress Testing Committee reviews and discusses all matters relating to market risk stress testing. Stress test exposures are discussed with senior management and relevant information is reported to the RBS Group Risk Committee, the ERF and the Board. Breaches in the RBS Group's market risk stress testing limits are monitored and reported.

In 2011, the market risk stress testing framework was further developed and enhanced. Reverse stress testing has been implemented, which is designed to assess the plausibility of stressing market risk factors until the loss reaches a given threshold.

In addition to VaR and stress testing, the RBS Group calculates a wide range of sensitivity and position risk measures, for example interest rate ladders or option revaluation matrices. These measures provide valuable additional controls, often at individual desk or strategy level.

* unaudited

Trading VaR

The table below analyses the VaR for the Group's trading portfolios segregated by type of market risk exposure.

	2011				2010				2009			
Trading VaR	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	52.9	68.3	77.8	28.1	51.0	54.5	80.9	32.2	57.4	50.3	108.2	29.0
Credit spread	82.4	73.7	150.6	47.6	161.7	130.6	237.0	109.0	156.2	176.3	249.2	76.7
Currency	9.6	16.1	18.8	5.2	17.7	9.8	28.6	8.9	17.2	19.9	33.6	9.8
Equity	6.7	7.2	11.1	3.5	6.1	6.9	13.2	2.5	9.5	6.5	18.0	3.7
Commodity	1.0	2.5	6.0	—	9.6	0.4	18.1	0.3	14.3	8.9	31.9	6.3
Diversification (1)		(51.1)				(55.3)				(81.5)		
	107.8	116.7	174.9	61.8	170.1	146.9	254.7	110.8	164.3	180.4	238.3	73.9

Note:

(1) The Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, industry counterparties, currencies and regions. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. Diversification has an inverse relationship with correlation. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

Key points

- The credit spread risk exposure significantly decreased in 2011, primarily due to the reduction in ABS trading inventory in Core and the restructuring of some monoline hedges for banking book exposures in Non-Core, in line with the overall business strategy to reduce risk exposures.

- The credit spread VaR also decreased due to the adoption of a more appropriate daily time series for sub-prime/subordinated RMBS and as the period of high volatility relating to the 2008/2009 financial crisis dropped out of the VaR calculation.

- At the end of 2010, the commodity VaR was materially lower than the average for that year as a result of the completion of the sale of the Group's interest in the RBS Sempra Commodities joint venture. The commodity VaR increased slightly from mid September in 2011, due to improvements in capturing risk for commodity futures and indices.

- The average interest rate trading VaR was relatively unchanged between 2011 and 2010.

Non-trading portfolios

The table below analyses the risk for the Group's non-trading portfolios.

VaR is not always the most appropriate measure of risk for assets in the banking book and particularly for those in Non-Core, which will diminish over time as the asset inventory is sold down.

In order to better represent the risk of the non-traded portfolios, the table below analyses the VaR for the non-trading portfolios but excludes the Non-Core Structured Credit Portfolio (SCP). These assets are shown separately on a drawn notional and fair value basis by maturity profile and asset class. The risk in this portfolio is managed on both a third party asset and RWA basis.

Also excluded from the non-trading VaR are the loans and receivable products that are managed within the credit risk management framework.

	2011				2010				2009			
Non-trading VaR	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	6.3	9.0	9.1	4.2	8.0	6.1	19.1	4.5	12.7	12.0	27.5	7.6
Credit spread	14.4	11.2	26.1	8.4	32.5	13.3	101.2	12.1	81.7	99.9	134.4	39.7
Currency	2.0	3.9	5.5	—	2.1	1.9	6.1	0.3	1.2	0.5	3.9	0.2
Equity	—	0.1	0.2	—	—	—	0.7	—	—	—	0.1	—
Diversification (1)		(12.4)				(5.2)				(18.5)		
	14.8	11.8	26.4	9.3	31.2	16.1	98.2	14.4	79.2	93.9	124.0	45.7

Note:

(1) The Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, industry counterparties, currencies and regions. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. Diversification has an inverse relationship with correlation. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

Risk management: Market risk continued

Key points

- The Group's total non-trading VaR at 31 December 2011 was lower than at 31 December 2010, due to the exceptional volatility of the 2008/2009 financial crisis dropping out of the two-year time series data used in the VaR calculation.
- The maximum credit spread VaR in 2010 was considerably higher than the average for the year, primarily due to the disposal of a large portfolio of illiquid available-for-sale securities.

Structured credit portfolios

	Drawn notional					Fair value				
	CDOs	CLOs	MBS (1)	Other ABS	Total	CDOs	CLOs	MBS (1)	Other ABS	Total
2011	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
1-2 years	—	—	—	27	27	—	—	—	22	22
2-3 years	—	—	10	196	206	—	—	9	182	191
4-5 years	—	37	37	95	169	—	34	30	88	152
5-10 years	32	503	270	268	1,073	30	455	184	229	898
>10 years	2,180	442	464	593	3,679	766	371	291	347	1,775
	2,212	982	781	1,179	5,154	796	860	514	868	3,038
2010										
1-2 years	—	—	—	47	47	—	—	—	42	42
2-3 years	85	19	44	98	246	81	18	37	91	227
3-4 years	—	41	20	205	266	—	37	19	191	247
4-5 years	16	—	—	—	16	15	—	—	—	15
5-10 years	98	466	311	437	1,312	87	422	220	384	1,113
>10 years	412	663	584	550	2,209	161	515	397	367	1,440
	611	1,189	959	1,337	4,096	344	992	673	1,075	3,084
2009										
1-2 years	—	—	—	81	81	—	—	—	68	68
2-3 years	40	—	—	19	59	24	—	—	18	42
3-4 years	19	18	42	99	178	16	17	31	76	140
4-5 years	17	47	36	332	432	3	41	29	275	348
5-10 years	107	685	424	521	1,737	90	594	251	394	1,329
>10 years	594	1,114	820	573	3,101	193	896	468	325	1,882
	777	1,864	1,322	1,625	5,588	326	1,548	779	1,156	3,809

Note:
(1) Mortgage-backed securities (MBS) include sub-prime residential mortgage-backed securities (RMBS) with a drawn notional amount of £401 million (31 December 2010 - £471 million; 2009 - £682 million) and a fair value of £252 million (31 December 2010 - £329 million; 2009 - £415 million), all with residual maturities of greater than 10 years.

The Structured Credit Portfolio is within Non-Core. The risk on this portfolio is not measured or disclosed using VaR, as the RBS Group believes this is not an appropriate tool for the banking book portfolio, which comprises illiquid debt securities. These assets are reported on a drawn notional and fair value basis, and managed on a third party asset and RWA basis.

Key points

- The increase in total and collateralised debt obligation (CDO) drawn notional year-on-year is due to the inclusion of banking book exposures that were previously hedged by monoline protection. As a result of the restructuring of some monoline protection, those previously protected assets are now reported on a drawn notional and fair value basis.
- The overall reduction in collateralised loan obligation (CLO), MBS and other ABS drawn notional is due to the amortisations and pay-downs over the year in line with expected amortisation profiles. In addition to this, fair value has declined due to falling market prices.

* unaudited

Risk management: Operational risk*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It is an integral and unavoidable part of the RBS Group's business as it is inherent in the processes it operates to provide services to customers and meet strategic objectives.

Operational risk management

The objective of operational risk management is not to remove operational risk altogether, but to manage it to an acceptable level, taking into account the cost of minimising the risk against the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

The RBS Group delivered significant improvements in its operational risk framework during 2011, enhancing its management of operational risks. This is particularly evident in respect of risk appetite, the RBS Group Policy Framework, risk assessment, scenario analysis and statistical modelling for capital requirements. Further development will continue in 2012.

Details of these, and other elements of operational risk management, including developments undertaken and planned, are set out below along with the key processes through which the RBS Group manages operational risk.

Governance, structure and risk appetite

Governance and structure

Group Operational Risk is an independent function reporting to the Deputy Group Chief Risk Officer. Group Operational Risk is responsible for the design and maintenance of the operational risk policy standards (ORPS).

The ORPS are incorporated in the Group Policy Framework (GPF). They provide the direction for delivering effective operational risk management and are designed to allow the consistent identification, assessment, management, monitoring and reporting of operational risk across the RBS Group.

The Operational Risk Executive Committee, which was formed in January 2011, oversees the operational risk framework and profile of the Group in line with the agreed risk appetite. It provides guidance, oversight and advice. It also escalates and reports any issues or areas of concern to the Board Risk Committee and to other senior committees.

Risk appetite

The RBS Group's operational risk appetite statement is agreed by the RBS Group Board. It comprises a number of specific measures of risk, such as:

- the maximum operational risk losses the RBS Group is prepared to accept. This is expressed as a percentage of the RBS Group's estimated gross income for the year ahead; or

- the value of a single extreme but plausible operational impact. These are identified and assessed through the scenario analysis programme (refer to Scenario analysis on page 150).

To ensure the RBS Group operates within the set risk appetite, the high-level statements are supplemented by specific tolerances for different types of operational risk. The GPF sets out how to manage risk within acceptable limits, which in turn enables the RBS Group to operate within the overall risk appetite and the specific tolerances. The RBS Group has a zero tolerance for risks such as breaches of laws and regulations.

Operational risk cycle and key management tools

The operational risk cycle comprises four stages:

- Identification of risks;

- Assessment or measurement of the scale of risks;

- Management or control of risks to prevent their recurrence or minimise the potential impact; and

- Monitoring and reporting of risks.

Although the operational risk tools encompass all stages of the risk cycle, they can be broadly categorised as follows:

Identification and assessment

Risk and control assessments

Controls that are effective without being excessive ensure the RBS Group retains its reputation for efficient customer service and security. Risk and control assessments are used to identify and assess material operational risks and key controls across all business areas. The process is designed to ensure that risks are effectively managed in line with stated risk appetite, prioritised and documented. Controls are tested frequently with a view to ensuring they remain fit for purpose and operate effectively. The RBS Group's risk assessment methodology was enhanced during 2011 to ensure a more consistent approach to identifying risks and their associated controls and measuring expected loss. Risk assessments consider the new firm-wide taxonomy and will soon be captured in the RBS Group-wide repository for operational risk.

Risk assessments are often conducted in a workshop environment, bringing together subject matter experts from across the division and key functions. By sharing expertise, they can identify improvements to risk identification, measurement and control. Risk governance is reviewed regularly ensuring that there is clarity and ownership of key risk areas. Through coming together and sharing knowledge, participants gain a broader understanding of how their work fits together.

Risk management: Operational risk* continued

RBS Group new product approval process

The RBS Group's new product approval process ensures there is a consistent process to identify, assess and approve the risks associated with new products.

Following the conclusion of reviews conducted during 2011, enhancements will be made during 2012 to the product governance forums, to provide earlier engagement between the business, RBS Group and divisional risk teams and subject matter experts when assessing whether the risks associated with new products are in line with appetite. The forums will be supported by an upgrade to the RBS Group's key tools used to manage and report on new product approval.

Scenario analysis

Scenario analysis is used to assess the possible impact of extreme but plausible operational risk loss events. It provides a forward-looking basis for managing exposures beyond the RBS Group's risk appetite. The methodology provides a structured and consistent approach to scenario scoping and measurement. A significant portfolio of scenarios was developed in 2011 across divisions, covering material risks to which the RBS Group is exposed. RBS Group-wide scenarios are centrally scoped and workshops are facilitated by Group Operational Risk in conjunction with functions and policy owners, before being assessed by divisions to derive specific impact estimates. This also allows the RBS Group to review operational risk impacts as they arise from macroeconomic stresses (e.g. eurozone distress) in a time-efficient and effective manner.

By assessing extreme but plausible events, scenario analysis is an important component in the operational risk framework, providing senior management with valuable insight into systemic risk that could significantly impact its financial performance if these events were to occur. Using its forward-looking nature, senior management cross-examines various risk topics against a range of circumstances and assumptions.

Similar to risk assessments, scenarios are run in a workshop environment, bringing business, risk and control experts together and thereby ensuring that risk management is approached holistically.

Stress testing

During the economic downturn, there has been an increase in large operational risk losses within the banking industry.

Consequently, the RBS Group enhanced its approach to assessing the impact of the economic cycle on its operational risk losses in 2011, by specifically assessing the impact of the FSA's published Anchor II scenario, which describes a series of country-specific shocks around the world on:

- Expected levels of operational risk losses; and
- Unexpected levels of operational risk losses, by stressing its existing portfolio of operational risk scenarios.

The impact of the FSA Anchor II scenario on the RBS Group's operational risk capital, as calculated under the standardised approach, was also projected based on the outputs of the RBS Group's stress-testing exercises.

During 2012, additional operational risk scenarios will be run, further broadening the RBS Group's understanding of its exposures to tail risks.

Management, monitoring and reporting

Issues management

The objective of the operational risk issues management framework is the adoption of a consistent approach to the identification, capture, classification, monitoring, closure and acceptance of operational risk issues and associated actions across the RBS Group, in accordance with the RBS Group's three lines of defence model.

Significant enhancements were made to the issues management process during 2010 including rollout of a single repository for capturing issues and actions; mapping issues to GPF; and a tightening of governance over issue management. These improvements were further embedded during 2011, through training and assurance reviews.

The enhancements have improved risk management by allowing RBS Group-wide analyses of all operational risk issues. In certain cases, this has resulted in global assurance reviews focused on specific areas, helping to identify operational risks to be mitigated.

Event and loss data management

Event and loss data management (ELDM) covers the discovery, escalation, capture, investigation, approval and closure, and reporting and analysis of operational risk events and loss data. It also provides for the clear, simple, quick and consistent communication of operational risk events that meet defined threshold criteria to those members of the RBS Group's senior management and Executives who need to know of these events.

During 2011, an enhanced ELDM process was launched to promote consistency in the management of operational risk events and the collection of loss data across the RBS Group. It included the introduction of a single repository to capture all events and loss data in the RBS Group and the establishment of thresholds above which operational risk events will trigger a risk assessment.

The improvements in approach, and use of a single RBS Group-wide database, have enhanced the completeness and accuracy of the RBS Group's internal loss data, and therefore better inform the RBS Group's operational risk profile.

At the start of 2012, the robustness of the historic data migrated into the new repository will be reviewed to confirm its suitability as an input to capital modelling. In addition, the process will be further enhanced to ensure continued compliance with changing regulatory and industry standards regarding the collection of internal loss data.

* unaudited

Insurance
The RBS Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements. Insurance is used as a risk mitigation tool in controlling the RBS Group's exposures, providing protection against financial loss once a risk has crystallised.

Reporting and monitoring
Reporting and monitoring forms an integral part of all of the RBS Group's operational risk management processes, which are designed to ensure that risks and issues are identified, escalated and managed on a timely basis. Exposures for each division are reported through monthly risk and control reports, which provide detail on the risk exposures and action plans. Enhancements made to reporting and monitoring during the year include analysing operational risk events, losses and issues against the GPF components; this has led to better identification of areas requiring management focus and remediation.

Control environment certification
Control environment certification (CEC) is used by the RBS Group Executive management to review and assess its internal control framework, and provide a self-certification of its current state. It demonstrates to the RBS Group and the RBS Group's key stakeholders that it is operating a robust control framework, with mechanisms in place to understand and manage its risks, and to drive action to resolve areas of weakness or concern.

CEC provides a twice-yearly assessment of the robustness of the Group's internal control environment including:

- compliance with the GPF and key divisional/functional policy standards;
- compliance with the requirements of the UK Corporate Governance Code; and
- effectiveness of the risk frameworks, culture and governance structures for each division or function.

CEC was enhanced during 2011 to improve the quality and depth of certification, and to implement a risk-based approach to the analysis of policy compliance. The enhancements have delivered a greater degree of analysis of the key risk areas for each business and Group policy standard owner. Improved alignment with RBS Group Internal Audit has been delivered through the implementation of a common rating system for the assessment of the control environment, and CEC outcomes are reported at both the divisional risk and audit committees and the RBS Group Audit Committee.

Capital model development
At the end of 2011, the RBS Group started to develop a statistical modelling capability for operational risk based on the requirements set out under the Basel II advanced measurement approach. The model is a hybrid encompassing internal and external loss data as well as scenarios. Business environment and internal control factors will be utilised when constructing scenarios and allocating capital. Development activities in 2011 focused on building the standalone loss data and scenario components within the model; integration activities, correlation and allocation will continue in 2012. Final model validation is expected to take place during 2012.

Compliance risk*
Compliance risk arises from non-compliance with national and international laws, rules and regulations. The RBS Group believes that being a compliant organisation is fundamental to protecting sustainable growth, rebuilding its reputation and maintaining stakeholder confidence.

The regulatory environment remained highly challenging during 2011, as policymakers and regulators continued to strengthen regulation and supervision in response to the events of 2007/2008 and subsequent economic and financial stress.

The regulatory agenda - largely framed by the G20 but with many instances of EU and national initiatives - constitutes the most sweeping set of changes seen in many decades. At 31 December 2011, the RBS Group was managing some 140 major regulatory or legislative policy initiatives; during the year as a whole, it had also reviewed over 300 consultations in its core markets. In addition to these changes, many supervisory authorities also continued to intensify their ongoing level of scrutiny and intervention.

These trends have posed multiple challenges for banking groups, including the RBS Group, namely:

- tracking, analysing and engaging with policymakers on proposed changes;
- implementing change programmes to ensure compliance with new requirements;
- revisiting strategy, business and operating models in response to the new environment; and
- driving through cultural and other changes to minimise compliance and enforcement risks.

Below is an outline some of the key developments in the regulatory environment that took place during 2011. An explanation of how the RBS Group manages compliance risk begins on page 154.

Risk management: Compliance risk* continued

Global regulatory developments

The global agenda continues to be guided by the G20, drawing on the original action plan for strengthening financial stability agreed by G20 leaders at the November 2008 Washington summit. During 2011, G20 countries continued to implement various elements of this action plan, culminating in the G20 leaders' summit held in Cannes in November 2011.

A progress report on the action plan was issued at the Cannes summit. Key developments during 2011 included the following:

Basel III

Following publication by the Basel Committee on Banking Supervision in December 2010 of rules text for the new Basel III capital and liquidity framework, work during 2011 focused on finalising the remaining elements of policy and preparing for implementation. Highlights were:

- The issuance of minimum requirements regarding the loss absorbency of capital instruments at the point of non-viability (January 2011);
- The finalisation of rules for the capital treatment of counterparty credit risk in bilateral trades (June 2011);
- Technical changes to Basel III relating to the treatment of trade finance, aimed at helping promote trade with low-income countries (October 2011);
- Further work on the capitalisation of bank exposures to central counterparties (November 2011); and
- A Basel Committee paper proposing that debit valuation adjustments for over-the-counter derivatives and securities financing transactions should be fully deducted from Common Equity Tier 1 capital (December 2011). The RBS Group is evaluating the potential impact of this proposal.

Systemic financial institutions

The main focus of policy development at the global level during 2011 was delivering on the G20-mandated target of agreeing a framework by the end of 2011 for dealing with global systemically important financial institutions (G-SIFIs). This target was met, with the Cannes summit endorsing:

- a new Financial Stability Board (FSB) international standard, "The Key Attributes of Effective Resolution Regimes for Financial Institutions", which amongst other things provides a benchmark for national resolution regimes, as well as mandatory requirements for resolvability assessments and recovery and resolution plans for each G-SIFI; and
- a new Basel Committee framework for identifying an initial list of global systemically important banks (G-SIBs), and applying to these an additional common equity capital requirement, above the Basel III minimum standards, rising from 1% to 2.5% of risk-weighted assets in line with their systemic impact.

The names of the initial list of G-SIBs (though not their ranking) were published by the FSB at the end of the summit: RBS is included in the 29 names.

Shadow banking

In response to concerns that heightened regulation of banks should not lead to risks being displaced into un-regulated sectors, regulatory authorities started to pay growing attention to the "shadow banking" system during 2011. This term broadly refers to entities and financial transactions that fall outside the scope of existing financial (banking) regulation, such as hedge funds, money market funds and structured investment vehicles.

Work was initiated in five areas to assess the need for regulatory intervention, and this topic is likely to attract even more attention during 2012, when recommendations for action are expected.

The five areas include: banks' interactions with shadow banking entities; ways to reduce the susceptibility of money market funds to runs; the regulation of other shadow banking entities on prudential grounds; retention requirements and transparency in securitisation; and the possible regulation of margins and haircuts in securities lending and repos.

Other

During 2011, the authorities started to pay more attention to the consistent implementation of G20 and FSB financial reforms, with plans developed to focus more on monitoring and the public reporting of implementation progress. Although a priority, little progress was made during 2011 on developing a global policy framework for over-the-counter derivative reform, so as to help align ongoing activity in this space, particularly in the US and the EU (see below).

EU regulatory developments

The EU regulatory agenda in 2011 continued to focus mainly on prudential and market structure measures; retail issues also started receiving more attention and are likely to come under increased focus in 2012. Key highlights were as follows:

New regulatory architecture

2011 saw the implementation of a new EU regulatory architecture, with the start of operations of the European Systemic Risk Board (ESRB) and three supervisory authorities: the European Banking Authority (EBA), the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority.

The new framework marks a significant transfer of power to the three supervisory authorities, particularly with respect to detailed rule-making, where over time they will be issuing "binding technical standards" across a range of policy areas that will replace national rules.

However, an early preoccupation of the new regulatory authorities was the eurozone crisis. In particular, the EBA was heavily engaged in overseeing the stress testing of EU banks, including UK groups.

* unaudited

Prudential and related reforms

A key focus here during 2011 was work on amending the EU's Capital Requirements Directive (CRD): a key step in that process was the publication of draft legislative text in September, the so-called CRD IV package, which is expected to be finalised during 2012 and will implement Basel III in the EU.

Another key area of work was the EU's "crisis management" legislative package, aimed at dealing with issues similar to those addressed by the FSB work on G-SIFIs. An early 2011 EU Commission consultation included proposals on enhanced supervision and early powers of intervention; recovery and resolution planning; resolution frameworks; resolution funds and debt write down (but not capital surcharges). Draft legislation to implement these measures was at the time of writing expected to be issued in early 2012, after several postponements.

Other initiatives in the prudential space have included, notably, continued work on developing the Solvency II framework for insurers; the development of legislative proposals on corporate governance in financial institutions; and the further development and UK implementation of the EU's common reporting framework (COREP) for banks.

Market and structural reforms

Key developments in this space included:

- *European Markets Infrastructure Regulation (EMIR)* - negotiations continued during 2011 on this draft Regulation on OTC derivatives, central counterparties and trade repositories, which represents a major element of the financial crisis regulatory response agenda. Agreement was close to being reached in early 2012.
- *Markets in Financial Instruments Directive Review (MiFID2)* - the EU review of this directive, which sets the framework for investment markets, culminated in the publication of draft legislative text in October 2011.
- *Financial Transaction Tax (FTT)* - the EU Commission published proposals for an FTT, which would see trades in bonds and shares taxed at 0.1% and complex derivatives taxed at 0.01%. However, the proposal requires approval from all 27 EU members, but is opposed by some, including notably the UK, which reduces the likelihood of it being imposed.
- *Other initiatives* - these have included changes to the market abuse regime and prospectus requirements, initiatives on short-selling, further legislative developments impacting credit rating agencies and changes to depositor and investor protection.

EU retail market reforms

Notwithstanding the focus on prudential and market reforms in response to the financial crisis, the EU Commission during 2011 also continued to work on a wide range of retail agenda initiatives. These included a draft legislative proposal for a mortgage credit directive, with a focus on responsible lending and borrowing; the development of proposals on collective redress; and ongoing discussions with the banking industry to improve the transparency and comparability of bank fees. The RBS Group also continued to work on implementing the requirements coming into force at end-2011, contained in the EU Payment Services Directive.

UK regulatory developments

UK regulatory developments during 2011 continued to be extensively determined by global and EU developments, with UK regulators working to implement requirements coming into force, such as the CRD III package of reforms, and actively participating in policy development at the EU and global levels. In addition, there were a number of developments specific to the UK.

Independent Commission on Banking (ICB)

The ICB was appointed by the UK Government in June 2010 to review possible structural measures to reform the UK banking system in order to promote, amongst other things, stability and competition. It published its final report to the Cabinet Committee on Banking Reform on 12 September 2011 (the "Final Report"), which set out the ICB's views on possible reforms to improve stability and competition in UK banking.

The Final Report made a number of recommendations, including in relation to: (i) the implementation of a ring-fence of retail banking operations; (ii) increased loss-absorbency (including bail-in, i.e. the ability to write down debt or convert it into an issuer's ordinary shares in certain circumstances); and (iii) promotion of competition.

On 19 December 2011, the UK Government published its response to the Final Report and indicated its support and intention to implement the recommendations set out in the Final Report substantially as proposed. The Government indicated that it would work towards putting in place the necessary legislation by May 2015, requiring compliance as soon as practicable thereafter and a final deadline for full implementation of 2019.

The RBS Group will continue to participate in the debate and to consult with the UK Government on the implementation of the recommendations set out in the Final Report and in the Government's response.

Regulatory architecture reforms

Work on the UK coalition government's plans for reforming the UK's regulatory structure continued during 2011, with major consultations from HM Treasury, a number of calls for evidence from parliamentary committees and the publication of a draft Bill for pre-legislative scrutiny purposes in June 2011. In addition, the FSA and Bank of England published policy documents setting out initial high-level policy thinking on the new regulatory bodies; and an interim version of the Financial Policy Committee started to meet in advance of legislation being enacted. However, the timescale for completing the legislative process and fully implementing the new framework has been delayed until 2013 (from the end of 2012).

Payment Protection Insurance (PPI)

The Judicial Review requested by the British Bankers' Association (BBA) in respect of the FSA's policy statement on PPI complaints and guidance published by the Financial Ombudsman Service concluded in April with an adverse ruling. The BBA and the banks concerned decided not to appeal and the UK banks including RBS Group have moved towards settling claims in accordance with the FSA's revised principles. Under the terms of a waiver granted by the FSA, RBS Group, along with the rest of the industry, has had to deal with the backlog of complaints within specified timescales.

Risk management: Compliance risk* continued

Retail conduct issues

In addition to EU retail initiatives, the UK authorities continued to pursue additional issues during 2011. These included initiatives relating to financial inclusion, where the Government is seeking to widen access to bank accounts; the implementation of the recommendations of the Retail Distribution Review relating to the provision of investment advice; ongoing work on the Mortgage Market Review; the establishment of a Steering Group by HM Treasury to devise a suite of simple financial products; and a review of the insurance products that form part of packaged current accounts.

Supervisory developments

In line with that of other regulatory authorities, the FSA's supervisory scrutiny has intensified in response to the financial crisis and ongoing market stresses. Front-end supervisory resources have been increased and existing tools have been used more frequently and robustly – evidenced, for instance, in terms of the heightened number of information requests, the increased deployment by the FSA of skilled person reports as well as the increased fines charged against the industry. Across the industry fines for 2011 totalled £66.1 million versus £5.3 million in 2007. In addition, the FSA continued to develop new supervisory approaches, notably its Core Prudential Programme for those major financial institutions it oversees, which includes in-depth rolling thematic assessments on governance, business models, risk management, capital and liquidity.

US regulatory developments

In the US, activity was dominated by rulemaking following the 2010 Dodd-Frank Act. Although there was some slippage on, for example, derivatives rules, output from the authorities has still been considerable.

Key final rules were issued on a range of issues, including living wills, the Collins Amendment (which floors capital requirements at the level of Basel II advanced approaches), rights for shareholders to have an advisory "say on pay", and limits on debit card interchange fees. Meanwhile the new Consumer Financial Protection Bureau was established on the Act's first anniversary on 21 July 2011.

High-profile draft rules that were published included the Volcker Rule (limiting proprietary trading and investments in private equity or hedge funds), the securitisation risk retention rule and rules applicable to Nationally Recognized Statistical Rating Organizations (credit rating agencies).

Compliance risk management

The RBS Group manages its compliance risk through a regulatory affairs and compliance framework that seeks to ensure it complies with all banking, securities, insurance and anti-money laundering regulations, defined by over 120 different regulatory bodies and central banks, wherever the RBS Group operates. This framework is managed by the RBS Group's Regulatory Affairs and Compliance functions and includes: the tracking and management of regulatory developments; regulatory relationship management; the implementation of global compliance risk policies; assurance and monitoring; training and awareness; and mitigation activity.

* unaudited

Against the backdrop of intensified regulatory pressure, RBS Group Regulatory Affairs has managed the increased levels of scrutiny and legislation by increasing the capacity of its team, as well as improving and refining its operating model, tools, systems and processes. Simultaneously, in response to enforcement actions against the RBS Group in 2010 and 2011, RBS Group Compliance initiated and led large-scale remediation and infrastructure changes, driving both the definition and the proactive management of conduct risk.

Management of regulatory change

The early identification and effective management of changes in legislative, regulatory and other requirements that may impact the RBS Group is critical to the successful mitigation of compliance risk.

RBS Group Regulatory Affairs maintains a well-established policy and supporting processes for the identification and management of such changes across the RBS Group. RBS Group Board and Executive Committee oversight is supported by a Prudential Regulatory Developments Executive Steering Group, which was formed in early 2010 to provide a specific focus on a range of key regulatory changes. Communication and coordination were strengthened in 2011 with the formalisation of two RBS Group-wide forums, one focusing on prudential and wholesale market issues, the other on retail conduct issues. In addition, a divisional Heads of Regulatory Developments forum was established, and RBS Americas' regional governance strengthened.

Reporting and internal communications activity expanded in 2011 in response to the growing regulatory change agenda. This included:

- The enhancement of quarterly reporting to the RBS Group Audit Committee, with a particular focus on tracking progress on compliance readiness programmes implementing new requirements;
- Six-monthly reporting to the RBS Board Risk Committee, in addition to the standard monthly risk reports produced for the RBS Board and other governance committees; and
- Increased communications, such as the development of a fortnightly Regulatory Affairs Flash Report, circulated widely across the RBS Group, which captures key regulatory developments and relationship topics.

Regulatory relationship management

The Regulatory Relations Forum, chaired by RBS Group Regulatory Affairs, meets fortnightly and now has global coverage with representatives from all divisions and regions. It facilitates the sharing of key regulatory engagements and the lessons learned from them.

Quarterly reporting to the RBS Group Audit Committee captures all material regulatory reviews and investigations and upstream regulatory developments worldwide, as well as tracking the status and trends in key regulatory relationships.

Other key regulatory policies, specifically 'RBS Group Relationships with Regulators' and 'Political, Legislative and Regulatory Environment', were reviewed and re-launched. Each incorporates a new risk appetite statement, a benchmarking exercise against the RBS Group's peer banks and, for the latter, an end-to-end review and mapping of the upstream risk management process.

Recovery and Resolution Planning

The RBS Group considers effective resolution regimes, coordination between regulators, and recovery and resolution planning, to be important components of an extensive reform agenda to improve safety and stability within the banking industry. Accordingly, the RBS Group recognises the potential value of Recovery and Resolution Plans (RRPs) as mechanisms for preparing banks to deal with: severe stress events (through a range of developed recovery options in the Recovery Plan); and ensuring authorities will have all the critical information they need to identify and carry out appropriate resolutions in the event of failure (the Resolution Plan).

To ensure effective management of financial stability across jurisdictions, and to avoid duplication and inefficiency for cross-border banks, it is important that the approach, content and role of RRPs are globally consistent across jurisdictions.

The RBS Group intends to sustain its strong momentum on the development of RRPs. As well as working with the UK authorities, the RBS Group will continue to work with global policy developers in order to contribute to the development of RRPs in other jurisdictions, in particular within the EU and the US. The timeframes for the development of RRPs in these regions are considerably longer than in the UK, and it will be important to ensure that a consistent policy approach and format are adopted if the RRPs of UK-based global banks are to meet local requirements, and do not have to be redrawn or duplicated.

Global compliance risk and compliance policies

Within the RBS Group Policy Framework, compliance risk and compliance policies define minimum standards to which all businesses must adhere. The policies are primarily driven by the rules and regulations set by the FSA, the RBS Group's lead regulator. However, these global minimum standards are supplemented, where appropriate, by divisional policies to meet local product or market requirements.

In compliance risk management, the term 'conduct risk' is used to refer to the risk of breaches of: (a) regulation or law; or (b) regulatory expectation. This is distinguished from 'prudential risk', i.e. compliance risks related to capital management, liquidity, credit risk, operational risk and market risk. A significantly enhanced compliance / conduct policy structure was outlined during 2011. It is aligned to a new Conduct Risk Appetite statement as well as the expected direction of the new Financial Conduct Authority (FCA), which will be one of the successors of the FSA. As a result, in future, it will be possible to assess the pan-Group risk profile for conduct risk against its risk appetite. In addition, it will be possible to provide more detailed policy direction to divisions on key areas of conduct risk.

Assurance and monitoring

Assurance and monitoring activities are essential to ensure that the Group can demonstrate compliance with existing rules and regulations.

During 2011, a 'heatmap' of the key inherent conduct risks across all the Group's global businesses, reflecting both internal and external change and divisional priorities, was developed. This, in turn, drove a comprehensive programme of assurance reviews across the RBS Group. These reviews introduced a global, end-to-end thematic approach, looking at customer outcomes as well as process adherence. In addition to immediate issues, for which action plans were developed, the reviews identified a number of wider themes that required a more strategic approach.

Training and awareness

Maintaining compliance with existing rules and regulations requires continued investment in professional training, as well as maintaining risk awareness. During 2011, the RBS Group focused on strengthening the capabilities of its compliance risk functions, at both RBS Group and divisional level. The RBS Group facilitates extensive compliance training through computer-based RBS Group Policy Learning modules, with each one designed to promote the relevant regulatory RBS Group Policy Standard.

To support the professional development of the RBS Group's compliance teams, it also has a comprehensive and progressive training programme that is deployed globally. All of the RBS Group's regulatory staff are actively engaged in compliance e-learning, which incorporates a mandatory 'essentials' course, and the RBS Risk Academy, through which all staff are required to complete foundation courses in other risk disciplines, such as operational risk, market risk and retail credit risk. Formal training is supplemented by more informal regulatory familiarisation; this is designed to share knowledge, and support both personal development and technical training across the wider risk community.

Anti-Money Laundering

During 2011, RBS continued to enhance its Anti Money Laundering (AML) Change Programme across the RBS Group. Key developments include:

- A new cohesive target operating model to support the capability required and reviewed divisional AML capabilities against the target operating model to identify and analyse gaps;

- A framework for understanding and managing compliance and conduct risk, including the introduction of a clear RBS Group-level conduct risk appetite statement and the design of a new conduct risk policy framework; and

- An enhanced global whistle-blowing service called 'Right Call' that allows all employees, irrespective of location, to escalate any concerns outside of their normal line management. Whistle-blowing call volumes have increased since the launch and the new framework is a further positive step to help the RBS Group identify and manage compliance risk.

Risk management: Reputational risk*

Reputational risk is the risk of brand damage arising from financial and non-financial events due to a failure to meet stakeholders' expectations of the RBS Group's performance and behaviour.

Such loss in reputation has the potential to put the entire business at risk. It could also lead to negative publicity, loss of revenue, costly litigation or a decline in the customer base.

Reputational risk can arise from actions taken by the RBS Group or a failure to take action, such as failing to assess the environmental, social or ethical impacts of clients or projects to which the RBS Group has provided products or services.

The RBS Group seeks to safeguard its reputation by considering the impact on the value of its franchise from how it conducts business, its choice of customers and the way stakeholders view the RBS Group. Managing the Group's reputation is the joint responsibility of all employees, and reputational considerations should, as part of standard practice, be integrated into the RBS Group's day-to-day decision making structures.

Currently the Group manages reputational risk through a number of functions, such as divisions, RBS Group Communications, RBS Group Sustainability and an Environmental, Social and Ethical (ESE) risk management function. The latter function is responsible for assessing ESE risks associated with business engagements and business divisions.

The RBS Group Board has ultimate responsibility for managing any impact on the reputation of the RBS Group arising from its operations. The RBS Group Sustainability Committee (established at the beginning of 2010) sets the overall strategy and approach for the management of RBS Group sustainability. However, all parts of the RBS Group take responsibility for reputation management.

The risk is viewed as material given the central nature of the RBS Group's market reputation in the strategic risk objectives.

Business risk*

Business risk is the potential risk of revenues being lower than expected and/or operating costs being higher than expected. It is influenced by a variety of factors, including pricing, sales volumes, input costs, regulations and the prevailing market and economic environment.

The RBS Group seeks to minimise its exposure to business risk, subject to its wider strategic objectives (e.g. return on equity). As a large financial services group, it recognises and values the potential diversification benefits associated with differences in the nature and timing of potential business risk across its portfolio of businesses.

Business risk is identified, measured and managed through the RBS Group's bi-annual strategic planning cycles. Expected profiles for revenues and costs are determined, on a bottom-up basis, through strategic plans and expectations of the external environment. These profiles are tested against a range of stress scenarios and factors to identify the key risk drivers behind any potential volatility, along with management actions to address and manage them.

The RBS Group Board has ultimate responsibility for the impact of any volatility in revenues and costs on the RBS Group's performance. Business risk is incorporated within the RBS Group's risk appetite target for earnings volatility, with an assessment of volatility in revenues and costs a key component in determining whether the RBS Group and its underlying businesses are within risk appetite.

The management of business risk lies primarily with divisional and business unit strategic teams, with oversight at the RBS Group level from the Finance, Strategy and Risk functions. Elements of business risk (e.g. regulatory changes) also overlap with other areas and are managed by the appropriate risk functions.

The risk is viewed as material given the central nature of unexpected changes in revenues and costs on the RBS Group's ability to achieve its strategic objectives.

* unaudited

Pension risk*

The RBS Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. The RBS Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the RBS Group could be obliged, or may choose, to make additional contributions to the schemes.

The RBS Group Pension Fund ('Main scheme') is the largest of the schemes and the main source of pension risk. The Main scheme operates under a trust deed under which the corporate trustee, RBS Pension Trustees Limited, is a wholly owned subsidiary of The Royal Bank of Scotland plc and the trustee board comprises six directors selected by the RBS Group and four directors nominated by members.

The trustee is solely responsible for the investment of the Main scheme's assets which are held separately from the assets of the RBS Group. Significant changes to asset strategy are discussed within the RBS Group Pension Risk Committee, which was established in 2011.The RBS Group and the trustee must agree on the Main Scheme and the funding plan.

In October 2006, the Main scheme was closed to new employees. In November 2009, the RBS Group confirmed that it was making changes to the Main scheme and a number of other defined benefit schemes including the introduction of a limit of 2% per annum (or the annual change in the Consumer Price Index, if lower) to the amount of any salary increase that will count for pensionable purposes.

Risk appetite and investment policy are agreed by the trustee with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustee also consults with the RBS Group to obtain its view on the appropriate level of risk within the pension fund.

Risk management framework

From a sponsor perspective, the RBS Group manages this risk using a framework that encompasses risk reporting and monitoring, stress testing, modelling and an associated governance structure that helps ensure the RBS Group is able to fulfil its obligation to support the defined benefit pension schemes to which it has exposure.

Reporting and monitoring

The RBS Group maintains an independent review of risk from a sponsor perspective within its pension funds. It achieves this through underlying regular pension risk reporting and monitoring to the RBS Group Board, RBS Group Board Risk Committee and RBS Group Risk Committee on the material pension schemes that the RBS Group has an obligation to support.

Stress testing and modelling

Throughout 2011, various pension risk stress testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios undertaken to meet integrated EBA, IMF and FSA stress testing requirements. On an annual basis, the Internal Capital Adequacy Assessment Process is also modelled; this entails assessing changes in pension asset and liability values over a 12-month horizon under various stresses and scenarios.

Governance

A key component of the pension risk framework is the RBS Group Pension Risk Committee, which was established in 2011 and has the authority to articulate the RBS Group's view of risk appetite for the various RBS pension schemes. The Pension Risk Committee also serves as a formal link between the RBS Group and the Trustee of the RBS Group's largest pension schemes on risk management asset strategy and financing issues and, during 2011, facilitated an agreement between the two on mechanisms for reducing risk within the RBS Group Pension Fund.

Improvements in 2011 and next steps

As part of the continuing development of the pension risk management framework within RBS Group, key achievements in 2011 focused on improved stress testing and risk governance mechanisms. The framework will continue to be developed in 2012 with improvements in risk reporting and monitoring, modelling and stress testing capability along with the embedding of the pension risk governance structure implemented in 2011.

Main scheme

The most recent funding valuation, as at 31 March 2010, was agreed during 2011. It showed that the value of liabilities exceeded the value of assets by £3.5 billion as at 31 March 2010, a ratio of assets to liabilities of 84%. In order to eliminate this deficit, the RBS Group has agreed to pay additional contributions each year over the period 2011 to 2018. These contributions started at £375 million per annum in 2011, increasing to £400 million per annum in 2013 and from 2016 onwards will be further increased in line with price inflation. Further details are given in Note 4 on the accounts.

The assets of the Main scheme, which represent 84% of RBS Group pension plan assets at 31 December 2011, are invested in a diversified portfolio of quoted and private equity, government and corporate fixed interest and index-linked bonds, and other assets including property and hedge funds. The trustee has taken measures to partially mitigate inflation and interest rate risks both by investment in suitable physical assets and by entering into inflation and interest rate swaps. The Main scheme also uses derivatives within its portfolio to manage the allocation to asset classes and to manage risk within asset classes.

Risk management: Pension risk* continued

The table below shows the impact of the Main scheme's assets and liabilities (measured according to IAS 19 'Employee Benefits') to changes in interest rates and equity values at the year end, taking account of the current asset allocation and hedging arrangements.

	Change in value of assets £m	Change in value of liabilities £m	Increase in net pension obligations £m
At 31 December 2011			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	106	200	(94)
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	557	911	(354)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	104	1,118	(1,014)
Fall in equity values of 10%	(935)	—	(935)
At 31 December 2010			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	67	193	(126)
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	355	799	(444)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	98	1,005	(907)
Fall in equity values of 10%	(1,083)	—	(1,083)

* unaudited

Asset Protection Scheme*

All the disclosures in this section (pages 159 to 162) are unaudited and are marked with an asterisk (*).

Key aspects of the Scheme

On 22 December 2009, the RBS Group acceded to the Asset Protection Scheme (APS or 'the Scheme') with HM Treasury acting on behalf of the UK Government. Under the Scheme, the RBS Group purchased credit protection over a portfolio of specified assets and exposures ("covered assets") from HM Treasury. The portfolio of covered assets had a par value of approximately £282 billion at 31 December 2008, of which £48.8 billion of assets are held by RBS N.V., a fellow subsidiary, and are not included on the Group's balance sheet. The protection is subject to a first loss of £60 billion and covers 90% of subsequent losses net of recoveries. Once through the first loss, when a covered asset has experienced a trigger event, losses and recoveries in respect of that asset are included in the balance receivable under the APS. Receipts from HM Treasury will, over time, amount to 90% of cumulative losses (net of cumulative recoveries) on the portfolio of covered assets less the first loss amount.

The RBS Group has the right to terminate the Scheme at any time provided that the Financial Services Authority has confirmed in writing to HM Treasury that it has no objection. On termination, the RBS Group is liable to pay HM Treasury a termination fee, which comprises the difference between £2.5 billion (or, if higher, a sum related to the economic benefit of regulatory capital relief obtained from the APS) and the aggregate fees paid. In addition, the RBS Group would have to repay any amounts received from HM Treasury under the terms of the APS. The RBS Group has paid APS premiums totalling £2,225 million (2011 - £125 million; 2010 - £700 million; 2009 - £1,400 million). From 31 December 2011 premiums of £125 million are payable quarterly until the earlier of 2099 and the date the RBS Group leaves the Scheme.

Losses are recognised when a covered asset has experienced a trigger event which comprises of failure to pay subject to grace periods, bankruptcy and restructuring.

APS assets are spread across the Group's main divisions. High volume commercial and retail exposures were selected on a portfolio basis where assets were high risk and in arrears at 31 December 2008. Large corporate and GBM exposures were selected at the counterparty/asset level based on individual risk reviews and defaulted assets in the workout/restructuring unit.

HM Treasury has the right to appoint step-in managers to carry out any oversight, management or additional functions on their behalf, to ensure that the covered assets are managed and administered in compliance with the agreed terms and conditions. This right is exercisable if certain step-in triggers occur. These include:

- losses on covered assets in total exceed 125% of the first loss amount or losses on an individual covered asset class exceed specified thresholds;
- a breach of specified obligations in the APS rules or the accession agreement;
- the Group has failed or is failing to comply with any of the conditions in the APS rules in relation to asset management, monitoring and reporting, and governance and oversight, and such failure is persistent and material or it is evidence of a systematic problem; and
- material or systematic data deficiencies in the information provided to HM Treasury in accordance with the terms of the APS.

HM Treasury may at any time elect to cease to exercise its step-in rights in whole or part when it is satisfied that the step-in triggers have been remedied.

The Bank has also entered into two agreements with RBS N.V. under which it has sold credit protection over the exposures held by RBS N.V. and its subsidiaries that are subject to the APS. These agreements cover 100% of losses on these assets. One agreement provides protection over a portfolio that includes significant exposure in the form of derivatives; the other covers assets that are measured at amortised cost. The former agreement is accounted for as a credit derivative. The second agreement meets the definition of a financial guarantee contract and is accounted for as such.

Risk management: Asset Protection Scheme* continued

Covered assets

The table below details the movement in covered assets.

	Group £bn	RBS N.V. £bn	RBS Group £bn
At 1 January 2010	203.3	27.2	230.5
Disposals	(8.8)	(0.9)	(9.7)
Maturities, amortisation and early repayments	(20.1)	(8.6)	(28.7)
Intra-RBS Group transfers	0.8	(0.8)	—
Reclassified assets	5.0	(1.9)	3.1
Withdrawals	(2.8)	(0.1)	(2.9)
Currency translation and other adjustments	(0.1)	2.5	2.4
At 31 December 2010	177.3	17.4	194.7
Disposals	(4.5)	(0.8)	(5.3)
Maturities, amortisation and early repayments	(38.7)	(3.7)	(42.4)
Withdrawals	(9.5)	(2.9)	(12.4)
Currency translation and other adjustments	(2.6)	(0.2)	(2.8)
At 31 December 2011	122.0	9.8	131.8

Key points

- The reduction in covered assets was due to run-off of the portfolio, disposals, early repayments and maturing loans.
- The RBS Group continues to take advantage of market conditions and execute sales from a number of its portfolios.
- The RBS Group withdrew £12.4 billion of covered assets with a lower than average risk profile from the Scheme.

Credit impairments and write-downs

The table below analyses the credit impairment provision (adjusted for write-downs) and adjustments to par value (including available-for-sale reserves) relating to covered assets.

	2011			2010			2009		
	Group £m	RBS N.V. £m	RBS Group £m	Group £m	RBS N.V. £m	RBS Group £m	Group £m	RBS N.V. £m	RBS Group £m
Loans and advances	18,712	1,874	20,586	15,904	2,129	18,033	11,857	2,383	14,240
Debt securities	10,532	171	10,703	11,571	176	11,747	7,512	304	7,816
Derivatives	1,418	1,638	3,056	1,008	1,035	2,043	4,908	1,926	6,834
	30,662	3,683	34,345	28,483	3,340	31,823	24,277	4,613	28,890
Core	7,334	292	7,626	6,257	389	6,646	5,216	336	5,552
Non-Core	23,328	3,391	26,719	22,226	2,951	25,177	19,061	4,277	23,338
	30,662	3,683	34,345	28,483	3,340	31,823	24,277	4,613	28,890

Key points

- The increase in Non-Core impairments of £1.5 billion accounted for the majority of the increase in credit impairments and write-downs in 2011.
- The increase in Core is largely accounted for by impairments offset by asset withdrawals.

* unaudited

First loss utilisation

The RBS Group has agreed with HM Treasury modifications to the Scheme rules, which affect most APS portfolios in Global Banking & Markets and an APS portfolio in UK Corporate that relates to larger clients. All other APS portfolios in the RBS Group are unaffected. The overall economic aspects of the Scheme are unchanged, including value and term of cover, credit derivative valuation and capital effects.

The modified rules for recognition of triggered assets align more closely to the RBS Group's normal accounting and risk management procedures and will reduce the administrative burden of operating the Scheme. For the portfolios subject to these changes, the calculation of loss now takes into account expected recoveries in addition to those already received. This has resulted in a reduction in first loss utilisation. A comparison of losses arising under the original Scheme rules with those arising under the modified Scheme rules is set out below. This covers the period from Scheme inception to 31 March 2011 (the last point at which the original rules applied for the affected assets).

	£m
Original first loss utilisation	38,961
Assets not triggered under modified rules (1)	(4,126)
Assets triggered under modified rules (2)	997
Expected recoveries (3)	(6,272)
Revised first loss utilisation	29,560

Notes:
(1) Assets that had triggered under the original Scheme rules but were not impaired or defaulted are not triggered under the modified rules.
(2) Assets that had not yet triggered under the original Scheme rules but had impaired or defaulted are triggered under the modified rules.
(3) For assets which have triggered under both original and modified rules, this amount represents the excess of expected recoveries over cash recoveries received to date.

The table below shows the first loss utilisation under the original and modified rules.

	2011				2010			
	Original Scheme rules		Modified Scheme rules		Original Scheme rules		Modified Scheme rules	
	Gross loss amount £m	Cash recoveries to date £m	Net triggered loss £m	Net triggered total £m	Gross loss amount £m	Cash recoveries to date £m	Net triggered loss £m	Net triggered total £m
Core	8,451	(2,240)	1,567	7,778	6,865	(1,042)	1,559	7,382
Non-Core	17,486	(2,992)	8,158	22,652	13,946	(1,876)	6,923	18,993
	25,937	(5,232)	9,725	30,430	20,811	(2,918)	8,482	26,375
Loss credits				1,802				1,241
				32,232				27,616

Key points

- The cumulative first loss is £32.2 billion however, the RBS Group does not expect to claim under the Scheme, which has a first loss of £60 billion.
- The RBS Group received loss credits of £0.6 billion in 2011 which related to disposals. Cumulative loss credits at 31 December 2011 were £1.8 billion.
- The RBS Group continues to expect an average recovery rate of approximately 40% across all portfolios.

Risk management: Asset Protection Scheme* continued

Risk-weighted assets

The table below analyses risk-weighted assets (RWAs) covered by the APS.

	2011 £bn	2010 £bn	2009 £bn
Core	40.2	54.7	76.1
Non-Core	28.9	50.9	51.5
APS RWAs	69.1	105.6	127.6
of which: RBS N.V.	2.8	15.8	11.2

Key points

- The decrease of £36.5 billion in RWAs covered by the Scheme reflects pool movements, assets moving into default and changes in risk parameters.

- The decrease in RWAs covererd by the Scheme for RBS N.V. is primarily driven by withdrawal of assets.

* unaudited

The directors present their report together with the audited accounts for the year ended 31 December 2011.

Group structure

The Royal Bank of Scotland plc (the 'Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 17 on the accounts. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

The financial statements of The Royal Bank of Scotland Group plc can be obtained from RBS Secretariat, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or through the RBS Group's website, www.rbs.com

Following placing and open offers in December 2008 and in April 2009, HM Treasury ('HMT') owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HMT. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital.

In 2011, the holding company issued 770.3 million ordinary shares in connection with employee share schemes. At 31 December 2011, HMT's holding in the holding company's ordinary shares was 66.9%.

Results and dividends

The loss attributable to the ordinary shareholders of the Bank for the year ended 31 December 2011 amounted to £1,645 million compared with a loss of £973 million for the year ended 31 December 2010, as set out in the consolidated income statement on page 169.

The Bank did not pay a dividend on ordinary shares in 2010 or 2011.

Business review

Activities

The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its divisions and the competitive markets in which they operate, are contained in the Financial review on pages 3 to 5.

Asset Protection Scheme

On 22 December 2009, the Bank entered into an agreement, the Asset Protection Scheme (APS), with HMT acting on behalf of the UK Government, under which it purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HMT. The APS provides additional protection to the RBS Group's capital ratios and financial position.

The Bank has entered into agreements with other RBS Group companies under which it has sold credit protection over the exposures held that are subject to the APS.

Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Certain risk factors the Group faces are summarised on page 6. Fuller details of these and other risk factors are set out on pages 283 to 296.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 175 to 185.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk is discussed in the Risk and balance sheet management section of the Financial review on pages 24 to 162.

Financial performance

A review of the Group's performance during the year ended 31 December 2011, including details of each division, and the Group's financial position as at that date is contained in the Financial review on pages 7 to 23.

Employees

Policies and practices in respect of employee issues are managed on a consistent basis across the RBS Group, and the following sections reflect this approach.

As at 31 December 2011, the Bank and its subsidiaries employed over 113,700 employees (full time equivalent basis), throughout the world. Details of employee related costs are included in Note 3 on the accounts.

The RBS Group operates certain employee share plans in which eligible employees are able to participate and which align the interests of employees with those of RBS Group shareholders.

Employee learning and development

The RBS Group maintains a strong commitment to providing all its employees with the opportunity to grow through learning and development, which in turn helps to achieve business objectives and drive excellent customer service. Employee Volunteering schemes make it easy for individuals and teams to give something back to their communities and make a real difference.

Employee communication

Employee engagement is encouraged through a range of communication channels, at both divisional and RBS Group level. These channels provide access to news and information in a number of ways, including the intranet, magazines, video, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Group Chief Executive and other senior RBS Group executives regularly communicate with and encourage feedback from employees across a range of channels.

Employee feedback
Every year since 1999, through the Your Feedback survey, employees in all the RBS Group's businesses have shared their thoughts about what it's like working for the RBS Group. These insights inform what the RBS Group needs to do to improve the way it works, whether it's a local issue or something that affects everyone. Apart from an opportunity to listen to employees, the survey also enables the RBS Group to monitor levels of employee satisfaction and engagement and how these compare with other companies.

Employee consultation
The RBS Group recognises employee representative organisations such as trade unions and work councils in a number of businesses and countries.

The RBS Group has two European employee fora that provide elected representatives with an opportunity to understand better its European operations.

Diversity and inclusion
During 2011, the RBS Group executive renewed its commitment to make workplace policies, processes and experiences inclusive for staff, customers and stakeholders.

Inclusion is built into the recruitment process, positive action programmes developing talent, flexible working policies and support for ill-health and disability-related absence. The RBS Group continues to support disabled people ensuring they have equal opportunities to recruitment, employment, promotion and training.

The RBS Group supports employee led networks such as Focused Women and Rainbow who support personal and career development through networking and training events.

This commitment to inclusion extends to supporting and participating in positive action programmes outside of the RBS Group aimed at cultivating future leaders including 'An Inspirational Journey', the FTSE-100 cross-company mentoring and Glass Ladder programmes. The RBS Group maintains its involvement with external charitable networks and events such as Manchester Pride.

This approach to inclusion extends to the marketplace with the RBS Women in Business Ambassadors who support and guide more and more women to take the step of starting their own business.

Performance is monitored and reviewed at RBS Group and divisional level and RBS is supportive of the recommendations of Lord Davies' Report. There are currently three female directors on the Board out of a total of 13 directors. RBS expects to meet the aspirational target of 25 per cent female Board representation in 2012. As at 31 December 2011, 18 per cent of executives and 53 per cent of employees were female.

Safety, health and wellbeing
Ensuring the safety, health and wellbeing of employees and customers is an important responsibility for the RBS Group.

The RBS Group is committed to ensuring legal compliance and managing health and safety risks. During 2011, increased focus on leadership, governance and the effectiveness of controls delivered improvements in health and safety performance.

A wide range of health benefits and services are in place to help employees maintain good physical and psychological health, and support them if they do become unwell. A number of these services have been enhanced and promoted in response to the impact of the economic environment.

Pre-employment screening
The RBS Group has a comprehensive pre-employment screening process to guard against possible infiltration and employee-related fraud for all direct and non-direct staff engaged on RBS Group business.

Code of conduct
The code of conduct applies to everyone who works for the RBS Group. It promotes honest and ethical conduct, including the handling of actual or apparent conflicts of interest between personal and professional relationships. The RBS Group recognises that personal conduct, business integrity and the RBS Group's security are crucial, and the code of conduct serves to inform those who work for us of the RBS Group's expectations of their behaviour and practices.

Sustainability
Sustainability is central to the way the RBS Group is managed. Sustainability is not just about the many responsibilities and obligations that the RBS Group has in a legal sense, but about specific issues that need to be addressed to ensure that the RBS Group is a healthy and respected business operating on a sustainable basis. There is a clear governance structure for RBS Group Sustainability that oversees and aligns the RBS Group's approach to the range of ethical, social and environmental issues which confront the business on a daily basis.

The RBS Group continues to do significant work and address challenges across five key themes: Fair banking, Supporting enterprise, Employee engagement, Safety and security and Citizenship and environmental sustainability.

Further details of the RBS Group's sustainability policies are available on www.rbs.com/sustainability and in the Annual Sustainability Report.

Going concern
The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Financial review. The risk factors which could materially affect the Group's future results are set out on pages 283 to 296. The Group's regulatory capital resources and significant developments in 2011 and anticipated future developments are detailed on pages 32 to 35. The liquidity and funding section on pages 36 to 46, describes the Group's funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

Corporate governance

Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The RBS Group is required to comply with Section 404 of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2011.

The RBS Group assessed the effectiveness of its internal control over financial reporting as of 31 December 2011 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2011, the RBS Group's internal control over financial reporting is effective.

The RBS Group's auditors have audited the effectiveness of the RBS Group's internal control over financial reporting and have given an unqualified opinion.

Management's report on the RBS Group's internal control over financial reporting will be filed with the Securities and Exchange Commission at the same time as the RBS Group's Annual Report on Form 20-F.

Board of directors

The Board is the main decision-making forum for the Bank. It has overall responsibility for management of the business and affairs of the Group, the establishment of Group strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance. The Board considers strategic issues and ensures the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations. The Board's terms of reference includes key aspects of the Bank's affairs reserved for the Board's decision and are reviewed bi-annually.

There are a number of areas where the Board has delegated specific responsibility to management, including the Group Chief Executive and the Group Finance Director. These include responsibility for the operational management of the Group's businesses as well as reviewing high level strategic issues and considering risk appetite, risk policies and risk management strategies in advance of these being considered by the

Board and/or its Committees. Specific delegated authorities are also in place in relation to business commitments across the Group.

The roles of Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with authority delegated by the Board. The non-executive directors combine broad business and commercial experience with independent and objective judgement.

The Group Audit Committee comprises at least three independent non-executive directors and assists the Board in discharging its responsibilities for the disclosure of the financial affairs of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit and reviews the practices of the Divisional Risk and Audit Committees.

The Board Risk Committee comprises at least three independent non-executive directors. It provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's performance on risk appetite and oversees the operation of the Group Policy Framework.

The Group Remuneration Committee comprises at least three independent non-executive directors and has oversight of the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on remuneration of executive directors.

The Group Nominations Committee comprises all of the non-executive directors, and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

The Group Sustainability Committee is chaired by the Senior Independent Director and is attended by the Chairman and members of the Group executive and senior management. It is responsible for reviewing the Group's overall sustainability strategy, values and policies and aligning the Group's approach to ethical, social and environmental issues.

The Executive Committee comprises the Group's most senior executives and is responsible for managing Group-wide issues and those operational issues that affect the broader Group. It reviews strategic issues and initiatives, monitors financial performance and capital allocations, and considers risk strategy, policy and risk management.

The Management Committee comprises members of the Executive Committee together with a number of other senior executives and meets regularly, up to three to four times annually, as a vehicle for strategy and business performance review.

Share capital
Details of the ordinary and preference share capital at 31 December 2011 are shown in Note 26 on the accounts.

Directors
The current members of the Board of directors are shown on page 2.

Sandy Crombie, Philip Hampton, Stephen Hester, Penny Hughes, Joe MacHale, John McFarlane, Brendan Nelson, Art Ryan, Philip Scott and Bruce Van Saun all served throughout the year and to the date of signing the financial statements.

Alison Davis and Baroness Noakes were appointed as non-executive directors on 1 August 2011. Tony Di Iorio was appointed as a non-executive director on 1 September 2011. Colin Buchan retired as a non-executive director on 5 August 2011, having served just over nine years on the Board. John McFarlane will step down from the Board on 31 March 2012.

All directors of the company stand for re-election annually and, with the exception of John McFarlane, all directors will stand for election or re-election at the Annual General Meeting in 2012.

Directors' interests
The interests of the directors in the shares of the holding company at 31 December 2011 are disclosed in the Report and Accounts of that company. None of the directors held an interest in the loan capital of the holding company or in the shares or loan capital of the Bank or any of the subsidiaries of the Bank, during the period from 1 January 2011 to 22 March 2012.

Directors' indemnities
In terms of section 236 of the Companies Act 2006 (the 'Companies Act'), Qualifying Third Party Indemnity Provisions have been issued by the holding company to directors, members of the RBS Group's Executive and Management Committees and FSA Approved Persons.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the RBS Group's pension schemes during 2011.

Post balance sheet events
There have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Charitable contributions
The total amount given for charitable purposes by the Group during the year ended 31 December 2011 was £33.9 million (2010 - £25.2 million).

Political donations
During 2011, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

Policy and practice on payment of creditors
The Group is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Group's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

At 31 December 2011, the Group's trade creditors represented 27 days (2010 - 29 days) of amounts invoiced by suppliers.

Directors' disclosure to auditors
Each of the directors at the date of approval of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the Bank's auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

Auditors
The auditors, Deloitte LLP, have indicated their willingness to continue in office. A resolution to re-appoint Deloitte LLP as the Bank's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor
Secretary
22 March 2012

The Royal Bank of Scotland plc
is registered in Scotland No. SC90312.

Statement of directors' responsibilities

The directors are responsible for the preparation of the Annual Report and Accounts.

The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare Bank accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the Bank. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare accounts on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board

Aileen Taylor
Secretary
22 March 2012

We, the directors listed below, confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and the undertakings included in the consolidation taken as a whole; and
- the Financial review, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Bank and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Stephen Hester
Group Chief Executive

Bruce Van Saun
Group Finance Director

22 March 2012

Board of directors

Chairman
Philip Hampton

Executive directors
Stephen Hester
Bruce Van Saun

Non-executive directors
Sandy Crombie
Alison Davis
Tony Di Iorio
Penny Hughes
Joe MacHale
John McFarlane
Brendan Nelson
Baroness Noakes
Arthur 'Art' Ryan
Philip Scott

Independent auditor's report to the members of The Royal Bank of Scotland plc

We have audited the financial statements of The Royal Bank of Scotland plc ("the Bank") and its subsidiaries (together the "Group") for the year ended 31 December 2011 which comprise the accounting policies, the balance sheets as at 31 December 2011, the consolidated income statement, the consolidated statement of comprehensive income, the statements of changes in equity and the cash flow statements for the year ended 31 December 2011, the related notes 1 to 41 and the information identified as 'audited' in the Risk and balance sheet management section of the Financial review. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of directors' responsibilities the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit on the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of the reasonableness of significant accounting estimates made by the directors in the preparation of the financial statements; whether the accounting policies are appropriate to the circumstances of the Bank and the Group and have been consistently applied and adequately disclosed; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2011 and of the Group's loss for the year then ended;
- the Group's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Separate opinion in relation to IFRS as issued by the IASB

As explained in the accounting policies, the Group in addition to complying with its legal obligation to comply with IFRS as adopted by the European Union, has also complied with the IFRS as issued by the International Accounting Standards Board (IASB).

In our opinion the Group financial statements comply with IFRS as issued by the IASB.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Report of the directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Kari Hale (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
22 March 2012

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Consolidated income statement for the year ended 31 December 2011

	Note	2011 £m	2010 £m	2009 £m
Interest receivable	1	19,110	19,417	21,160
Interest payable	1	(7,812)	(7,306)	(9,617)
Net interest income	1	11,298	12,111	11,543
Fees and commissions receivable	2	5,898	7,591	7,734
Fees and commissions payable	2	(1,047)	(2,060)	(1,972)
Income from trading activities	2	2,014	3,361	3,007
Gain on redemption of own debt	2	255	502	2,694
Other operating income	2	3,388	2,199	1,537
Non-interest income		10,508	11,593	13,000
Total income		21,806	23,704	24,543
Staff costs				
- excluding curtailment gains		(7,512)	(7,880)	(7,738)
- pension schemes curtailment gains		—	—	2,148
Premises and equipment		(2,083)	(1,909)	(1,983)
Other administrative expenses		(4,229)	(2,996)	(3,094)
Depreciation and amortisation		(1,590)	(1,689)	(1,587)
Write-down of goodwill and other intangible assets		(80)	(1)	(118)
Operating expenses	3	(15,494)	(14,475)	(12,372)
Profit before impairment losses		6,312	9,229	12,171
Impairment losses	13	(7,176)	(9,400)	(12,174)
Operating loss before tax		(864)	(171)	(3)
Tax (charge)/credit	6	(731)	(713)	523
(Loss)/profit for the year		(1,595)	(884)	520
(Loss)/profit attributable to:				
Non-controlling interests		(8)	29	235
Preference shareholders	7	58	60	523
Ordinary shareholders		(1,645)	(973)	(238)
		(1,595)	(884)	520

The accompanying notes on pages 187 to 280, the accounting policies on pages 175 to 185 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 24 to 162 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2011

	Note	2011 £m	2010 £m	2009 £m
(Loss)/profit for the year		(1,595)	(884)	520
Other comprehensive income/(loss)				
Available-for-sale financial assets		1,729	1,506	2,434
Cash flow hedges		1,487	114	850
Currency translation		(226)	331	(1,584)
Actuarial (losses)/gains on defined benefit plans	4	(621)	176	(3,676)
Other comprehensive income/(loss) before tax		2,369	2,127	(1,976)
Tax (charge)/credit		(727)	(519)	30
Other comprehensive income/(loss) after tax		1,642	1,608	(1,946)
Total comprehensive income/(loss) for the year		47	724	(1,426)
Total comprehensive income/(loss) is attributable to:				
Non-controlling interests		(37)	96	109
Preference shareholders		58	60	523
Ordinary shareholders		26	568	(2,058)
		47	724	(1,426)

The accompanying notes on pages 187 to 280, the accounting policies on pages 175 to 185 and the audited sections of the ‘Financial review: Risk and balance sheet management’ on pages 24 to 162 form an integral part of these financial statements.

Balance sheets as at 31 December 2011

	Note	Group 2011 £m	Group 2010 £m	Group 2009 £m	Bank 2011 £m	Bank 2010 £m	Bank 2009 £m
Assets							
Cash and balances at central banks	10	68,487	49,838	27,060	64,261	44,921	21,099
Loans and advances to banks	10	97,140	87,505	68,441	109,040	100,965	77,365
Loans and advances to customers	10	489,399	518,321	536,169	351,123	349,179	338,548
Debt securities subject to repurchase agreements	28	72,652	79,558	65,589	37,166	41,203	30,070
Other debt securities		96,489	86,471	119,592	144,294	148,005	184,528
Debt securities	15	169,141	166,029	185,181	181,460	189,208	214,598
Equity shares	16	11,762	2,340	2,405	10,486	1,016	1,025
Investments in Group undertakings	17	—	—	—	32,164	27,504	29,385
Settlement balances		6,902	8,748	9,153	4,059	3,529	4,159
Derivatives	14	532,807	429,005	446,353	537,297	432,812	450,913
Intangible assets	18	12,365	11,832	11,814	876	443	210
Property, plant and equipment	19	11,478	16,143	17,309	2,244	2,301	2,447
Deferred tax	24	3,320	1,790	2,228	2,584	794	1,728
Prepayments, accrued income and other assets	20	5,892	6,237	12,665	5,338	4,760	9,988
Assets of disposal groups	21	24,088	9,542	14,203	18,715	4,765	7,150
Total assets		1,432,781	1,307,330	1,332,981	1,319,647	1,162,197	1,158,615
Liabilities							
Deposits by banks	10	109,097	85,220	116,138	234,297	197,973	188,548
Customer accounts	10	472,388	472,325	453,302	296,902	295,358	289,792
Debt securities in issue	10	140,837	164,662	172,413	114,524	128,073	129,814
Settlement balances		6,778	8,501	7,922	3,517	3,343	4,541
Short positions	22	40,446	41,130	36,472	24,858	25,687	23,811
Derivatives	14	527,836	420,969	424,544	530,855	424,503	430,005
Accruals, deferred income and other liabilities	23	14,809	13,734	16,474	8,840	8,058	9,949
Retirement benefit liabilities	4	2,188	2,229	2,622	25	23	16
Deferred tax	24	1,384	1,422	1,187	—	—	—
Subordinated liabilities	25	32,324	32,023	34,717	30,014	29,299	30,513
Liabilities of disposal groups	21	22,840	7,508	10,993	20,478	2,336	6,108
Total liabilities		1,370,927	1,249,723	1,276,784	1,264,310	1,114,653	1,113,097
Non-controlling interests		128	597	1,146	—	—	—
Owners' equity	26	61,726	57,010	55,051	55,337	47,544	45,518
Total equity		61,854	57,607	56,197	55,337	47,544	45,518
Total liabilities and equity		1,432,781	1,307,330	1,332,981	1,319,647	1,162,197	1,158,615

The accompanying notes on pages 187 to 280, the accounting policies on pages 175 to 185 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 24 to 162 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 22 March 2012 and signed on its behalf by:

Stephen Hester
Group Chief Executive

Bruce Van Saun
Group Finance Director

The Royal Bank of Scotland plc
Registration No. SC90312

Statements of changes in equity for the year ended 31 December 2011

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Called-up share capital						
At 1 January	6,609	6,609	6,483	6,609	6,609	6,483
Ordinary shares issued	—	—	128	—	—	128
Preference shares redeemed	—	—	(2)	—	—	(2)
At 31 December	6,609	6,609	6,609	6,609	6,609	6,609
Share premium account						
At 1 January	25,375	25,375	25,175	25,375	25,375	25,175
Ordinary shares issued	—	—	8,023	—	—	8,023
Preference shares redeemed	—	—	(7,823)	—	—	(7,823)
At 31 December	25,375	25,375	25,375	25,375	25,375	25,375
Merger reserve						
At 1 January and 31 December	10,881	10,881	10,881	—	—	—
Available-for-sale reserve						
At 1 January	917	(168)	(1,893)	735	(324)	(1,755)
Unrealised gains	2,489	1,765	1,937	2,294	1,488	1,455
Realised (gains)/losses	(760)	(259)	497	(734)	(32)	534
Tax	(426)	(421)	(709)	(370)	(397)	(558)
At 31 December	2,220	917	(168)	1,925	735	(324)
Cash flow hedging reserve						
At 1 January	(81)	(129)	(723)	482	618	683
Amount recognised in equity	2,481	173	339	2,486	672	(308)
Amount transferred from equity to earnings	(994)	(59)	511	(1,403)	(867)	226
Tax	(388)	(66)	(256)	(258)	59	17
At 31 December	1,018	(81)	(129)	1,307	482	618
Foreign exchange reserve						
At 1 January	3,027	2,722	4,203	(317)	(305)	(328)
Retranslation of net assets	(176)	795	(1,842)	15	(12)	23
Foreign currency (losses)/gains on hedges of net assets	(21)	(531)	384	—	—	—
Tax	(1)	41	(23)	—	—	—
At 31 December	2,829	3,027	2,722	(302)	(317)	(305)
Retained earnings						
At 1 January	10,282	9,761	1,832	14,660	13,545	3,787
(Loss)/profit attributable to ordinary and equity preference shareholders	(1,587)	(913)	285	1,112	(214)	(540)
Ordinary dividends paid	—	—	(2,000)	—	—	(2,000)
Equity preference dividends paid	(58)	(60)	(523)	(58)	(60)	(523)
Actuarial (losses)/gains recognised in retirement benefit schemes						
- gross	(621)	176	(3,676)	(3)	—	(5)
- tax	88	(73)	1,018	—	—	1
Shares issued under employee share schemes	(39)	—	—	(27)	—	—
Capital contribution	4,539	1,000	12,500	4,539	1,000	12,500
Share-based payments						
- gross	200	385	325	200	385	325
- tax	(10)	6	—	—	4	—
At 31 December	12,794	10,282	9,761	20,423	14,660	13,545
Owners' equity at 31 December	61,726	57,010	55,051	55,337	47,544	45,518

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Non-controlling interests						
At 1 January	597	1,146	1,292	—	—	—
Currency translation adjustments and other movements	(29)	67	(126)	—	—	—
(Loss)/profit attributable to non-controlling interests	(8)	29	235	—	—	—
Dividends paid	(40)	(154)	(261)	—	—	—
Equity raised	—	58	9	—	—	—
Equity withdrawn and disposals	(392)	(549)	(3)	—	—	—
At 31 December	128	597	1,146	—	—	—
Total equity at 31 December	61,854	57,607	56,197	55,337	47,544	45,518
Total comprehensive income/(loss) recognised in the statement of changes in equity is attributable to:						
Non-controlling interests	(37)	96	109	—	—	—
Preference shareholders	58	60	523	58	60	523
Ordinary shareholders	26	568	(2,058)	3,082	637	322
	47	724	(1,426)	3,140	697	845

The accompanying notes on pages 187 to 280, the accounting policies on pages 175 to 185 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 24 to 162 form an integral part of these financial statements.

Cash flow statements for the year ended 31 December 2011

		Group			Bank		
	Note	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Operating activities							
Operating (loss)/profit before tax		(864)	(171)	(3)	1,867	384	(1,142)
Adjustments for:							
Depreciation and amortisation		1,590	1,689	1,587	613	561	495
Write-down of goodwill and other intangible assets		80	1	118	—	—	—
Interest on subordinated liabilities		1,034	816	959	947	647	672
Charge for defined benefit pension schemes		329	489	389	2	8	(4)
Pension scheme curtailment gains		—	(78)	(2,148)	—	—	(1,603)
Cash contribution to defined benefit pension schemes		(975)	(641)	(744)	(3)	(3)	(1)
Gain on redemption of own debt		(255)	(502)	(2,694)	—	(345)	(2,255)
Elimination of foreign exchange differences		1,743	(3,107)	5,715	2,331	(1,745)	3,623
Other non-cash items		3,499	3,806	7,252	(629)	160	2,700
Net cash inflow/(outflow) from trading activities		6,181	2,302	10,431	5,128	(333)	2,485
Changes in operating assets and liabilities		(3,645)	29,919	5,498	(2,701)	29,270	47,357
Net cash flows from operating activities before tax		2,536	32,221	15,929	2,427	28,937	49,842
Income taxes (paid)/received		(98)	771	(785)	(343)	507	2
Net cash flows from operating activities	31	2,438	32,992	15,144	2,084	29,444	49,844
Investing activities							
Sale and maturity of securities		64,506	35,032	62,263	63,905	50,043	55,257
Purchase of securities		(67,340)	(33,632)	(67,751)	(59,607)	(46,230)	(104,885)
Sale of property, plant and equipment		1,794	1,918	1,590	42	87	77
Purchase of property, plant and equipment		(3,362)	(1,954)	(4,255)	(474)	(294)	(385)
Net investment in business interests and intangible assets	32	6,516	2,607	(397)	2,067	2,040	(3,125)
Net cash flows from investing activities		2,114	3,971	(8,550)	5,933	5,646	(53,061)
Financing activities							
Issue of ordinary shares		—	—	8,151	—	—	8,151
Issue of subordinated liabilities		940	—	5,000	940	—	5,000
Proceeds of non-controlling interests issued		—	58	9	—	—	—
Capital contribution		4,539	1,000	12,500	4,539	1,000	12,500
Redemption of preference shares		—	—	(7,825)	—	—	(7,825)
Redemption of non-controlling interests		(392)	(549)	(3)	—	—	—
Repayment of subordinated liabilities		(624)	(880)	(3,200)	(193)	(8)	(2,235)
Dividends paid		(98)	(214)	(2,784)	(58)	(60)	(2,523)
Interest on subordinated liabilities		(1,062)	(895)	(1,151)	(970)	(680)	(822)
Net cash flows from financing activities		3,303	(1,480)	10,697	4,258	252	12,246
Effects of exchange rate changes on cash and cash equivalents		(1,196)	756	(4,767)	(1,322)	321	(3,762)
Net increase in cash and cash equivalents		6,659	36,239	12,524	10,953	35,663	5,267
Cash and cash equivalents at 1 January		129,177	92,938	80,414	114,379	78,716	73,449
Cash and cash equivalents at 31 December	35	135,836	129,177	92,938	125,332	114,379	78,716

The accompanying notes on pages 187 to 280, the accounting policies on pages 175 to 185 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 24 to 162 form an integral part of these financial statements.

Accounting policies

1. Presentation of accounts

The accounts are prepared on a going concern basis (see page 164 of the Report of the directors) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB: the Group's financial statements are prepared in accordance with IFRS as issued by the IASB.

The accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated as at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged. The Bank's financial statements and the Group's consolidated financial statements are presented in sterling which is the functional currency of the Bank.

The Bank is incorporated in the UK and registered in Scotland and its accounts are presented in accordance with the Companies Act 2006.

There are a number of changes to IFRS that were effective from 1 January 2011. They have had no material effect on the financial statements of the Group or the Bank:

IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments' provides guidance on the accounting treatment when financial liabilities are settled with equity instruments.

Amendment to IAS 32 'Financial Instruments: Presentation' - 'Classification of Rights Issues' amends IAS 32 so that rights, options or warrants that are fixed for fixed (i.e. a fixed amount of cash for a fixed number of instruments) offered pro rata to all owners of a class of instrument are classified as equity instruments regardless of the currency denomination of the exercise price.

Amendment to IFRIC 14 'IAS 19 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' - 'Prepayments of a Minimum Funding Requirement' applies in the limited circumstances where an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendment permits the benefit of such an early payment to be treated as an asset.

May 2010 'Annual Improvements to IFRS' makes non-urgent but necessary amendments to standards, primarily to remove inconsistencies and to clarify wording.

Revised IAS 24 'Related Party Disclosures' simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party.

2. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities (including certain special purpose entities) that are controlled by the Group. Control exists where the Group has the power to govern the financial and operating policies of the entity; generally conferred by holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. A subsidiary acquired is included in the consolidated financial statements from the date it is controlled by the Group up until the date the Group ceases to control it through a sale or a significant change in circumstances. Changes in interest that do not result in a loss of control are accounted for as equity transactions.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared using uniform accounting policies.

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables, available-for-sale or held-to-maturity and interest expense on financial liabilities other than those measured at fair value are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities held for trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

The application of this policy to significant fee types is outlined below.

Payment services - this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account monthly or quarterly in arrears. Income is accrued at period end for services provided but not yet charged.

Card related services - fees from credit card business include:

- Commission received from retailers for processing credit and debit card transactions: income is accrued to the income statement as the service is performed.
- Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place.
- An annual fee payable by a credit card holder is deferred and taken to profit or loss over the period of the service i.e. 12 months.

Insurance brokerage - this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy, as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

Investment management fees - fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised.

4. Assets held for sale
A non-current asset (or disposal group) is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

5. Employee benefits
Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Group employees may receive variable compensation satisfied by cash, by debt instruments issued by RBS Group or by shares in The Royal Bank of Scotland Group plc. The treatment of share-based compensation is set out in Accounting policy 24. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and claw back criteria.

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). A net surplus is limited to any unrecognised past service cost plus the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it. The current service cost, curtailments and any past service costs together with the expected return on scheme assets less the unwinding of the discount on scheme liabilities are charged to operating expenses. A gain or loss on a curtailment is recognised in profit or loss when the curtailment occurs. A curtailment occurs when the Group is committed to making a significant reduction in the number of employees covered by a plan or a plan is amended such that future service qualifies for no or reduced benefits. Actuarial gains and losses are recognised in full in the period in which they arise in other comprehensive income. Contributions to defined contribution pension schemes are recognised in profit or loss when payable.

6. Intangible assets and goodwill
Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and included in Depreciation and amortisation. The estimated useful economic lives are as follows:

Core deposit intangibles	6 to 10 years
Other acquired intangibles	5 to 10 years
Computer software	3 to 5 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives.

The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes to previous estimates.

8. Impairment of intangible assets and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

10. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the Bank.

Group entities record transactions in foreign currencies in the currency of the primary economic environment in which they operate (their functional currency) at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal or partial disposal of a foreign operation.

11. Leases

As lessor

Contracts with customers to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer; all other contracts with customers to lease assets are classified as operating leases.

Finance lease receivables are included in the balance sheet, within Loans and advances to banks and Loans and advances to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

12. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

13. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in income or in equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

14. Financial assets

On initial recognition, financial assets are classified into held-to-maturity investments; held-for-trading; designated as at fair value through profit or loss; loans and receivables; or available-for-sale financial assets. Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way transactions in financial assets are recognised on trade date.

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities, or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract. Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale financial assets - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

15. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience.

Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For portfolios that are collectively assessed for impairment, the timing of write off principally reflects historic recovery experience for each portfolio. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write offs will be prompted by bankruptcy, insolvency, restructuring and similar events. Most debt is written off within five years of the recognition of the initial impairment. It is not the Group's usual practice to write-off all or part of the asset at the time an impairment loss is recognised; it may however, take place in rare circumstances. Amounts recovered after a loan has been written off are credited to the loan impairment charge for the period in which they are received.

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

16. Financial liabilities

On initial recognition, financial liabilities are classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

Held-for-trading - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Financial liabilities designated as at fair value through profit or loss include structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see Accounting policy 3).

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price times the number of units of the instrument issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities.

17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at a value less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

19. Derecognition

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if substantially all the risks and rewards have been retained. It is derecognised if substantially all the risks and rewards have been transferred. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

21. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts; and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs that are directly attributable to an equity transaction are deducted from equity net of any related tax.

The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received is credited to equity, net of any directly attributable incremental costs and related tax.

23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income.

The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss in equity is recognised in profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss in equity is recognised in profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

24. Share-based compensation

RBS Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.

If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period. A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, RBS Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

25. Cash and cash equivalents

In the cash flow statement cash and cash equivalents comprises cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

26. Shares in Group entities

The Bank’s investments in its subsidiaries are stated at cost less any impairment.

Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Framework for the Preparation and Presentation of Financial Statements'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt restructuring; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2011, loans and advances to customers classified as loans and receivables totalled £402,324 million (2010 - £444,561 million; 2009 - £479,678 million) and customer loan impairment provisions amounted to £18,469 million (2010 - £16,682 million; 2009 - £11,930 million).

There are two components to the Group's loan impairment provisions: individual and collective.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

Pensions

The Group operates a number of defined benefit pension schemes as described in Note 4 on the accounts. The assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any recognisable surplus or deficit of scheme assets over liabilities is recorded in the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increases, earnings growth and the longevity of scheme members. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 4 on the accounts, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension asset of £24 million and a liability of £2,188 million were recognised on the balance sheet at 31 December 2011 (2010 - asset £39 million, liability £2,229 million; 2009 - asset £28 million, liability £2,622 million).

Fair value - financial instruments

Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. Gains or losses arising from changes in the fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised.

Financial instruments measured at fair value include:

Loans and advances (held-for-trading and designated as at fair value though profit or loss) - principally comprise reverse repurchase agreements (reverse repos) and cash collateral.

Debt securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale) - debt securities include those issued by governments, municipal bodies, mortgage agencies and financial institutions as well as corporate bonds, debentures and residual interests in securitisations.

Equity securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale) - comprise equity shares of companies or corporations both listed and unlisted.

Deposits by banks and customer accounts (held-for-trading and designated as at fair value though profit or loss) - deposits measured at fair value principally include repurchase agreements (repos).

Debt securities in issue (held-for-trading and designated as at fair value though profit or loss) - principally comprise medium term notes.

Short positions (held-for-trading) - arise in dealing and market making activities where debt securities and equity shares are sold which the Group does not currently possess.

Derivatives - these include swaps (currency swaps, interest rate swaps, credit default swaps, total return swaps and equity and equity index swaps), forward foreign exchange contracts, forward rate agreements, futures (currency, interest rate and equity) and options (exchange-traded options on currencies, interest rates and equities and equity indices and OTC currency and equity options, interest rate caps and floors and swaptions).

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values are determined from quoted prices in active markets for identical financial assets or financial liabilities where these are available. Fair value for a net open position in a financial instrument in an active market is the number of units of the instrument held times the current bid price (for financial assets) or offer price (for financial liabilities). In determining the fair value of derivative financial instruments gross long and short positions measured at current mid market prices are adjusted by bid-offer reserves calculated on a portfolio basis. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities to reflect the Group's own credit standing. Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. More details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 11 on pages 209 to 224.

Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £3,320 million were recognised as at 31 December 2011 (2010 - £1,790 million; 2009 - £2,228 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and temporary differences. Deferred tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future taxable profits against which the losses can be utilised. Business projections prepared for impairment reviews (see Note 18) indicate that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within six years (2010 - eight years). The Group's cumulative losses are principally attributable to the recent unparalleled market conditions. Deferred tax assets of £743 million (2010 - £298 million; 2009 - £26 million) have not been recognised in respect of tax losses carried forward in jurisdictions where doubt exists over the availability of future taxable profits.

Accounting developments

International Financial Reporting Standards

The IASB issued IFRS 9 'Financial Instruments' in November 2009 simplifying the classification and measurement requirements in IAS 39 in respect of financial assets. The standard reduces the measurement categories for financial assets to two: fair value and amortised cost. A financial asset is classified on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. Only assets with contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on principal and which are held within a business model whose objective is to hold assets in order to collect contractual cash flows are classified as amortised cost. All other financial assets are measured at fair value. Changes in the value of financial assets measured at fair value are generally taken to profit or loss.

In October 2010, IFRS 9 was updated to include requirements in respect of the classification and measurement of liabilities. These do not differ markedly from those in IAS 39 except for the treatment of changes in the fair value of financial liabilities that are designated as at fair value through profit or loss attributable to own credit; these must be presented in other comprehensive income.

In December 2010, the IASB issued amendments to IFRS 9 and to IFRS 7 'Financial Instruments: Disclosures' delaying the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 and introducing revised transitional arrangements including additional transition disclosures. If an entity implements IFRS 9 in 2012 the amendments permit it either to restate comparative periods or to provide the additional disclosures. The additional transition disclosures must be given if implementation takes place after 2012.

IFRS 9 makes major changes to the framework for the classification and measurement of financial instruments and will have a significant effect on the Group's financial statements. The Group is assessing the effect of IFRS 9 which will depend on the outcome of the other phases of the IASB's IAS 39 replacement project and on the outcome the IASB's tentative decision at its December 2011 meeting to reconsider the following topics:

- additional application guidance to clarify how the instrument characteristics test was intended to be applied.
- bifurcation of financial assets, after considering any additional guidance for the instrument characteristics test.
- expanded use of other comprehensive income or a third business model for some debt instruments.

'Disclosures - Transfers of Financial Assets (Amendments to IFRS 7)' was published by the IASB in October 2010. This replaces IFRS 7's existing derecognition disclosure requirements with disclosures about (a) transferred assets that are not derecognised in their entirety and (b) transferred assets that are derecognised in their entirety but where an entity has continuing involvement in the transferred asset. The amendments are effective for annual periods beginning on or after 1 July 2011.

The IASB issued an amendment to IAS 12 'Income Taxes' in December 2010 to clarify that recognition of deferred tax should have regard to the expected manner of recovery or settlement of the asset or liability. The amendment and consequential withdrawal of SIC 21 'Deferred Tax: Recovery of Underlying Assets', effective for annual periods beginning on or after 1 January 2012, is not expected to have a material effect on the Group or the company.

In May 2011, the IASB issued six new or revised standards:

IFRS 10 'Consolidated Financial Statements' which replaces SIC-12 'Consolidation - Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. The new standard adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.

IAS 27 'Separate Financial Statements' which comprises those parts of the existing IAS 27 that dealt with separate financial statements.

IFRS 11 'Joint Arrangements', which supersedes IAS 31' Interests in Joint Ventures', distinguishes between joint operations and joint ventures. Joint operations are accounted for by the investor recognising its assets and liabilities including its share of any assets held and liabilities incurred jointly and its share of revenues and costs. Joint ventures are accounted for in the investor's consolidated accounts using the equity method.

IAS 28 'Investments in Associates and Joint Ventures' covers joint ventures as well as associates; both must be accounted for using the equity method. The mechanics of the equity method are unchanged.

Accounting developments continued

IFRS 12 'Disclosure of Interests in Other Entities' covers disclosures for entities reporting under IFRS 10 and IFRS 11 replacing those in IAS 28 and IAS 27. Entities are required to disclose information that helps financial statement readers evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries, in associates and joint arrangements and in unconsolidated structured entities.

IFRS 13 'Fair Value Measurement' which sets out a single IFRS framework for defining and measuring fair value and requiring disclosures about fair value measurements.

The standards are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group is reviewing the standards to determine their effect on the Group's financial reporting.

In June 2011, the IASB issued amendments to two standards:

Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' require items that will never be recognised in profit or loss to be presented separately in other comprehensive income from those that are subject to subsequent reclassification. The amendments are effective for annual periods beginning on or after 1 July 2012. Earlier application is permitted.

Amendments IAS 19 'Employee Benefits' require the immediate recognition of all actuarial gains and losses eliminating the 'corridor approach'; interest cost to be calculated on the net pension liability or asset at the appropriate corporate bond rate; and all past service costs to be recognised immediately when a scheme is curtailed or amended.

These amendments are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group is reviewing the amendments to determine their effect on the Group's financial reporting.

In December 2011, the IASB issued 'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' and 'Disclosures-Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)'. The amendment to IAS 32 adds application guidance on the meaning of 'a legally enforceable right to set off' and on simultaneous settlement. IFRS 7 is amended to require disclosures facilitating comparisons between those entities reporting under IFRS and those reporting under US GAAP. The amendments are effective for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively.

1 Net interest income

	Group		
	2011 £m	2010 £m	2009 £m
Loans and advances to customers	16,716	17,068	18,176
Loans and advances to banks	561	348	425
Debt securities	1,833	2,001	2,559
Interest receivable	19,110	19,417	21,160
Customer accounts: demand deposits	761	701	668
Customer accounts: savings deposits	1,343	1,410	1,474
Customer accounts: other time deposits	830	826	1,756
Deposits by banks	646	892	1,533
Debt securities in issue	3,036	2,758	3,509
Subordinated liabilities	1,034	816	959
Internal funding of trading business	162	(97)	(282)
Interest payable	7,812	7,306	9,617
Net interest income	11,298	12,111	11,543

2 Non-interest income

	Group		
	2011 £m	2010 £m	2009 £m
Fees and commissions receivable			
Payment services	1,388	1,610	1,720
Credit and debit card fees	1,088	2,408	2,348
Lending (credit facilities)	1,580	1,531	1,731
Brokerage	587	499	420
Trade finance	281	262	245
Investment management	434	490	460
Other	540	791	810
	5,898	7,591	7,734
Fees and commissions payable	(1,047)	(2,060)	(1,972)
Income from trading activities (1)			
Foreign exchange	944	907	1,118
Interest rate	797	2,169	3,805
Credit	72	(406)	(2,867)
Equities	263	183	214
Commodities	3	387	799
Other	(65)	121	(62)
	2,014	3,361	3,007
Gain on redemption of own debt (2)	255	502	2,694
Other operating income			
Operating lease and other rental income	1,306	1,396	1,329
Changes in the fair value of own debt designated as at fair value through profit or loss attributable to own credit (3)			
- debt securities in issue	410	63	(131)
- subordinated liabilities	96	(19)	26
Changes in the fair value of securities and other financial assets and liabilities	187	17	4
Changes in the fair value of investment properties	(139)	(405)	(117)
Profit on sale of securities	867	253	312
Profit on sale of property, plant and equipment	11	50	40
(Loss)/profit on sale of subsidiaries and associates	(67)	675	(16)
Dividend income (4)	216	176	50
Share of profits/(losses) of associated entities	21	27	(19)
Other income/(loss) (5)	480	(34)	59
	3,388	2,199	1,537

Notes:

(1) The analysis of income from trading activities is based on how the business is organised and the underlying risks managed. Income from trading activities comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs. The types of instruments include:
- Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
- Interest rate: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
- Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
- Equities: equities, equity derivatives and related hedges and funding.
- Commodities: commodity contracts and related hedges and funding.

Includes £225 million (2010 - £(75) million; 2009 - £(193) million) in relation to changes in the fair value in the credit risk premium payable by the Group on debt securities in issue classified as held-for-trading.

(2) In June 2011, the Group redeemed certain mortgage backed debt securities in exchange for cash, resulting in gains totalling £255 million being credited to profit or loss. In a series of exchange and tender offers in April 2009 and May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. Gains of £502 million and £2,694 million were credited to profit or loss in 2010 and 2009 respectively. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability.

(3) Measured as the charge in fair value from movements in the year in the credit risk premium payable by the Group.

(4) Dividend income includes £165 million (2010 - £124 million; 2009 - nil) arising from investments in fellow subsidiaries of the RBS Group and consequently subject to the RBS Group's capital management policy (see Note 29).

(5) Includes income from activities other than banking.

3 Operating expenses

	Group		
	2011 £m	2010 £m	2009 £m
Wages, salaries and other staff costs	6,291	6,460	6,436
Bonus tax	78	50	141
Social security costs	548	537	424
Shared-based compensation	197	397	329
Pension costs			
- defined benefit schemes (see Note 4)	329	489	389
- curtailment gains (see Note 4)	—	(78)	(2,148)
- defined contribution schemes	69	25	19
Staff costs	7,512	7,880	5,590
Premises and equipment	2,083	1,909	1,983
Other administrative expenses	4,229	2,996	3,094
Property, plant and equipment (see Note 19)	1,197	1,335	1,288
Intangible assets (see Note 18)	393	354	299
Depreciation and amortisation	1,590	1,689	1,587
Write-down of goodwill and other intangible assets (see Note 18)	80	1	118
	15,494	14,475	12,372

Bank levy

The Finance Act 2011 introduced an annual bank levy in the UK. The levy is collected through the existing quarterly Corporation Tax collection mechanism starting with payment dates on or after 19 July 2011.

The levy is based on the total chargeable equity and liabilities as reported in the balance sheet at the end of a chargeable period. The first chargeable period for the RBS Group was the year ended 31 December 2011. In determining the chargeable equity and liabilities the following amounts are excluded: adjusted Tier 1 capital; certain "protected deposits" (for example those protected under the Financial Services Compensation Scheme); liabilities that arise from certain insurance business within banking groups; liabilities in respect of currency notes in circulation; Financial Services Compensation Scheme liabilities; liabilities representing segregated client money; and deferred tax liabilities, current tax liabilities, liabilities in respect of the levy, revaluation of property liabilities, liabilities representing the revaluation of business premises and defined benefit retirement liabilities. It is also permitted in specified circumstances to reduce certain liabilities: by netting them against certain assets; offsetting assets on the relevant balance sheets that would qualify as high quality liquid assets (in accordance with the FSA definition); and repo liabilities secured against sovereign and supranational debt.

The levy will be set at a rate of 0.088 per cent. from 2012. Three different rates applied during 2011, these average to 0.075 per cent. Certain liabilities are subject to only a half rate, namely any deposits not otherwise excluded (except for those from financial institutions and financial traders) and liabilities with a maturity greater than one year at the balance sheet date. The levy is not charged on the first £20 billion of chargeable liabilities. The cost of the levy to the RBS Group for 2011 is £300 million (included in Other administrative expenses). In the Budget statement on 21 March 2012, the Chancellor of the Exchequer announced that the full rate of the bank levy will increase to 0.105 per cent. from 1 January 2013.

Integration costs included in operating expenses comprise expenditure incurred in respect of cost reduction and revenue enhancement programmes connected with acquisitions made by the Group.

	Group		
	2011 £m	2010 £m	2009 £m
Staff costs	30	155	204
Premises and equipment	20	2	78
Other administrative expenses	45	78	157
Depreciation and amortisation	10	16	18
	105	251	457

3 Operating expenses continued

Restructuring costs included in operating expenses comprise:

	2011 £m	2010 £m	2009 £m
Staff costs	297	296	310
Premises and equipment	136	101	42
Other administrative expenses	209	95	50
	642	492	402

Divestment costs included in operating expenses comprise:

	2011 £m	2010 £m	2009 £m
Staff costs	84	51	—
Premises and equipment	11	6	—
Other administrative expenses	51	25	—
	146	82	—

The average number of persons employed, rounded to the nearest hundred, by the Group during the year, excluding temporary staff, was 111,500, (2010 - 114,600; 2009 - 121,000). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2011	2010	2009
UK Retail	29,200	30,300	33,000
UK Corporate	13,300	13,000	12,600
Wealth	5,400	5,200	4,800
Global Transaction Services	1,200	1,100	2,100
Ulster Bank	4,400	4,400	4,600
US Retail & Commercial	16,000	16,500	16,400
Global Banking & Markets	12,000	11,600	10,600
Central items	4,900	3,700	3,200
Core	86,400	85,800	87,300
Non-Core	1,700	2,300	2,900
Business Services	22,800	24,000	26,900
Total	110,900	112,100	117,100
UK	76,100	77,500	81,200
USA	22,900	23,700	25,000
Europe	5,300	5,500	6,800
Rest of the World	6,600	5,400	4,100
Total	110,900	112,100	117,100

Share-based payments

As described in the Remuneration report in the RBS Group Annual Report and Accounts 2011, the RBS Group grants share-based awards to employees principally on the following bases:

Award plan	Eligible employees	Nature of award (1)	Vesting conditions (2)	Issue dates
Sharesave	UK, Republic of Ireland, Channel Islands, Gibraltar and Isle of Man	Option to buy shares under employee savings plan	Continuing employment or leavers in certain circumstances	2012 to 2019
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2012 to 2014
Restricted share awards	Senior employees	Awards of conditional shares	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2012 to 2014
Long-term incentives (3)	Senior employees	Awards of conditional shares or share options	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2012 to 2019

Notes:
(1) Awards are equity-settled unless international comparability is better served by cash-settled awards.
(2) All awards have vesting conditions and therefore some may not vest.
(3) Long-term incentives include the Executive Share Option Plan, the Long-Term Incentive Plan and the Medium-Term Performance Plan.
(4) The strike price of options and the fair value on granting awards of fully paid shares is the average market price over the five trading days preceding grant date.

Sharesave

	2011		2010		2009	
	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)
At 1 January	0.48	1,012	0.50	1,038	2.88	84
Granted	0.23	298	0.43	147	0.38	1,176
Exercised	0.38	(7)	0.38	(5)	—	—
Cancelled	0.41	(664)	0.45	(168)	0.77	(222)
At 31 December	0.34	639	0.48	1,012	0.50	1,038

Options are exercisable within six months of vesting; 3 million were exercisable at 31 December 2011 (2010 - 23 million; 2009 - 26 million). The weighted average share price at the date of exercise of options was 42p (2010 - 45p; 2009 - not applicable). At 31 December 2011, exercise prices ranged from 23p to 393p and the average contractual life was 3.7 years (2010 - 38p to 393p and 3.3 years; 2009 - 38p to 393p and 3.2 years). The fair value of options granted in 2011 was £43 million (2010 - £48 million; 2009 - £220 million).

Deferred performance awards

	2011		2010	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)
At 1 January	1,009	2,665	—	—
Granted	258	578	1,043	2,755
Forfeited	(47)	(125)	(34)	(90)
Vested	(464)	(1,205)	—	—
At 31 December	756	1,913	1,009	2,665

The awards granted in 2011 vest evenly over the following three anniversaries.

3 Operating expenses continued

Restricted share awards

	2011		2010		2009	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)
At 1 January	110	335	117	325	48	31
Granted	—	—	26	55	94	309
Exercised	(6)	(26)	(6)	(15)	(16)	(5)
Lapsed	(4)	(10)	(27)	(30)	(9)	(10)
At 31 December	100	299	110	335	117	325

The market value of awards exercised in 2011 was £11 million (2010 - £6 million; 2009 - £2 million).

Long-term incentives

	2011			2010			2009		
	Value at grant £m	Shares awarded (million)	Options over shares (million)	Value at grant £m	Shares awarded (million)	Options over shares (million)	Value at grant £m	Shares awarded (million)	Options over shares (million)
At 1 January	219	250	377	122	7	413	79	1	92
Granted	154	369	9	115	247	3	70	8	353
Exercised	(6)	(14)	—	—	—	(1)	—	—	—
Lapsed	(22)	(29)	(15)	(18)	(4)	(38)	(27)	(2)	(32)
At 31 December	345	576	371	219	250	377	122	7	413

The market value of awards exercised in 2011 was £5 million (2010 - less than £1 million; 2009 - nil). There are vested options over 48 million shares exercisable up to 2019 (2010 - 33 million shares up to 2020; 2009 - £33 million shares up to 2014).

At 31 December 2011, a provision of £3 million had been made in respect of 4 million share awards and 14 million options over shares that may be cash-settled (2010 - £6 million in respect of 3 million share awards and 16 million options over shares; 2009 - £6 million in respect of 3 million share awards and 16 million options over shares).

The fair value of options granted in 2011 was determined using a pricing model that included: expected volatility of shares determined at the grant date based on historic volatility over a period of up to seven years; expected option lives that equal the vesting period; no dividends on equity shares; and a risk-free interest rate determined from the UK gilt rates with terms matching the expected lives of the options.

4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas, predominantly defined benefit schemes, whose assets are independent of the Group's finances. The principal defined benefit scheme is The Royal Bank of Scotland Group Pension Fund (the "Main scheme") which accounts for 88% (2010 - 88%; 2009 - 87%) of the Group's retirement benefit obligations.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees do not make contributions for basic pensions but may make voluntary contributions to secure additional benefits on a money-purchase basis. Since October 2006, the Main scheme has been closed to new entrants who have instead been offered membership of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. Since 2009, pensionable salary increases in the Main scheme and certain other UK and Irish schemes have been limited to 2% per annum or CPI inflation if lower.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

There is no contractual agreement or policy on the way that the cost of The Royal Bank of Scotland Group defined benefit pension schemes and healthcare plans are allocated to the Bank. The Bank therefore accounts for the charges it incurs as payments to a defined contribution scheme.

Interim valuations of the Group's schemes under IAS19 'Employee Benefits' were prepared to 31 December with the support of independent actuaries, using the following assumptions:

Principal actuarial assumptions at 31 December (weighted average)	2011 %	2010 %	2009 %
Discount rate	5.0	5.4	5.9
Expected return on plan assets	5.7	6.6	6.8
Rate of increase in salaries	1.8	1.8	1.8
Rate of increase in pensions in payment	2.8	3.1	3.3
Inflation assumption	2.9	3.2	3.4

Major classes of plan assets as a percentage of total plan assets	2011 %	2010 %	2009 %
Quoted equities	23.1	28.1	39.7
Private equity	5.1	4.8	4.5
Index-linked bonds	24.0	23.9	21.7
Government fixed interest bonds	2.3	1.4	0.7
Corporate and other bonds	22.8	25.5	19.9
Hedge funds	2.6	3.7	4.5
Property	3.6	3.6	3.6
Derivatives	2.1	0.8	(0.1)
Cash and other assets	14.1	8.1	5.3
Equity exposure of equity futures	15.6	22.5	9.4
Cash exposure of equity futures	(15.3)	(22.4)	(9.2)
	100.0	100.0	100.0

The Main scheme, which represents 89% of plan assets at 31 December 2011 (2010 - 88%; 2009 - 88%), is invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property and hedge funds.

The Main scheme also employs derivative instruments, where appropriate, to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the actual physical assets held by the scheme, with any derivative holdings valued on a mark-to-market basis. The return on assets on the total scheme has been based on the asset exposure created allowing for the net impact of the derivatives on the risk and return profile of the holdings.

4 Pensions continued

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2011			2010			2009		
	Notional amounts £m	Fair value Assets £m	Fair value Liabilities £m	Notional Amounts £m	Fair value Assets £m	Fair value Liabilities £m	Notional Amounts £m	Fair value Assets £m	Fair value Liabilities £m
Inflation rate swaps	2,585	67	178	2,132	69	8	1,171	75	3
Interest rate swaps	15,149	2,232	1,864	10,727	270	110	4,893	46	114
Total return swaps	2,085	169	—	466	16	—	—	—	—
Currency swaps	2,861	116	117	(973)	—	1	—	—	—
Credit default swaps	238	6	—	—	—	—	—	—	—
Equity and bond futures	3,745	80	10	4,851	49	14	1,730	37	—
Currency forwards	2,078	8	—	4,883	35	91	2,908	58	70
Equity and bond call options	814	67	4	—	—	—	—	—	—
Equity and bond put options	665	11	—	—	—	—	—	—	—

The investment strategy of other schemes is similar to that of the Main scheme, adjusted to take account of the nature of liabilities, risk appetite of the trustees, size of the scheme and any local regulatory constraints. The use of derivative instruments outside of the Main scheme is not material.

Swaps are part of the management of the inflation and interest rate sensitivity of the Main scheme liabilities. They have been executed at prevailing market rates and within standard market bid/offer spreads. Substantially all swaps are with The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2011, the gross notional value of the swaps was £22,918 million (2010 - £12,352 million; 2009 - £6,064 million) and had a net positive fair value of £431 million (2010 - £236 million positive; 2009 - £4 million positive) to the scheme.

Collateral is required on all swap transactions with those between the banks and the Main scheme on terms that do not allow the banks to re-hypothecate. The banks had delivered £375 million of collateral at 31 December 2011 (2010 - delivered £210 million; 2009 - held £6 million).

Ordinary shares of the holding company with a fair value of £3 million (2010 - £9 million; 2009 - £4 million) are held by the Group's Main scheme which also holds other financial instruments issued by the Group with a value of £424 million (2010 - £264 million; 2009 - £192 million).

The expected return on plan assets at 31 December is based upon the weighted average of the following assumed returns on the major classes of plan assets, allowing for the net impact of derivatives on the risk and return profile:

	2011 %	2010 %	2009 %
Quoted equities	7.8	7.9	8.1
Private equity	7.7	7.7	8.0
Index-linked bonds	3.1	4.2	4.5
Government fixed interest bonds	3.4	4.2	4.5
Corporate and other bonds	4.7	5.4	5.9
Hedge funds	6.0	5.3	4.3
Property	6.6	6.7	6.1
Cash and other assets	2.9	3.9	4.3
Equity exposure of equity futures	7.7	7.7	8.0
Cash exposure of equity futures	2.6	4.0	4.2
Total fund	5.7	6.6	6.8

Post-retirement mortality assumptions (Main scheme)	2011	2010	2009
Longevity at age 60 for current pensioners (years)			
Males	27.3	27.2	27.1
Females	29.6	29.6	29.5
Longevity at age 60 for future pensioners currently aged 40 (years)			
Males	29.3	29.3	29.2
Females	30.9	30.8	30.8

Changes in value of net pension deficit	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension deficit £m
At 1 January 2010	18,805	21,399	2,594
Currency translation and other adjustments	50	52	2
Income statement			
Expected return	1,266	—	(1,266)
Interest cost	—	1,239	1,239
Current service cost	—	441	441
Past service cost	—	75	75
Gains on curtailments	—	(78)	(78)
	1,266	1,677	411
Statement of comprehensive income			
- Actuarial gains and losses	1,789	1,613	(176)
Contributions by employer	641	—	(641)
Contributions by plan participants and other scheme members	8	8	—
Benefits paid	(817)	(817)	—
Expenses included in service cost	(55)	(55)	—
At 1 January 2011	21,687	23,877	2,190
Currency translation and other adjustments	(17)	(18)	(1)
Income statement			
Expected return	1,421	—	(1,421)
Interest cost	—	1,291	1,291
Current service cost	—	417	417
Past service cost	—	42	42
	1,421	1,750	329
Statement of comprehensive income			
- Actuarial gains and losses	610	1,231	621
Contributions by employer	975	—	(975)
Contributions by plan participants and other scheme members	9	9	—
Benefits paid	(802)	(802)	—
Expenses included in service cost	(53)	(53)	—
At 31 December 2011	23,830	25,994	2,164

Net pension deficit comprises	2011 £m	2010 £m	2009 £m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 20)	(24)	(39)	(28)
Net liabilities of schemes in deficit	2,188	2,229	2,622
	2,164	2,190	2,594

Curtailment gains of £78 million were recognised in 2010 arising from changes to pension benefits in a subsidiary's scheme.

4 Pensions continued

RBS Group and the Trustees of the Main scheme agreed the funding valuation as at 31 March 2010 during the year. It showed that the value of liabilities exceed the value of assets by £3.5 billion as at 31 March 2010, a ratio of assets to liabilities of 84%. In order to eliminate this deficit, RBS Group will pay additional contributions each year over the period 2011 to 2018. These contributions started at £375 million per annum in 2011, increasing to £400 million per annum in 2013 and from 2016 onwards will be further increased in line with price inflation. These contributions are in addition to the regular annual contributions of around £300 million for future accrual benefits.

The Group expects to contribute a total of £760 million to its defined benefit pension schemes in 2012. Of the net liabilities of schemes in deficit, £159 million (2010 - £155 million; 2009 - £146 million) relates to unfunded schemes.

Cumulative net actuarial losses of £4,301 million (2010 - £3,680 million; 2009 - £3,856 million) have been recognised in the statement of comprehensive income, of which £3,589 million losses (2010 - £3,252 million losses; 2009 - £3,296 million gains) relate to the Main scheme.

History of defined benefit schemes	Group				
	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of plan assets	23,830	21,687	18,805	16,651	20,264
Present value of defined benefit obligations	25,994	23,877	21,399	18,093	20,032
Net deficit/(surplus)	2,164	2,190	2,594	1,442	(232)
Experience (losses)/gains on plan liabilities	(224)	(851)	139	(91)	(204)
Experience gains/(losses) on plan assets	610	1,789	1,157	(5,318)	140
Actual return/(loss) on pension schemes assets	2,031	3,055	2,310	(3,917)	1,437
Actual return/(loss) on pension schemes assets - %	9.3%	16.3%	13.9%	(19.2%)	7.6%

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at 31 December to a change in the principal actuarial assumptions:

	Increase/(decrease) in pension cost for year			Increase/(decrease) in obligation at 31 December		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
0.25% increase in the discount rate	(18)	(23)	(31)	(1,137)	(1,037)	(899)
0.25% increase in inflation	68	67	60	997	886	742
0.25% additional rate of increase in pensions in payment	44	42	39	671	580	495
0.25% additional rate of increase in deferred pensions	22	22	17	304	286	229
0.25% additional rate of increase in salaries	9	9	13	76	77	94
Longevity increase of 1 year	40	38	37	653	573	480

5 Auditor's remuneration

Amounts paid to the Group's auditor for statutory audit and other services are set out below:

	Group	
	2011 £m	2010 £m
Fees payable for the audit of the Group's annual accounts	4.9	4.9
Fees payable to the auditor and its associates for other services to the Group		
- the audit of the Bank's subsidiaries pursuant to legislation	7.8	7.8
Total audit and audit-related assurance services fees	12.7	12.7

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

6 Tax

	Group		
	2011 £m	2010 £m	2009 £m
Current tax			
Credit/(charge) for the year	47	(269)	(198)
Over provision in respect of prior periods	173	13	229
	220	(256)	31
Deferred tax			
(Charge)/credit for the year	(953)	(389)	658
Over/(under) provision in respect of prior periods	2	(68)	(166)
Tax (charge)/credit for the year	(731)	(713)	523

The actual tax (charge)/credit differs from the expected tax credit computed by applying the standard rate of UK corporation tax of 26.5% (2010 and 2009 - 28%) as follows:

	2011 £m	2010 £m	2009 £m
Expected tax credit	229	48	1
Other losses in year where no deferred tax asset recognised	(334)	(292)	(14)
Foreign profits taxed at other rates	(373)	(496)	(232)
UK tax rate change - deferred tax impact (1)	(141)	31	—
Unrecognised timing differences	(20)	11	274
Non-deductible goodwill impairment	(21)	—	(33)
Items not allowed for tax			
- losses on strategic disposals and write-downs	(31)	(95)	(47)
- UK bank levy	(80)	—	—
- employee share schemes	(113)	(32)	(29)
- other disallowable items	(287)	(268)	(259)
Non-taxable items			
- gain on sale of Global Merchant Services	12	221	—
- gain on redemption of own debt	—	1	626
- other non-taxable items	249	218	134
Taxable foreign exchange movements	4	(5)	39
Adjustments in respect of prior years (2)	175	(55)	63
Actual tax (charge)/credit	(731)	(713)	523

Notes:
(1) In the Budget on 22 June 2010, the UK Government proposed, amongst other things, to reduce Corporation Tax rates in four annual decrements of 1% with effect from 1 April 2011. An additional 1% decrement was announced by the UK Government in the Budget on 23 March 2011. The first decrement was enacted on 27 July 2010, the second on 29 March 2011 and the third on 5 July 2011. Existing temporary differences may therefore unwind in periods subject to these reduced tax rates. Accordingly, the closing deferred tax assets and liabilities have been calculated at the rate of 25%. In the Budget statement on 21 March 2012, the Chancellor of the Exchequer announced a further reduction of 1% in the rate of corporation tax from April 2012. The rate is therefore expected to fall by 2% from 26% to 24% in April 2012, to 23% in April 2013 and to 22% in April 2014.
(2) Prior year tax adjustments include releases of tax provisions in respect of structured transactions and investment disposals and adjustments to reflect submitted tax computations in the UK and overseas.

7 Profit attributable to preference shareholders

	Group		
	2011 £m	2010 £m	2009 £m
Non-cumulative preference shares of US$0.01	40	42	267
Non-cumulative preference shares of €0.01	18	18	179
Non-cumulative preference shares of £1	—	—	77
Total	58	60	523

Note:
(1) Between 1 January 2012 and the date of approval of these accounts, dividends amounting to US$30 million have been declared in respect of equity preference shares for payment on 30 March 2012.

8 Ordinary dividends

The Bank did not pay an ordinary dividend in 2011 or 2010 (2009 - £2,000 million).

9 Profit/(loss) dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement. Of the loss attributable to ordinary shareholders, a profit of £1,054 million (2010 - £274 million loss; 2009 - £1,063 million loss) has been dealt with in the accounts of the Bank.

10 Financial instruments - classification

The following tables show the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Group								
2011	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	68,487				68,487
Loans and advances to banks									
- reverse repos	34,659	—		—	3,101				37,760
- other (1)	32,391	199		—	26,790				59,380
Loans and advances to customers									
- reverse repos	53,583	—		—	7,674				61,257
- other	24,597	476		—	394,650		8,419		428,142
Debt securities (2)	91,761	520		71,392	5,468				169,141
Equity shares	9,844	575		1,343	—				11,762
Settlement balances	—	—		—	6,902				6,902
Derivatives	525,755		7,052						532,807
Intangible assets								12,365	12,365
Property, plant and equipment								11,478	11,478
Deferred tax								3,320	3,320
Prepayments, accrued income and other assets	—	—		—	32			5,860	5,892
Assets of disposal groups								24,088	24,088
	772,590	1,770	7,052	72,735	513,104		8,419	57,111	1,432,781
Liabilities									
Deposits by banks									
- repos	23,342	—				15,558			38,900
- other (3)	39,007	—				31,190			70,197
Customer accounts									
- repos	65,526	—				22,651			88,177
- other (4)	13,669	5,627				364,915			384,211
Debt securities in issue (5)	11,438	26,777				102,622			140,837
Settlement balances	—	—				6,778			6,778
Short positions	40,446	—							40,446
Derivatives	524,037		3,799						527,836
Accruals, deferred income and other liabilities	—	—				1,683	19	13,107	14,809
Retirement benefit liabilities								2,188	2,188
Deferred tax								1,384	1,384
Subordinated liabilities	—	465				31,859			32,324
Liabilities of disposal groups								22,840	22,840
	717,465	32,869	3,799			577,256	19	39,519	1,370,927
Equity									61,854
									1,432,781

For the notes relating to this table refer to page 202.

Notes on the accounts continued

10 Financial instruments - classification continued

	Group								
2010	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	49,838				49,838
Loans and advances to banks									
- reverse repos	38,215	—		—	2,315				40,530
- other (1)	28,550	186		—	18,239				46,975
Loans and advances to customers									
- reverse repos	41,110	—		—	8,050				49,160
- other	21,121	1,092		—	436,511		10,437		469,161
Debt securities (2)	91,771	141		67,437	6,680				166,029
Equity shares	482	496		1,362	—				2,340
Settlement balances	—	—		—	8,748				8,748
Derivatives	424,380		4,625						429,005
Intangible assets								11,832	11,832
Property, plant and equipment								16,143	16,143
Deferred tax								1,790	1,790
Prepayments, accrued income and other assets	—	—		—	30			6,207	6,237
Assets of disposal groups								9,542	9,542
	645,629	1,915	4,625	68,799	530,411		10,437	45,514	1,307,330
Liabilities									
Deposits by banks									
- repos	20,555	—				8,039			28,594
- other (3)	32,788	—				23,838			56,626
Customer accounts									
- repos	52,952	—				24,814			77,766
- other (4)	13,464	4,824				376,271			394,559
Debt securities in issue (5)	7,725	11,013				145,924			164,662
Settlement balances	—	—				8,501			8,501
Short positions	41,130	—							41,130
Derivatives	418,549		2,420						420,969
Accruals, deferred income and other liabilities	—	—				1,793	458	11,483	13,734
Retirement benefit liabilities								2,229	2,229
Deferred tax								1,422	1,422
Subordinated liabilities	—	468				31,555			32,023
Liabilities of disposal groups								7,508	7,508
	587,163	16,305	2,420			620,735	458	22,642	1,249,723
Equity									57,607
									1,307,330

For the notes relating to this table refer to page 202.

2009	Group Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	27,060				27,060
Loans and advances to banks									
- reverse repos	26,886	—		—	3,944				30,830
- other (1)	22,539	178		—	14,894				37,611
Loans and advances to customers									
- reverse repos	26,313	—		—	7,499				33,812
- other	15,595	1,354		—	472,179		13,229		502,357
Debt securities (2)	103,139	249		71,502	10,291				185,181
Equity shares	356	239		1,810	—				2,405
Settlement balances	—	—		—	9,153				9,153
Derivatives	443,518		2,835						446,353
Intangible assets								11,814	11,814
Property, plant and equipment								17,309	17,309
Deferred tax								2,228	2,228
Prepayments, accrued income and other assets	—	—		—	33			12,632	12,665
Assets of disposal groups								14,203	14,203
	638,346	2,020	2,835	73,312	545,053		13,229	58,186	1,332,981
Liabilities									
Deposits by banks									
- repos	20,962	—				14,620			35,582
- other (3)	38,437	—				42,119			80,556
Customer accounts									
- repos	41,520	—				24,505			66,025
- other (4)	12,786	3,450				371,041			387,277
Debt securities in issue (5)	4,084	10,087				158,242			172,413
Settlement balances	—	—				7,922			7,922
Short positions	36,472	—							36,472
Derivatives	421,765		2,779						424,544
Accruals, deferred income and other liabilities	—	—				2,887	467	13,120	16,474
Retirement benefit liabilities								2,622	2,622
Deferred tax								1,187	1,187
Subordinated liabilities	—	646				34,071			34,717
Liabilities of disposal groups								10,993	10,993
	576,026	14,183	2,779			655,407	467	27,922	1,276,784
Equity									56,197
									1,332,981

For the notes related to this table refer to page 202.

10 Financial instruments - classification continued

The above includes amounts due from/to:

Group	2011 Holding company £m	2011 Fellow subsidiaries £m	2010 Holding company £m	2010 Fellow subsidiaries £m	2009 Holding company £m	2009 Fellow subsidiaries £m
Assets						
Loans and advances to banks	—	27,232	—	4,848	—	5,274
Loans and advances to customers	322	470	—	1,946	4	1,945
Derivatives	79	10,301	231	17,238	446	31,574
Liabilities						
Deposits by banks	—	11,945	—	6,626	—	8,888
Customer accounts	2,596	583	4,507	4,427	16,494	2,297
Derivatives	1,502	9,875	1,475	12,780	1,169	28,175
Subordinated liabilities	15,772	—	15,028	—	14,966	—

Notes:

(1) Includes items in the course of collection from other banks of £1,470 million (2010 - £1,958 million; 2009 - £2,474 million).

(2) Debt securities balances with Group companies are shown on pages 100 and 101.

(3) Includes items in the course of transmission to other banks of £506 million (2010 - £577 million; 2009 - £770 million).

(4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £166 million higher (2010 - £233 million higher; 2009 - £101 million higher) than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable.

(5) Comprises bonds and medium term notes of £112,220 million (2010 - £109,528 million; 2009 - £92,612 million) and certificates of deposit and other commercial paper of £28,617 million (2010 - £55,134 million; 2009 - £79,801 million).

(6) During 2009, the Group reclassified financial assets from the held-for-trading category into the loans and receivables category, and in 2008 from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category (see pages 206 and 207).

Amounts included in the consolidated income statement:

	Group 2011 £m	Group 2010 £m	Group 2009 £m
Gains on financial assets/liabilities designated as at fair value through profit or loss	795	169	1,027
Gains/(losses) on disposal or settlement of loans and receivables	13	78	(16)

The following tables show the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

2011	Bank Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	64,261				64,261
Loans and advances to banks									
- reverse repos	25,396	—		—	14				25,410
- other (1)	33,475	199		—	49,956				83,630
Loans and advances to customers									
- reverse repos	40,797	—		—	1,251				42,048
- other	36,966	386		—	271,723				309,075
Debt securities (2)	51,670	1,266		57,288	71,236				181,460
Equity shares	9,793	329		364					10,486
Investment in Group undertakings								32,164	32,164
Settlement balances	—	—		—	4,059				4,059
Derivatives	531,498		5,799						537,297
Intangible assets								876	876
Property, plant and equipment								2,244	2,244
Deferred tax								2,584	2,584
Prepayments, accrued income and other assets								5,338	5,338
Assets of disposal groups								18,715	18,715
	729,595	2,180	5,799	57,652	462,500			61,921	1,319,647
Liabilities									
Deposits by banks									
- repos	21,406	—				7,311			28,717
- other (3)	42,646	—				162,934			205,580
Customer accounts									
- repos	32,458	—				4,670			37,128
- other (4)	36,371	1,588				221,815			259,774
Debt securities in issue (5)	11,438	26,773				76,313			114,524
Settlement balances	—	—				3,517			3,517
Short positions	24,858	—							24,858
Derivatives	529,104		1,751						530,855
Accruals, deferred income and other liabilities						1,130		7,710	8,840
Retirement benefit liabilities	—	—						25	25
Subordinated liabilities	—	465				29,549			30,014
Liabilities of disposal groups								20,478	20,478
	698,281	28,826	1,751			507,239		28,213	1,264,310
Equity									55,337
									1,319,647

For the notes relating to this table refer to page 206.

10 Financial instruments - classification continued

2010	Bank Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Non financial assets/ liabilities £m	Total £m
Assets								
Cash and balances at central banks	—	—		—	44,921			44,921
Loans and advances to banks								
- reverse repos	27,359	—		—	44			27,403
- other (1)	29,228	186		—	44,148			73,562
Loans and advances to customers								
- reverse repos	29,900	—		—	1,324			31,224
- other	28,237	561		—	289,157			317,955
Debt securities (2)	55,715	1,011		53,825	78,657			189,208
Equity shares	466	197		353	—			1,016
Investments in Group undertakings							27,504	27,504
Settlement balances	—	—		—	3,529			3,529
Derivatives	428,823		3,989					432,812
Intangible assets							443	443
Property, plant and equipment							2,301	2,301
Deferred tax							794	794
Prepayments, accrued income and other assets	—	—		—	—		4,760	4,760
Assets of disposal groups							4,765	4,765
	599,728	1,955	3,989	54,178	461,780		40,567	1,162,197
Liabilities								
Deposits by banks								
- repos	17,551	—				2,224		19,775
- other (3)	36,781	—				141,417		178,198
Customer accounts								
- repos	20,384	—				98		20,482
- other (4)	35,817	1,628				237,431		274,876
Debt securities in issue (5)	7,726	11,006				109,341		128,073
Settlement balances	—	—				3,343		3,343
Short positions	25,687	—						25,687
Derivatives	423,494		1,009					424,503
Accruals, deferred income and other liabilities	—	—				1,094	6,964	8,058
Retirement benefit liabilities							23	23
Subordinated liabilities	—	468				28,831		29,299
Liabilities of disposal groups							2,336	2,336
	567,440	13,102	1,009			523,779	9,323	1,114,653
Equity								47,544
								1,162,197

For the notes relating to this table refer to page 206.

2009	Bank							
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m
Assets								
Cash and balances at central banks	—	—		—	21,099			21,099
Loans and advances to banks								
- reverse repos	18,350	—		—	1,494			19,844
- other (1)	23,913	178		—	33,430			57,521
Loans and advances to customers								
- reverse repos	21,601	—		—	1,588			23,189
- other	22,156	817		—	292,386			315,359
Debt securities (2)	71,219	1		53,527	89,851			214,598
Equity shares	349	7		669	—			1,025
Investments in Group undertakings							29,385	29,385
Settlement balances	—	—		—	4,159			4,159
Derivatives	448,395		2,518					450,913
Intangible assets							210	210
Property, plant and equipment							2,447	2,447
Deferred tax							1,728	1,728
Prepayments, accrued income and other assets	—	—		—	—		9,988	9,988
Assets of disposal groups							7,150	7,150
	605,983	1,003	2,518	54,196	444,007		50,908	1,158,615
Liabilities								
Deposits by banks								
- repos	20,316	—				4,675		24,991
- other (3)	37,659	—				125,898		163,557
Customer accounts								
- repos	25,514	—				1,340		26,854
- other (4)	26,971	659				235,308		262,938
Debt securities in issue (5)	4,483	10,059				115,272		129,814
Settlement balances	—	—				4,541		4,541
Short positions	23,811	—						23,811
Derivatives	428,787		1,218					430,005
Accruals, deferred income and other liabilities	—	—				2,170	7,779	9,949
Retirement benefit liabilities							16	16
Subordinated liabilities	—	646				29,867		30,513
Liabilities of disposal groups							6,108	6,108
	567,541	11,364	1,218			519,071	13,903	1,113,097
Equity								45,518
								1,158,615

For the notes relating to this table refer to page 206.

10 Financial instruments - classification continued

The above includes amounts due from/to:

	Bank								
	2011			2010			2009		
	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Subsidiaries £m
Assets									
Loans and advances to banks	—	118	58,854	—	169	39,958	—	5,192	28,418
Loans and advances to customers	322	27,131	118,304	—	5,159	122,658	4	1,626	101,223
Derivatives	79	10,297	8,081	231	17,224	6,630	446	31,554	7,233
Liabilities									
Deposits by banks	—	672	157,327	—	311	138,295	—	—	113,240
Customer accounts	2,596	10,339	150,680	4,507	6,090	158,561	16,494	1,363	142,266
Derivatives	1,502	9,870	4,133	1,475	12,770	4,110	1,169	28,170	5,912

Notes:

(1) Includes items in the course of collection from other banks of £316 million (2010 - £463 million; 2009 - £426 million).

(2) Debt securities balances with Group companies are shown on pages 101 and 102.

(3) Includes items in the course of transmission to other banks of £138 million (2010 - £266 million; 2009 - £319 million).

(4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £46 million higher (2010 - £57 million higher; 2009 - £28 million higher) than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable.

(5) Comprises bonds and medium term notes of £97,838 million (2010 - £89,492 million; 2009 - £70,482 million) and certificates of deposit and other commercial paper of £16,686 million (2010 - £38,576 million; 2009 - £59,332 million).

(6) During 2009, the Bank reclassified financial assets from the held-for-trading category into the loans and receivables category, and in 2008 from the held-for-trading and available-for-sale categories into the loans and receiveables category and from the held-for-trading category into the available-for-sale category (see below).

Reclassification of financial instruments

The Group and Bank reclassified financial assets from the held-for-trading (HFT) and available-for-sale (AFS) categories into the loans and receivables (LAR) category (as permitted by paragraph 50D of IAS 39 as amended) and from the held-for-trading category into the available-for-sale category (as permitted by paragraph 50B of IAS 39 as amended).

The tables below show the carrying value, fair value and the effect on profit or loss of reclassifications undertaken by the Group in 2008 and 2009. There were no reclassifications in 2010 or 2011.

	Group					
			Amount recognised in income statement			
2011	Carrying value £m	Fair value £m	Income £m	Impairment releases/(losses) £m	Amount that would have been recognised had reclassification not occurred £m	Reduction/ (Increase) in profit or loss as a result of reclassification £m
Reclassified from HFT to LAR						
Loans	4,128	3,305	157	18	297	122
Debt securities	2,268	1,657	44	(12)	(255)	(287)
	6,396	4,962	201	6	42	(165)
Reclassified from HFT to AFS (1)						
Debt securities	2,601	2,601	(4)	1	2	5
Reclassified from AFS to LAR (2)						
Debt securities	248	229	(11)	(13)	(24)	—
	9,245	7,792	186	(6)	20	(160)

For the notes relating to this table refer to page 207.

2010	Carrying value £m	Fair value £m	Amount recognised in income statement: Income £m	Amount recognised in income statement: Impairment losses £m	Amount that would have been recognised had reclassification not occurred £m	Reduction in profit or loss as a result of reclassification £m
Reclassified from HFT to LAR						
Loans	5,210	4,261	227	(146)	483	402
Debt securities	3,008	2,678	65	(12)	387	334
	8,218	6,939	292	(158)	870	736
Reclassified from HFT to AFS (1)						
Debt securities	4,395	4,395	241	(3)	373	135
Reclassified from AFS to LAR (2)						
Debt securities	422	380	(31)	(50)	(81)	—
	13,035	11,714	502	(211)	1,162	871
2009						
Reclassified from HFT to LAR						
Loans	7,716	6,211	233	(1,263)	185	1,215
Debt securities	4,310	3,666	(105)	(16)	297	418
	12,026	9,877	128	(1,279)	482	1,633
Reclassified from HFT to AFS (1)						
Debt securities	5,775	5,775	285	(312)	839	866
Reclassified from AFS to LAR (2)						
Debt securities	869	745	21	—	21	—
	18,670	16,397	434	(1,591)	1,342	2,499

Group

Notes:

(1) The amount taken to AFS reserves was £17 million (2010 - £137 million; 2009 - £763 million).

(2) The amount that would have been taken to AFS reserves if reclassification had not occurred is £24 million (2010 - £98 million; 2009 - £(73) million).

The following table provides information for reclassifications made in 2009.

Group	2009 - on reclassification: Carrying value £m	2009 - on reclassification: Effective interest rate %	2009 - on reclassification: Expected cash flows £m	31 December 2009: Carrying value £m	31 December 2009: Fair value £m	2009: Losses up to the date of reclassification £m	2009: After reclassification: Income £m	2009: After reclassification: Impairment losses £m	2009: Additional amount that would have been recognised had reclassification not occurred £m	2009: Reduction in profit or loss as a result of reclassification £m	2008: Losses recognised in the income statement in prior period £m
Reclassified HFT to LAR											
Loans	1,740	5.9	2,640	887	924	(103)	(44)	(251)	(256)	39	(62)
Debt securities	255	5.5	349	190	188	(33)	—	—	(2)	(2)	(39)
	1,995		2,989	1,077	1,112	(136)	(44)	(251)	(258)	37	(101)

10 Financial instruments - classification continued

The table below shows the carrying value and fair value of reclassifications undertaken by the Bank in 2008 and 2009.

	Bank					
	2011		2010		2009	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Reclassified from HFT to LAR						
Loans	3,838	3,036	6,182	5,330	8,553	7,237
Debt securities	2,268	1,656	3,008	2,678	4,310	3,666
	6,106	4,692	9,190	8,008	12,863	10,903
Reclassified from HFT to AFS (1)						
Debt securites	2,601	2,601	4,395	4,395	5,775	5,775
Reclassified from AFS to LAR (2)						
Debt securities	248	229	422	380	869	745
	8,955	7,522	14,007	12,783	19,507	17,423

Notes:

(1) The amount taken to AFS reserves was £17 million (2010 - £137 million; 2009 - £763 million).

(2) The amount that would have been taken to AFS reserves if reclassification had not occurred is £24 million (2010 - £98 million; 2009 - £(73) million).

The following table provides information for reclassifications made in 2009.

	Bank				
	2009 - on reclassification			31 December 2009	
	Carrying value £m	Effective interest rate %	Expected cash flows £m	Carrying value £m	Fair value £m
Reclassified from HFT to LAR					
Loans	1,740	5.9	2,640	887	924
Debt securities	255	5.5	349	190	188
	1,995		2,989	1,077	1,112

11 Financial instruments - valuation

Valuation of financial instruments carried at fair value

Control environment

Common valuation policies, procedures, frameworks and models apply across the RBS Group. Therefore for the most part, discussions on these aspects below reflect those in the RBS Group as relevant for businesses and operations in the Group.

The RBS Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The RBS Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

A key element of the control environment is the independent price verification (IPV) process. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in light of available pricing evidence.

IPV variances are classified as hard, soft or indicative. A variance is hard where the independent information represents tradable or liquid prices and soft where it does not. Variances are classed as indicative where the independent evidence is so subjective or sparse that conclusions cannot be formed with a sufficient degree of confidence. Adjustments are required for all hard variances and for aggressive soft variances, with conservative and indicative variances not requiring automatic adjustment.

IPV is performed at a frequency to match the availability of independent data. For liquid instruments, the standard is to perform IPV daily. The minimum frequency of review in the RBS Group is monthly for exposures in the regulatory trading book and six monthly for exposures in the regulatory banking book. Monthly meetings are held between the business and the support functions to discuss the results of the IPV and reserves process in detail. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Global Pricing Unit (GPU) determines IPV policy, monitors adherence to that policy and performs additional independent reviews on highly subjective valuation issues for GBM and Non-Core.

During 2011, the Group made a significant and ongoing investment into enhancing its already robust control environment. This included continuing investment into a new global IPV and reserving tool, which partly automates the process of carrying out IPV and consolidation of reserves into a single central portal.

Valuation models are subject to a review process which requires different levels of model documentation, testing and review, depending on the complexity of the model and the size of the Group's exposure. A key element of the control environment for model use is a Modelled Product Review Committee, made up of valuations experts from several functions within the RBS Group. This committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure for review by the RBS Group's Quantitative Research Centre (QuaRC). Potential valuation uncertainty is a key input in determining model review priorities at these meetings. The QuaRC team within Group Risk, which is independent of the trading businesses, assesses the appropriateness of the application of the model to the product, the mathematical robustness of the model, and (where appropriate), considers alternative modelling approaches.

Senior management valuation control committees meet formally on a monthly basis to discuss independent pricing, reserving and valuation issues relating to both GBM and Non-Core exposures. All material methodology changes require review and ratification by these committees. The committees include valuation specialists representing several independent review functions which comprise market risk, QuaRC and finance.

The RBS Group Executive Valuation Committee discusses the issues escalated by the Modelled Product Review Committee, GBM and Non-Core senior management Valuations Control Committee and other relevant issues, including the APS credit derivative valuation. This committee covers key material and subjective valuation issues within the trading business and provides a ratification to the appropriateness of areas with high levels of residual valuation uncertainty. Committee members include the RBS Group Finance Director, the RBS Group Chief Accountant, RBS Group Global Head of Market and Insurance Risk, GBM Chief Financial Officer and Non-Core Chief Financial Officer, and representation from front office trading and finance.

Valuation issues, adjustments and reserves are reported to GBM, Non-Core and Group Audit Committees. Key judgmental issues are described in reports submitted to these Audit Committees.

New products

The Group has formal review procedures owned by Group Operational Risk to ensure that new products, asset classes and risk types are appropriately reviewed to ensure, amongst other things, that valuation is appropriate. The scope of this process includes new business, markets, models, risks and structures.

Valuation hierarchy

There is a process to review and control the classification of financial instruments into the three level hierarchy established by IFRS 7. Some instruments may not easily fall into a level of the fair value hierarchy per IFRS 7 (see page 214) and judgment may be required as to which level the instrument is classified.

Initial classification of a financial instrument is carried out by the Business Unit Control team following the principles in IFRS. The Business Unit Control team base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

11 Financial instruments - valuation continued

These initial classifications are challenged by GPU and are subject to senior management review. Particular attention is paid during the review processes upon instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

Valuation techniques

The Group derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

Non-modelled products

Non-modelled products are valued directly from a price input and are typically valued on a position by position basis and include cash, equities and most debt securities.

Modelled products

Modelled products are those that are valued using a pricing model, ranging in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

Inputs to valuation models

Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk. The principal inputs to these valuation techniques are as follows:

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.

- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.

- Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.

- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.

- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.

- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.

- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Volatility is a key input in valuing options and the valuation of certain products such as derivatives with more than one underlying variable that are correlation-dependent. Volatility and correlation values are obtained from broker quotations, pricing services or derived from option prices.

- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.

- Counterparty credit spreads - adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).

- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

The Group may use consensus prices for the source of independent pricing for some assets. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. GBM and Non-Core contribute to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services is used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available.

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price. Furthermore, on an ongoing basis, the Group assesses the appropriateness of any model used. To the extent that the price provided by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, the Group makes adjustments to the model valuation to calibrate to other available pricing sources. Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation. When establishing the fair value of a financial instrument using a valuation technique, the Group considers certain adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for any known model limitations.

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. The following table shows the Group's valuation reserves and adjustments.

	2011 £m	2010 £m	2009 £m
Credit valuation adjustments			
Monoline insurers	1,012	800	1,925
Credit derivative product companies	1,034	490	495
Other counterparties	2,069	1,609	1,401
	4,115	2,899	3,821
Bid-offer and liquidity reserves	2,652	2,607	2,532
	6,767	5,506	6,353

Credit valuation adjustments (CVA)

Credit valuation adjustments represent an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.

Monoline insurers

The Group has purchased protection from monoline insurers ("monolines"), mainly against specific Asset-backed securities. Monolines specialise in providing credit protection against the principal and interest cash flows due to the holders of debt instruments in the event of default by the debt instrument counterparty. This protection is typically held in the form of derivatives such as credit default swaps (CDSs) referencing underlying exposures held directly or synthetically by the Group.

The gross mark-to-market of the monoline protection depends on the value of the instruments against which protection has been bought. A positive fair value, or a valuation gain, in the protection is recognised if the fair value of the instrument it references decreases. For the majority of trades the gross mark-to-market of the monoline protection is determined directly from the fair value price of the underlying reference instrument However, for the remainder of the trades the gross mark-to-market is determined using industry standard models.

The methodology employed to calculate the monoline CVA uses market implied probability of defaults and internally assessed recovery levels to determine the level of expected loss on monoline exposures of different maturities. The probability of default is calculated with reference to market observable credit spreads and recovery levels. CVA is calculated at a trade level by applying the expected loss corresponding to each trade's expected maturity, to the gross mark-to-market of the monoline protection. The expected maturity of each trade reflects the scheduled notional amortisation of the underlying reference instruments and whether payments due from the monoline are received at the point of default or over the life of the underlying reference instruments.

Credit derivative product companies (CDPC)

A CDPC is a company that sells protection on credit derivatives. CDPCs are similar to monoline insurers however, they are not regulated as insurers.

The Group has purchased credit protection from CDPCs through tranched and single name credit derivatives. The Group's exposure to CDPCs is predominantly due to tranched credit derivatives ("tranches"). A tranche references a portfolio of loans and bonds and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point).

The Group has predominantly traded senior tranches with CDPCs, the average attachment and detachment points are 13% and 47% respectively (2010 - 13% and 49%; 2009 - 15% and 51%), and the majority of the loans and bonds in the reference portfolios are investment grade.

The gross mark-to-market of the CDPC protection is determined using industry standard models. The methodology employed to calculate the CDPC CVA is different to that outlined above for monolines, as there are no market observable credit spreads and recovery levels for these entities. The level of expected loss on CDPC exposures is estimated with reference to recent market events impacting CDPCs (including communication activity); risk mitigation strategies (including analysing the underlying trades and the cost of hedging expected default losses in excess of the available capital); and the total notional of trades transacted by each CDPC together with the level of resources available to settle default payments.

11 Financial instruments - valuation continued

Other counterparties

The CVA for all other counterparties is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Expected losses are applied to estimated potential future exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors. Potential future exposures arising from vanilla products (including interest rate and foreign exchange derivatives) are modelled jointly using the Group's core counterparty risk systems. The majority of the Group's CVA held in relation to other counterparties arises on these vanilla products. The exposures arising from all other product types are modelled and assessed individually. The potential future exposure to each counterparty is the aggregate of the exposures arising on the underlying product types.

The correlation between exposure and counterparty risk is also incorporated within the CVA calculation where this risk is considered significant. The risk primarily arises on trades with emerging market counterparties where the gross mark-to-market value of the trade, and therefore the counterparty exposure, increases as the strength of the local currency declines.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

CVA is held against exposures to all counterparties with the exception of the CDS protection that the Group has purchased from HM Treasury, as part of its participation in the Asset Protection Scheme, due to the unique features of this derivative.

Bid-offer and liquidity reserves

Fair value positions are adjusted to bid or offer levels, by marking individual cash based positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Risk data are used as the primary sources of information within bid-offer calculations and are aggregated when they are more granular than market standard buckets. Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together) and others) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market. Risk associated with non-identical underlying exposures is not netted down unless there is evidence that the cost of closing the combined risk exposure is less than the cost of closing on an individual basis.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

Netting is applied on a portfolio basis to reflect the level at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio’s individual trades. For example, netting is applied where long and short risk in two different maturity buckets can be closed out in a single market transaction at less cost than by way of two separate transactions (calendar netting). This reflects the fact that to close down the portfolio, the net risk can be settled rather than each long and short trade individually.

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations. Aggregation of risk arising from different models is in line with the Group's risk management practices; the model review control process considers the appropriateness of model selection in this respect.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how moves in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2011, net gains of £156 million (2010 - £156 million; 2009 - £159 million) were carried forward on the balance sheet. During the year, net gains of £87 million (2010 - £96 million; 2009 - £138 million) were deferred and £87 million (2010 - £99 million; 2009 - £21 million) were recognised in the income statement.

Own credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value in accordance with IFRS. Own credit spread adjustments are made are issued debt held at fair value, including issued structured notes and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). At the beginning of the year the spreads were based on levels which the market would demand when purchasing new senior or sub-debt issuances from the Group. During the year, primary debt issuance activity in the market reduced whilst liquidity remained in the secondary trading of Group senior debt. These secondary senior debt issuance spreads were considered to provide a more accurate reflection of fair value and these levels are therefore now used in the calculation of the own credit adjustment applied to senior debt. Where necessary, these quotes are interpolated using a curve shape derived from credit default swap prices.

The fair value of the RBS Group's derivative financial liabilities has also been adjusted to reflect the RBS Group's own credit risk. The adjustment takes into account collateral posted by it and the effects of master netting agreements.

The own credit adjustment for fair value does not alter cash flows, is not used for performance management, disregarded for regulatory capital reporting processes and will reverse over time as the liabilities mature.

The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserves are stated by conversion of underlying currency balances at spot rates for each period whereas the income statement includes intra-period foreign exchange sell-offs.

The effect of change in credit spreads could be reversed in future periods, or provided the liability is not repaid at a premium or a discount.

The following table shows the Group's own credit adjustments on own liabilities.

	Debt securities in issue (1)			Subordinated liabilities			
Cumulative own credit adjustment	HFT £m	DFV (2) £m	Total £m	DFV (2) £m	Total £m	Derivatives £m	Total £m
2011	882	1,995	2,877	241	3,118	540	3,658
2010	517	510	1,027	138	1,165	444	1,609
2009	548	482	1,030	267	1,297	417	1,714

Carrying values of underlying liabilities	£bn	£bn	£bn	£bn	£bn
2011	11.4	26.8	38.2	0.5	38.7
2010	7.7	11.0	18.7	0.5	19.2
2009	4.1	10.1	14.2	0.6	14.8

Notes:
(1) Consists of wholesale and retail note issuances.
(2) Designated as at fair value through profit and loss.

11 Financial instruments - valuation continued

Valuation hierarchy

The following table shows financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy - level 1, level 2 and level 3.

	2011				2010				2009			
	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn	Level 1 £bn	Level 2 £bn	Level 3 £bn	Total £bn
Assets												
Loans and advances to banks	—	66.8	0.4	67.2	—	66.6	0.4	67.0	—	49.6	—	49.6
Loans and advances to customers	—	78.2	0.4	78.6	—	63.1	0.2	63.3	—	42.8	0.5	43.3
Debt securities	101.2	55.0	7.5	163.7	92.7	59.3	7.3	159.3	94.9	76.0	4.0	174.9
Equity shares	10.2	1.0	0.6	11.8	0.7	1.0	0.6	2.3	0.7	0.9	0.8	2.4
Derivatives	0.2	525.8	6.8	532.8	1.7	421.8	5.5	429.0	0.3	440.5	5.5	446.3
	111.6	726.8	15.7	854.1	95.1	611.8	14.0	720.9	95.9	609.8	10.8	716.5
Proportion	13.1%	85.1%	1.8%	100%	13.2%	84.9%	1.9%	100%	13.4%	85.1%	1.5%	100%
Of which is classified as AFS (2)												
Debt securities	40.6	25.1	5.7	71.4	35.6	27.5	4.3	67.4	35.2	35.0	1.3	71.5
Equity shares	0.3	0.8	0.2	1.3	0.3	0.9	0.2	1.4	0.3	0.9	0.6	1.8
Total AFS assets (2)	40.9	25.9	5.9	72.7	35.9	28.4	4.5	68.8	35.5	35.9	1.9	73.3
Liabilities												
Deposits by banks and customers	—	147.2	—	147.2	—	124.4	0.2	124.6	—	117.1	0.1	117.2
Debt securities in issue	—	36.4	1.8	38.2	—	18.5	0.2	18.7	—	13.6	0.6	14.2
Short positions	34.1	6.1	0.2	40.4	33.5	6.8	0.8	41.1	24.4	11.9	0.2	36.5
Derivatives	0.4	523.4	4.0	527.8	0.2	419.4	1.4	421.0	0.2	422.7	1.6	424.5
Subordinated liabilities	—	0.5	—	0.5	—	0.5	—	0.5	—	0.6	—	0.6
	34.5	713.6	6.0	754.1	33.7	569.6	2.6	605.9	24.6	565.9	2.5	593.0
Proportion	4.6%	94.6%	0.8%	100%	5.6%	94.0%	0.4%	100%	4.2%	95.4%	0.4%	100%

Notes:

(1) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.

Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using;

(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or

(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued and certain money market securities and loan commitments and most OTC derivatives.

Level 3: Instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input. Financial instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, the majority of CDOs, other mortgage-backed products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

(2) Available-for-sale.

The following table analyses level 3 balances and related sensitivities.

	2011			2010			2009			
		Sensitivity (1)			Sensitivity (1)			Sensitivity (1)		
	Balance £bn	Favourable £m	Unfavourable £m	Balance £bn	Favourable £m	Unfavourable £m	Balance £bn	Favourable £m	Unfavourable £m	Assumptions
Assets										
Loans and advances	0.8	120	(70)	0.6	70	(60)	0.5	40	(10)	c, k
Debt securities										
Corporate	0.5	30	(30)	0.7	190	(140)	1.1	160	(50)	c
Financial institutions	7.0	510	(140)	6.6	510	(160)	2.9	280	(180)	a, c, d, i, j, m, n, o, p
	7.5	540	(170)	7.3	700	(300)	4.0	440	(230)	
Equity shares	0.6	80	(90)	0.6	110	(120)	0.8	120	(110)	h
Derivatives										
Credit - APS	—	—	—	0.6	860	(940)	1.4	1,370	(1,540)	a, c, e, g, l
Credit - other	3.8	670	(390)	3.0	300	(140)	2.6	360	(350)	a, b, q
Other	3.0	180	(190)	1.9	150	(140)	1.5	80	(90)	a, f, q, s
	6.8	850	(580)	5.5	1,310	(1,220)	5.5	1,810	(1,980)	
	15.7	1,590	(910)	14.0	2,190	(1,700)	10.8	2,410	(2,330)	
Liabilities										
Deposits	—	20	(20)	0.2	60	(80)	0.1	—	(10)	a, c
Debt securities in issue	1.8	50	(30)	0.2	30	(40)	0.6	—	—	a, q, r
Short positions	0.2	10	(30)	0.8	20	(50)	0.2	10	(20)	a, c
Derivatives										
Credit - other	1.5	70	(130)	0.3	40	(80)	0.7	40	(60)	a, b, q, s, t
Credit - APS (2)	0.2	300	(40)	—	—	—	0.2	20	(10)	a, c, e, g, l
Other	2.3	140	(140)	1.1	60	(100)	0.7	30	(30)	a, f, q, r
	4.0	510	(310)	1.4	100	(180)	1.6	90	(100)	
	6.0	590	(390)	2.6	210	(350)	2.5	100	(130)	

Key to assumptions:
(a) Correlation; (b) counterparty credit risk; (c) credit spreads; (d) default rates; (e) discount rate recoveries; (f) dividends; (g) expected losses; (h) fund valuation; (i) housing prices; (j) implied collateral valuation; (k) indices; (l) loss credits; (m) prepayment rates; (n) probability of default; (o) loss severity and yield; (p) recovery rates; (q) volatility; (r) proprietary model; (s) proprietary CVA model; (t) industry option models.

Notes:
(1) Sensitivity represents the favourable and unfavourable effect respectively on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs to the Group's valuation techniques or models. Totals for sensitivities are not indicative of the total potential effect on the income statement or the statement of comprehensive income.
(2) Asset Protection Scheme, reflecting arrangements with fellow subsidiaries.

The level 3 sensitivities above are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely overall potential uncertainty on the whole portfolio. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be observed. For example, with assets in the APS, the downwards sensitivity on the underlying asset would be partially offset by the consequent upward movement of the APS derivative, so whilst the net sensitivity of the two positions may be lower, it would be shown with the gross upside and downside sensitivity of the two assets inflating the overall sensitivity figures in the above table. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

11 Financial instruments - valuation continued

Judgmental issues

The diverse range of products traded by the Group results in a wide range of instruments that are classified into the three level hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of the Group's financial instruments carried at fair value are classified as level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is liquidity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input. For example, a derivative can be placed into level 2 or level 3 dependent upon its liquidity.

Where markets are liquid or very liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be made more difficult as assessing the liquidity of a market may not always be straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange can be more difficult.

A key related issue is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects.

Interaction with the IPV process

The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in level 2 or level 3 depending on whether the reference counterparty is liquid or illiquid.

As part of the Group's IPV process, data is gathered at a trade level from market trading activity, trading systems, pricing services, consensus pricing providers, brokers and research material amongst other sources.

The breadth and detail of this data allows a good assessment to be made of liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available the instrument will be considered to be level 3.

Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using the Group's model.

The decision to classify a modelled asset as level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability of input parameters and other factors. All these need to be assessed to classify the asset.

An assessment is made of each input into a model. There may be multiple inputs into a model and each is assessed in turn for observability and quality. If an input fails the observability or quality tests then the instrument is considered to be in level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments are classified as level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available. Examples of these products would be vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives.

Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the 3 levels. This is determined by the liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process.

The availability and quality of independent pricing information is considered during the classification process. An assessment is made regarding the quality of the independent information. For example where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be level 3. This hurdle rate is consistent with the rate used in the IPV process to determine whether or not the data is of sufficient quality to adjust the instrument's valuations. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations an assessment is made as to which source is the highest quality and this will be used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

Instruments that cross levels

Some instruments will predominantly be in one level or the other, but others may cross between levels. For example, a cross currency swap may be between very liquid currency pairs where pricing is readily observed in the market and will therefore be classified as level 2. The cross currency swap may also be between two illiquid currency pairs in which case the swap would be placed into level 3. Defining the difference between liquid and illiquid may be based upon the number of consensus providers the consensus price is made up from and whether the consensus price can be supplemented by other sources.

Level 3 portfolios and sensitivity methodologies

For each of the portfolio categories shown in the tables above, there follows a description of the types of products that comprise the portfolio and the valuation techniques that are applied in determining fair value, including a description of valuation techniques used for levels 2 and 3 and inputs to those models and techniques. Where reasonably possible alternative assumptions of unobservable inputs used in models would change the fair value of the portfolio significantly, the alternative inputs are indicated. Where there have been significant changes to valuation techniques during the year a discussion of the reasons for this are also included.

Loans and advances to customers

Loans in level 3 primarily comprise loans to emerging market counterparties, structured loans and legacy commercial mortgages.

Commercial mortgages

These senior and mezzanine commercial mortgages are loans secured on commercial land and buildings that were originated or acquired by the Group for securitisation. Senior commercial mortgages carry a variable interest rate and mezzanine or more junior commercial mortgages may carry a fixed or variable interest rate. Factors affecting the value of these loans may include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratios, prepayment rates, cumulative loan loss information, yields, investor demand, market volatility since the last securitisation. Where observable market prices for a particular loan are not available, the fair value will typically be determined with reference to observable market transactions in other loans or credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the loan and the available benchmark data.

Debt securities

Level 3 debt securities principally comprise asset-backed securities.

Residential mortgage-backed securities (RMBS)

RMBS where the underlying assets are US agency-backed mortgages and there is regular trading are generally classified as level 2 in the fair value hierarchy. RMBS are also classified as level 2 when regular trading is not prevalent in the market, but similar executed trades or third-party data including indices, broker quotes and pricing services can be used to substantiate the fair value. RMBS are classified as level 3 when trading activity is not available and a model with significant unobservable data is utilised.

In determining whether an instrument is similar to that being valued, the Group considers a range of factors, principally: the lending standards of the brokers and underwriters that originated the mortgages, the lead manager of the security, the issue date of the respective securities, the underlying asset composition (including origination date, loan to value ratios, historic loss information and geographic location of the mortgages), the credit rating of the instrument, and any credit protection that the instrument may benefit from, such as insurance wraps or subordinated tranches. Where there are instances of market observable data for several similar RMBS tranches, the Group considers the extent of similar characteristics shared with the instrument being valued, together with the frequency, tenor and nature of the trades that have been observed. This method is most frequently used for US and UK RMBS. RMBS of Dutch and Spanish originated mortgages guaranteed by those governments are valued using the credit spreads of the respective government debt and certain assumptions made by the Group, or based on observable prices from Bloomberg or consensus pricing services.

The Group primarily uses an industry standard model to project the expected future cash flows to be received from the underlying mortgages and to forecast how these cash flows will be distributed to the various holders of the RMBS. This model utilises data provided by the servicer of the underlying mortgage portfolio, layering on assumptions for mortgage prepayments, probability of default, expected losses, and yield. The Group uses data from third-party sources to calibrate its assumptions, including pricing information from third party pricing services, independent research, broker quotes, and other independent sources. An assessment is made of third-party data source to determine its applicability and reliability. The Group adjusts the model price with a liquidity premium to reflect the price that the instrument could be traded in the market and may also make adjustments for model deficiencies.

The fair value of securities within each class of asset changes on a broadly consistent basis in response to changes in given market factors. However, the extent of the change, and therefore the range of reasonably possible alternative assumptions, may be either more or less pronounced, depending on the particular terms and circumstances of the individual security. The Group believes that probability of default was the least transparent input into Alt-A and prime RMBS modelled valuations (and most sensitive to variations).

Commercial mortgage-backed securities (CMBS)

CMBS are valued using an industry standard model and the inputs, where possible, are corroborated using observable market data.

11 Financial instruments - valuation continued

Collateralised debt obligations (CDO)

CDOs purchased from third parties are valued using independent, third-party quotes or independent lead manager indicative prices. For super senior CDOs which have been originated by the Group no specific third-party information is available. The valuation of these super senior CDOs therefore takes into consideration outputs from a proprietary model, market data and appropriate valuation adjustments.

A collateral net asset value methodology using dealer buy side marks is used to determine an upper bound for super senior CDO valuations. An ABS index implied collateral valuation, is also used to provide a market calibrated valuation data point. Both the ABS index implied valuation and the collateral net asset value methodology apply an assumed immediate liquidation approach.

Collateralised loan obligations (CLO)

To determine the fair value of CLOs purchased from third parties, the Group uses third party broker or lead manager quotes as the primary pricing source. These quotes are benchmarked to consensus pricing sources where they are available.

For CLOs originated and still held by the Group, the fair value is determined using a correlation model based on a Monte Carlo simulation framework. The main model inputs are credit spreads and recovery rates of the underlying assets and their correlation. A credit curve is assigned to each underlying asset based on prices from third party dealer quotes and cash flow profiles, sourced from an industry standard model. Losses are calculated taking into account the attachment and detachment point of the exposure. Where the correlation inputs to this model are not observable, CLOs are classified as level 3.

Other asset-backed and corporate debt securities

Where observable market prices for a particular debt security are not available, the fair value will typically be determined with reference to observable market transactions in other related products, such as similar debt securities or credit derivatives. Assumptions are made about the relationship between the individual debt security and the available benchmark data. Where significant management judgement has been applied in identifying the most relevant related product, or in determining the relationship between the related product and the instrument itself, the instrument is classified as level 3.

Equity shares

Private equity investments include unit holdings and limited partnership interests primarily in corporate private equity funds, debt funds and fund of hedge funds. Externally managed funds are valued using recent prices where available. Where not available, the fair value of investments in externally managed funds is generally determined using statements or other information provided by the fund managers.

The Group considers that valuations may rely significantly on the judgements and estimates made by the fund managers, particularly in assessing private equity components. Given the decline in liquidity in world markets, and the level of subjectivity, these are included in level 3.

Derivatives

Derivatives are priced using quoted prices for the same or similar instruments where these are available. However, the majority of derivatives are valued using pricing models. Inputs for these models are usually observed directly in the market, or derived from observed prices. However, it is not always possible to observe or corroborate all model inputs. Unobservable inputs used are based on estimates taking into account a range of available information including historic analysis, historic traded levels, market practice, comparison to other relevant benchmark observable data and consensus pricing data.

Credit derivatives - APS

The Group purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HM Treasury. The Group has a right to terminate the APS at any time provided that the Financial Services Authority has confirmed in writing to HM Treasury that it has no objection to the proposed termination. On termination the Group must pay HM Treasury the higher of the regulatory capital relief received and £2.5 billion less premiums paid plus the aggregate of amounts received from the UK Government under the APS. The Group has paid APS premiums totalling £2,225 million (2011 - £125 million; 2010 - £700 million; 2009 - £1,400 million). From 31 December 2011 premiums of £125 million are payable quarterly until the earlier of 2099 and the date the Group leaves the Scheme.

The APS is a single contract providing credit protection in respect of the covered assets. Under IFRS, credit protection is treated either as a financial guarantee contract or as a derivative financial instrument depending on the terms of the agreement and the nature of the protected assets and exposures. The Group has concluded, principally because the covered portfolio includes significant exposure in the form of derivatives, that the APS does not meet the criteria to be treated as a financial guarantee contract. The contract has therefore been accounted for as a derivative financial instrument. It was recognised initially and measured subsequently at fair value with changes in fair value recognised in profit or loss within income from trading activities. There is no change in the recognition and measurement of the covered assets as a result of the APS.

For the purpose of the APS, a loss is deemed to have arisen on a covered asset when that asset has experienced a trigger event which comprises of failure to pay subject to grace periods, bankruptcy and restructuring.

The Bank has also entered into two agreements with RBS N.V., a fellow subsidiary, under which it has sold credit protection over the exposures held by its subsidiaries that are subject to the APS. These agreements cover 100% of losses on these assets. One agreement provides protection over a portfolio that includes significant exposure in the form of derivatives; the other covers assets that are measured at amortised cost. The former agreement is accounted for as a credit derivative. The second agreement meets the definition of a financial guarantee contract and is accounted for as such.

Where protection is provided on a particular seniority of exposure, as is the case with the APS, which requires initial losses to be taken by the Group, it is termed ‘tranched’ protection. The model being used to value the APS - a Gaussian Copula model with stochastic recoveries - is used by the Group to value tranches traded by the exotic credit desk and is a model that is currently used within the wider market.

The option to exit the APS is not usually present in such tranched trades and consequently, there is no standard market practice for reflecting this part of the trade within the standard model framework. The approach that has been adopted assumes that the Group will not exit the trade before the minimum level of fees have been paid and at this point it will be clear whether it should exit the trade or not. The APS derivative is valued as the payment of the minimum level of fees in return for protection receipts which are in excess of both the first loss and the total future premiums.

The model primarily uses the following inputs in relation to each individual non-triggered asset: notional, maturity, probability of default and expected recovery rate given default. Other key inputs include: the correlation between the underlying assets; the range of possible recovery rates on the underlying assets ("alpha"); the size of the first loss. The size of the first loss is adjusted to reflect both realised and expected losses on triggered assets as well as the level of expected losses on covered assets that have been sold, that can be treated as losses for the purpose of the APS ("loss credits").

During 2011, refinements were made to the treatment of expected losses on certain triggered assets following a modification to the trigger events that apply to some portfolios. The valuation refinement was made to accurately reflect the impact of the changes. The expected losses arising on assets that trigger under the modified rules now reflect a range of possible recovery rates.

The APS protects a wide range of asset types, and hence, the correlation between the underlying assets cannot be observed from market data. In the absence of this, the Group determines a reasonable level for this input. The expected recovery rate given default is based on internally assessed levels. The probability of default is calculated with reference to data observable in the market. Where possible, data is obtained for each asset within the APS, but for most of the assets, such observable data does not exist. In these cases, this important input is determined from information available for similar entities by geography and rating. The approach for doing this was refined during the year in order to accurately reflect both changes in market conditions and the profile of the portfolio of covered assets.

As the inputs into the valuation model are not all observable the APS derivative is a level 3 instrument. The fair value of the credit protection at 31 December 2011 was a £0.2 billion liability (2010 - £0.6 billion asset; 2009 - £1.4 billion asset).

The Group has used the following reasonably possible alternative assumptions in relation to those inputs that could have a significant effect on the valuation of the APS:

Correlation: +/- 10%
The correlation uncertainty relates to both the nature of the underlying portfolio and the seniority of protection. The +/- 10% correlation range looks reasonable in light of market observable correlations of similar levels of protection seniority, for portfolios of investment grade and high yield assets.

Range of possible recovery rates on underlying assets (alpha): +/- 10%
The level of alpha used in the valuation of the APS is in line with that used to value tranches traded by the exotic credit desk and assumes that the underlying assets have a wide range of potential recovery rates. As the APS protects a wider range of asset classes than is generally referenced by exotic credit trades, there is uncertainty in relation to this approach. A comparison of actual recoveries to expected recoveries supports the approach adopted and, in light of this, only changes of +/- 10% in the assumed width of this range are considered reasonable.

Credit spreads: +/- 10%
The credit spread uncertainty relates to determining the probability of default for assets where there is no such observable data in the market. An analysis of the impact on credit spreads of small changes in the ratings assumptions in key geographic regions indicated that overall credit spread movements in the +/- 10% range look reasonable.

Discount curve: +/- 1%
Due to the long-dated contractual maturity of the APS, and the requirement to pay fixed levels of premiums each year, the valuation is sensitive to long-term interest rates. Valuation uncertainty arises due to the illiquidity of such interest rates. An interest rate range of +/- 1% is considered reasonable.

Loss credits: +/- 10%
The level of expected losses on covered assets that have been sold that can be treated as losses for the purpose of the APS are assessed by the Asset Protection Agency. For disposals made by the Group where this assessment has not been completed, the Group makes an estimate of the likely assessment for the purpose of valuing of the APS. A range of +/- 10% in the level of assessment is considered reasonable.

Using the above reasonably possible alternative assumptions, the fair value of the APS derivative could be higher by approximately £295 million or lower by approximately £44 million as detailed in the table below.

Sensitivity	Favourable £m	Unfavourable £m
Correlation +/- 10%	35	(23)
Recover alpha +/- 10%	64	(44)
Spreads +/- 10%	5	(5)
Discount curve +/- 1%	48	(34)
Loss credit +/- 10%	2	(2)
Cumulative offset	141	64
Total	295	(44)

Individual sensitivities above have been aggregated and do not reflect the correlated effect of some of the assumptions as related sensitivities.

Additionally the credit derivative with RBS N.V. was insignificant at 31 December 2011 and 2010. At 31 December 2009, the value was £0.2 billion.

11 Financial instruments - valuation continued

Credit derivatives - other

The Group's other credit derivatives include vanilla and bespoke portfolio tranches, gap risk products and certain other unique trades.

Valuation of single name credit derivatives is carried out using industry standard models. Where single name derivatives have been traded and there is a lack of independent data or the quality of the data is weak, these instruments are classified into level 3. These assets will be priced using the Group's standard credit derivative model using a proxy curve based upon a suitable alternative single name curve, a cash based product or a sector based curve. Where the sector based curve is used, the proxy will be chosen taking maturity, rating, seniority, geography and internal credit review on recoveries into account. Sensitivities for these instruments will be based upon the selection of reasonable alternative assumptions which may include adjustments to the credit curve and recovery rate assumptions.

The bespoke portfolio tranches are synthetic tranches referenced to a bespoke portfolio of corporate names on which the Group purchases credit protection. Bespoke portfolio tranches are valued using Gaussian Copula, a standard method which uses observable market inputs (credit spreads, index tranche prices and recovery rates) to generate an output price for the tranche by way of a mapping methodology. In essence this method takes the expected loss of the tranche expressed as a fraction of the expected loss of the whole underlying portfolio and calculates which detachment point on the liquid index, and hence which correlation level, coincides with this expected loss fraction. Where the inputs into this valuation technique are observable in the market, bespoke tranches are considered to be level 2 assets. Where inputs are not observable, bespoke tranches are considered to be level 3 assets. However, all transactions executed with a CDPC counterparty are considered level 3 as the counterparty credit risk assessment is a significant component of these valuations.

Gap risk products are leveraged trades, with the counterparty's potential loss capped at the amount of the initial principal invested. Gap risk is the probability that the market will move discontinuously too quickly to exit a portfolio and return the principal to the counterparty without incurring losses, should an unwind event be triggered. This optionality is embedded within these portfolio structures and is very rarely traded outright in the market. Gap risk is not observable in the markets and, as such, these structures are deemed to be level 3 instruments.

Other unique trades are valued using a specialised model for each instrument and the same market data inputs as all other trades where applicable. By their nature, the valuation is also driven by a variety of other model inputs, many of which are unobservable in the market. Where these instruments have embedded optionality they are valued using a variation of the Black-Scholes option pricing formula, and where they have correlation exposure they are valued using a variant of the Gaussian Copula model. The volatility or unique correlation inputs required to value these products are generally unobservable and the instruments are therefore deemed to be level 3 instruments.

Equity derivatives

Equity derivative products are split into equity exotic derivatives and equity hybrids. Equity exotic derivatives have payouts based on the performance of one or more stocks, equity funds or indices. Most payouts are based on the performance of a single asset and are valued using observable market option data. Unobservable equity derivative trades are typically complex basket options on stocks. Such basket option payouts depend on the performance of more than one equity asset and require correlations for their valuation. Valuation is then performed using industry standard valuation models, with unobservable correlation inputs calculated by reference to correlations observed between similar underlyings.

Equity hybrids have payouts based on the performance of a basket of underlyings where underlyings are from different asset classes. Correlations between these different underlyings are typically unobservable with no market information on closely related assets available. Where no market for the correlation input exists, these inputs are based on historical time series.

Interest rate and commodity derivatives

Interest rate and commodity options provide a payout (or series of payouts) linked to the performance of one or more underlying, including interest rates, foreign exchange rates and commodities.

Exotic options do not trade in active markets except in a small number of cases. Consequently, the Group uses models to determine fair value using valuation techniques typical for the industry. These techniques can be divided firstly, into modelling approaches and secondly, into methods of assessing appropriate levels for model inputs. The Group uses a variety of proprietary models for valuing exotic trades.

Exotic valuation inputs include the correlation between interest rates, foreign exchange rates and commodity prices. Correlations for more liquid rate pairs are valued using independently sourced consensus pricing levels. Where a consensus pricing benchmark is unavailable, these instruments are classified as level 3.

The carrying value of debt securities in issue is represented partly by underlying cash and partly through a derivative component. The classification of the amount in level 3 is driven by the derivative component and not by the cash element.

Other financial instruments

In addition to the portfolios discussed above, there are other financial instruments which are held at fair value determined from data which are not market observable, or incorporating material adjustments to market observed data.

Level 3 movement table

2011	At 1 January £m	Amounts recorded in the Income statement (1) £m	Amounts recorded in the SOCI (2) £m	Level 3 transfers In £m	Level 3 transfers Out £m	Issuances £m	Purchases £m	Settlements £m	Sales £m	Foreign exchange £m	At 31 December £m	Amounts recorded in the income statement relating to instruments held at year end £m
Assets												
FVTPL (3)												
Loans and advances	658	2	—	145	—	—	698	(658)	(85)	(1)	759	(11)
Debt securities	2,920	(17)	—	114	(254)	—	1,066	(149)	(1,761)	(8)	1,911	(91)
Equity shares	410	(18)	—	32	(16)	—	49	(22)	(80)	(5)	350	(20)
Derivatives	5,484	(479)	—	3,142	(1,360)	—	776	(653)	(120)	60	6,850	(592)
FVTPL assets	9,472	(512)	—	3,433	(1,630)	—	2,589	(1,482)	(2,046)	46	9,870	(714)
AFS												
Debt securities	4,335	2	3	2,097	(21)	—	98	(806)	(47)	2	5,663	2
Equity shares	188	(5)	33	6	—	—	6	(1)	(17)	—	210	(4)
AFS assets	4,523	(3)	36	2,103	(21)	—	104	(807)	(64)	2	5,873	(2)
	13,995	(515)	36	5,536	(1,651)	—	2,693	(2,289)	(2,110)	48	15,743	(716)
Liabilities												
Deposits	262	(40)	—	—	—	—	—	(4)	(195)	(1)	22	(25)
Debt securities in issue	231	(41)	—	857	(436)	275	908	(2)	—	1	1,793	(41)
Short positions	772	(71)	—	—	(1)	20	14	—	(502)	3	235	(207)
Derivatives	1,359	291	—	1,860	(173)	8	873	(165)	(97)	35	3,991	275
Other financial liabilities	1	—	—	—	(1)	—	—	—	—	—	—	—
	2,625	139	—	2,717	(611)	303	1,795	(171)	(794)	38	6,041	2
Net (losses)/gains		(654)	36									(718)

For the notes relating to this table refer to page 223.

11 Financial instruments - valuation continued

Level 3 movement table continued

2010	At 1 January £m	Amounts recorded in the Income statement (1) £m	SOCI (2) £m	Transfers in/(out) of level 3 £m	Issuances £m	Purchases £m	Settlements £m	Sales £m	Foreign exchange £m	At 31 December £m	Amounts recorded in the income statement relating to instruments held at year end £m
Assets											
FVTPL (3)											
Loans and advances	549	(1)	—	(24)	—	519	(229)	(165)	9	658	(4)
Debt securities	2,684	206	—	1,067	—	1,908	(373)	(2,605)	33	2,920	79
Equity shares	198	74	—	52	—	216	—	(132)	2	410	54
Derivatives	5,509	(1,479)	—	1,996	—	1,034	(152)	(1,475)	51	5,484	(1,479)
FVTPL assets	8,940	(1,200)	—	3,091	—	3,677	(754)	(4,377)	95	9,472	(1,350)
AFS											
Debt securities	1,278	26	512	2,902	—	306	(444)	(274)	29	4,335	10
Equity shares	615	(4)	(39)	(118)	—	18	(2)	(297)	15	188	(4)
AFS assets	1,893	22	473	2,784	—	324	(446)	(571)	44	4,523	6
	10,833	(1,178)	473	5,875	—	4,001	(1,200)	(4,948)	139	13,995	(1,344)
Liabilities											
Deposits	102	—	—	(10)	—	200	(32)	—	2	262	—
Debt securities in issue	592	71	—	—	—	—	(432)	—	—	231	71
Short positions	162	(186)	—	792	6	—	(2)	—	—	772	(179)
Derivatives	1,602	(115)	—	(120)	—	275	(257)	(61)	35	1,359	(86)
Other financial liabilities	1	—	—	—	—	—	—	—	—	1	—
	2,459	(230)	—	662	6	475	(723)	(61)	37	2,625	(194)
Net (losses)/gains		(948)	473								(1,150)

For the notes relating to this table refer to page 223.

2009	At 1 January £m	Amounts recorded in the Income statement (1) £m	Amounts recorded in the SOCI (2) £m	Transfers in/out of level 3 £m	Reclassification £m	Purchases and issues £m	Sales and settlements £m	Foreign exchange £m	At 31 December £m	Amounts recorded in the income statement relating to instruments held at year end £m
Assets										
FVTPL (3)										
Loans and advances to customers	3,148	108	—	(156)	(1,537)	19	(898)	(135)	549	7
Debt securities	3,780	(124)	—	(835)	(157)	1,291	(1,147)	(124)	2,684	(89)
Equity shares	352	(49)	—	(7)	—	14	(106)	(6)	198	(20)
Derivatives	6,345	(3,057)	—	366	—	3,327	(1,276)	(196)	5,509	(381)
FVTPL assets	13,625	(3,122)	—	(632)	(1,694)	4,651	(3,427)	(461)	8,940	(483)
AFS										
Debt securities	2,277	(325)	(47)	(255)	—	128	(470)	(30)	1,278	(8)
Equity shares	729	(127)	(13)	62	—	53	(51)	(38)	615	(127)
AFS assets	3,006	(452)	(60)	(193)	—	181	(521)	(68)	1,893	(135)
	16,631	(3,574)	(60)	(825)	(1,694)	4,832	(3,948)	(529)	10,833	(618)
Liabilities										
Deposits by banks and customers	290	43	—	(217)	—	15	(24)	(5)	102	—
Debt securities in issue	804	(13)	—	3	—	72	(274)	—	592	(75)
Short positions	41	(45)	—	166	—	4	(4)	—	162	12
Derivatives	2,798	(51)	—	(713)	—	305	(638)	(99)	1,602	(32)
Other financial liabilities	257	—	—	—	—	—	(242)	(14)	1	—
	4,190	(66)	—	(761)	—	396	(1,182)	(118)	2,459	(95)
Net (losses)/gains		(3,508)	(60)							(523)

Notes:
(1) Net losses on held-for-trading instruments of £650 million (2010 - £1,018 million; 2009 - £3,018 million) were recorded in income from trading activities. Net losses on other instruments of £4 million (2010 - £70 million gains; 2009 - £490 million losses) were recorded in other operating income, interest income and impairment losses as appropriate.
(2) Consolidated statement of comprehensive income.
(3) Fair value through profit or loss.

There were no significant transfers between level 1 and level 2 during 2009, 2010 and 2011.

Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

	Group						Bank					
	2011 Carrying value £bn	2011 Fair value £bn	2010 Carrying value £bn	2010 Fair value £bn	2009 Carrying value £bn	2009 Fair value £bn	2011 Carrying value £bn	2011 Fair value £bn	2010 Carrying value £bn	2010 Fair value £bn	2009 Carrying value £bn	2009 Fair value £bn
Financial assets												
Cash and balances at central banks	68.5	68.5	49.8	49.8	27.1	27.1	64.3	64.3	44.9	44.9	21.1	21.1
Loans and advances to banks	29.9	29.8	20.6	20.5	18.8	18.8	50.0	50.2	44.2	43.8	34.9	34.9
Loans and advances to customers	410.7	381.8	455.0	431.0	492.9	465.1	273.0	258.1	290.5	281.2	294.0	277.5
Debt securities	5.5	4.9	6.7	6.0	10.3	9.5	71.2	70.8	78.7	77.4	89.9	90.0
Settlement balances	6.9	6.9	8.7	8.7	9.2	9.2	4.1	4.1	3.5	3.5	4.2	4.2
Financial liabilities												
Deposits by banks	46.7	46.1	31.9	31.8	56.7	56.7	170.2	170.1	143.6	143.6	130.6	130.5
Customer accounts	387.6	387.7	401.1	401.1	395.5	395.0	226.5	223.5	237.5	234.6	236.6	238.5
Debt securities in issue	102.6	100.5	145.9	142.8	158.2	155.4	76.3	75.7	109.3	108.4	115.3	115.6
Subordinated liabilities	31.9	28.7	31.6	30.4	34.1	31.7	29.5	27.0	28.8	27.8	29.9	27.8
Settlement balances	6.8	6.8	8.5	8.5	7.9	7.9	3.5	3.5	3.3	3.3	4.5	4.5

11 Financial instruments - valuation continued

The fair value is the amount an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement. As a wide range of valuation techniques is available, it may be inappropriate to compare the Group's fair value information to independent markets or other financial institutions.

The fair values of intangible assets, such as core deposits, credit card and other customer relationships are not included in the calculation of these fair values as they are not financial instruments.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

The fair value of financial instruments which are of short maturity (three months or less) approximates their carrying value. This mainly applies to cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks and demand deposits.

Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

(a) contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for the majority of GBM's lending portfolios where most counterparties have external ratings.

(b) expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK Retail, UK Corporate and Ulster Bank reflecting the more homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, for example Ulster Bank's corporate property lending portfolio, a bespoke approach is used based on available market data.

The discount to amortised cost reflects current stressed markets for Non-Core loans, real estate lending in Ireland and other commercial real estate loans, and, in GBM, corporate downgrades.

Debt securities

Fair values are determined using quoted prices where available or by reference to quoted prices of similar instruments.

Deposits by banks and customer accounts

Fair values of deposits are estimated using discounted cash flow valuation techniques.

Debt securities in issue and subordinated liabilities

Fair values are determined using quoted prices where available or by reference to valuation techniques, adjusting for own credit spreads where appropriate.

12 Financial instruments - maturity analysis

Remaining maturity

The following tables show the residual maturity of financial instruments, based on contractual date of maturity.

	Group								
	2011			2010			2009		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets									
Cash and balances at central banks	68,487	—	68,487	49,830	8	49,838	27,051	9	27,060
Loans and advances to banks	93,304	3,836	97,140	84,281	3,224	87,505	65,422	3,019	68,441
Loans and advances to customers	181,880	307,519	489,399	180,573	337,748	518,321	171,907	364,262	536,169
Debt securities	37,178	131,963	169,141	30,031	135,998	166,029	54,042	131,139	185,181
Equity shares	—	11,762	11,762	—	2,340	2,340	—	2,405	2,405
Settlement balances	6,902	—	6,902	8,748	—	8,748	9,150	3	9,153
Derivatives	60,216	472,591	532,807	62,662	366,343	429,005	70,023	376,330	446,353
Liabilities									
Deposits by banks	95,725	13,372	109,097	80,850	4,370	85,220	111,025	5,113	116,138
Customer accounts	458,230	14,158	472,388	457,106	15,219	472,325	436,337	16,965	453,302
Debt securities in issue	60,642	80,195	140,837	80,233	84,429	164,662	96,732	75,681	172,413
Settlement balances and short positions	14,037	33,187	47,224	13,229	36,402	49,631	12,468	31,926	44,394
Derivatives	62,487	465,349	527,836	66,808	354,161	420,969	70,968	353,576	424,544
Subordinated liabilities	684	31,640	32,324	1,076	30,947	32,023	1,366	33,351	34,717

	Bank								
	2011			2010			2009		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets									
Cash and balances at central banks	64,261	—	64,261	44,921	—	44,921	21,099	—	21,099
Loans and advances to banks	96,531	12,509	109,040	91,901	9,064	100,965	66,292	11,073	77,365
Loans and advances to customers	182,666	168,457	351,123	155,713	193,466	349,179	146,843	191,705	338,548
Debt securities	53,676	127,784	181,460	47,383	141,825	189,208	56,574	158,024	214,598
Equity shares	—	10,486	10,486	—	1,016	1,016	—	1,025	1,025
Settlement balances	4,059	—	4,059	3,529	—	3,529	4,156	3	4,159
Derivatives	60,230	477,067	537,297	62,905	369,907	432,812	70,322	380,591	450,913
Liabilities									
Deposits by banks	210,057	24,240	234,297	185,766	12,207	197,973	176,708	11,840	188,548
Customer accounts	189,210	107,692	296,902	178,670	116,688	295,358	202,735	87,057	289,792
Debt securities in issue	48,718	65,806	114,524	61,878	66,195	128,073	72,799	57,015	129,814
Settlement balances and short positions	9,957	18,418	28,375	5,918	23,112	29,030	8,695	19,657	28,352
Derivatives	62,467	468,388	530,855	67,015	357,488	424,503	71,667	358,338	430,005
Subordinated liabilities	372	29,642	30,014	585	28,714	29,299	429	30,084	30,513

12 Financial instruments - maturity analysis continued

On balance sheet liabilities

The following tables show, by contractual maturity, the undiscounted cash flows payable up to a period of 20 years from the balance sheet date, including future payments of interest.

	Group					
2011	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Deposits by banks	35,596	4,487	5,256	400	1,008	364
Customers accounts	351,077	22,742	12,282	5,076	1,207	758
Debt securities in issue	63,623	11,342	17,869	14,241	15,640	3,380
Derivatives held for hedging	216	524	1,174	739	739	583
Subordinated liabilities	13,819	2,341	5,315	5,085	7,700	9,700
Settlement balances and other liabilities	8,461	5	10	3	1	1
	472,792	41,441	41,906	25,544	26,295	14,786
Guarantee and commitments - notional amount						
Guarantees (1, 2)	9,244	—	—	—	—	—
Commitments (3)	221,145	—	—	—	—	—
	230,389	—	—	—	—	—
2010						
Deposits by banks	26,306	3,298	1,276	385	612	374
Customer accounts	371,310	17,859	7,459	3,729	2,117	719
Debt securities in issue	82,291	36,368	14,783	12,667	12,190	4,100
Derivatives held for hedging	240	549	919	428	285	28
Subordinated liabilities	13,230	2,741	8,032	5,770	7,404	10,327
Settlement balances and other liabilities	10,309	32	78	67	204	25
	503,686	60,847	32,547	23,046	22,812	15,573
Guarantee and commitments - notional amount						
Guarantees (1, 2)	10,393	—	—	—	—	—
Commitments (3)	234,203	—	—	—	—	—
	244,596	—	—	—	—	—
2009						
Deposits by banks	44,112	7,622	2,959	1,371	135	11
Customer accounts	379,452	9,988	3,784	2,387	3,277	2,011
Debt securities in issue	75,943	28,689	43,068	8,806	7,095	1,599
Derivatives held for hedging	391	1,008	1,174	173	14	19
Subordinated liabilities	2,231	2,291	4,607	5,107	13,678	2,523
Settlement balances and other liabilities	9,817	39	93	91	233	83
	511,946	49,637	55,685	17,935	24,432	6,246
Guarantee and commitments - notional amount						
Guarantees (1, 2)	11,202	—	—	—	—	—
Commitments (3)	248,529	—	—	—	—	—
	259,731	—	—	—	—	—

Notes:

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.

(2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £5,753 million (2010 - £12,479 million; 2009 - £20,680 million) between the Bank and a fellow subsidiary.

(3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

2011	Bank 0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Deposits by banks	147,543	6,828	9,692	3,992	926	85
Customers accounts	212,668	6,526	2,343	2,337	3,396	1,325
Debt securities in issue	40,982	11,296	17,577	14,183	15,618	3,232
Derivatives held for hedging	67	221	535	374	347	312
Subordinated liabilities	13,786	1,981	5,074	4,586	6,984	9,234
Settlement balances and other liabilities	4,646	—	—	1	—	—
	419,692	26,852	35,221	25,473	27,271	14,188
Guarantee and commitments - notional amount						
Guarantees (1, 2)	4,145	—	—	—	—	—
Commitments (3)	145,472	—	—	—	—	—
	149,617	—	—	—	—	—
2010						
Deposits by banks	126,755	7,315	3,808	2,018	1,169	1,023
Customer accounts	221,228	5,648	2,561	2,323	5,605	4,156
Debt securities in issue	53,991	33,292	14,919	12,603	11,844	3,014
Derivatives held for hedging	59	133	332	275	250	21
Subordinated liabilities	13,208	2,220	7,575	5,297	7,186	9,694
Settlement balances and other liabilities	4,437	—	—	—	—	—
	419,678	48,608	29,195	22,516	26,054	17,908
Guarantee and commitments - notional amount						
Guarantees (1, 2)	4,716	—	—	—	—	—
Commitments (3)	144,276	—	—	—	—	—
	148,992	—	—	—	—	—
2009						
Deposits by banks	100,007	13,531	15,069	2,160	556	28
Customer accounts	196,316	7,049	1,124	3,265	28,606	2,733
Debt securities in issue	42,687	26,770	41,699	8,187	6,726	553
Derivatives held for hedging	135	427	508	96	28	58
Subordinated liabilities	592	1,874	3,667	4,864	12,953	1,770
Settlement balances and other liabilities	5,709	4	—	—	—	—
	345,446	49,655	62,067	18,572	48,869	5,142
Guarantee and commitments - notional amount						
Guarantees (1, 2)	5,592	—	—	—	—	—
Commitments (3)	158,752	—	—	—	—	—
	164,344	—	—	—	—	—

Notes:
(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.
(2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £5,753 million (2010 - £12,479 million; 2009 - £20,680 million) between the Bank and a fellow subsidiary.
(3) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months' period whatever the level of the index at the year end. The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

12 Financial instruments - maturity analysis continued

Liabilities with a contractual maturity of greater than 20 years - the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the table along with interest payments after 20 years.

Held-for-trading assets and liabilities - held-for-trading assets of £772.6 billion and liabilities of £717.5 billion (2010 - £645.6 billion assets and £587.2 billion liabilities; 2009 - £638.3 billion assets and £576.0 billion liabilities) for the Group and £729.6 billion of assets and £698.3 billion of liabilities (2010 - £599.7 billion assets and £567.4 billion liabilities; 2009 - £606.0 billion assets and £567.5 billion liabilities) for the Bank, have been excluded from the table in view of their short-term nature.

13 Financial assets - impairments

The following tables show the movement in the provision for impairment losses on loans and advances.

	Group					
	Individually assessed £m	Collectively assessed £m	Latent £m	2011 £m	2010 £m	2009 £m
At 1 January	9,105	5,166	2,499	16,770	12,020	6,655
Transfers to disposal groups	(158)	(536)	(79)	(773)	(72)	—
Currency translation and other adjustments	(178)	(45)	(38)	(261)	(5)	(243)
Transfers from fellow subsidiaries	3	—	—	3	—	—
Disposal of subsidiaries	—	—	—	—	(13)	—
Amounts written-off	(1,966)	(2,217)	—	(4,183)	(4,375)	(5,716)
Recoveries of amounts previously written-off	267	241	—	508	360	307
Charged to the income statement	4,896	2,570	(497)	6,969	9,299	11,373
Unwind of discount (recognised in interest income)	(337)	(142)	—	(479)	(444)	(356)
At 31 December (1)	11,632	5,037	1,885	18,554	16,770	12,020

Note:
(1) Includes £85 million relating to loans and advances to banks (2010 - £88 million; 2009 - £90 million).

	Bank					
	Individually assessed £m	Collectively assessed £m	Latent £m	2011 £m	2010 £m	2009 £m
At 1 January	3,564	1,294	723	5,581	4,650	2,475
Transfers to disposal groups	(148)	(519)	(79)	(746)	(72)	—
Currency translation and other adjustments	(21)	(9)	2	(28)	(6)	(263)
Transfers from fellow subsidiaries	3	—	—	3	—	—
Amounts written-off	(1,211)	(553)	—	(1,764)	(2,537)	(2,701)
Recoveries of amounts previously written-off	206	81	—	287	145	66
Charged to the income statement	1,198	402	(175)	1,425	3,514	5,169
Unwind of discount (recognised in interest income)	(90)	(45)	—	(135)	(113)	(96)
At 31 December (1)	3,501	651	471	4,623	5,581	4,650

Note:
(1) Includes £76 million relating to loans and advances to banks (2010 - £79 million; 2009 - £80 million).

	Group		
Impairment losses charged to the income statement	2011 £m	2010 £m	2009 £m
Loans and advances to customers	6,969	9,299	11,365
Loans and advances to banks	—	—	8
	6,969	9,299	11,373
Debt securities	172	71	603
Equity shares	35	30	198
	207	101	801
	7,176	9,400	12,174

	Group		
	2011 £m	2010 £m	2009 £m
Gross income not recognised but which would have been recognised under the original terms of the impaired loans			
Domestic	634	568	613
Foreign	905	530	657
	1,539	1,098	1,270
Interest on impaired loans included in net interest income			
Domestic	217	214	213
Foreign	261	230	143
	478	444	356

The following tables analyse impaired financial assets.

	Group								
	2011			2010			2009		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables									
Loans and advances to banks (1)	94	85	9	98	88	10	100	90	10
Loans and advances to customers (2)	37,020	16,584	20,436	33,693	14,183	19,510	27,415	9,569	17,846
	37,114	16,669	20,445	33,791	14,271	19,520	27,515	9,659	17,856

	Group		
	Carrying value 2011 £m	Carrying value 2010 £m	Carrying value 2009 £m
Available-for-sale securities			
Debt securities	546	566	758
Equity shares	57	43	178
Loans and receivables			
Debt securities	114	107	—
	717	716	936

	Bank								
	2011			2010			2009		
	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m	Cost £m	Provision £m	Carrying value £m
Loans and receivables									
Loans and advances to banks (1)	85	76	9	89	79	10	90	80	10
Loans and advances to customers (3)	12,215	4,076	8,139	12,584	4,779	7,805	11,696	3,797	7,899
	12,300	4,152	8,148	12,673	4,858	7,815	11,786	3,877	7,909

	Bank		
	Carrying value 2011 £m	Carrying value 2010 £m	Carrying value 2009 £m
Available-for-sale securities			
Debt securities	537	560	754
Equity shares	9	16	153
Loans and receivables			
Debt securities	114	107	—
	660	683	907

Notes:
(1) Impairment provisions individually assessed.
(2) Impairment provisions individually assessed on balances of £27,614 million (2010 - £23,679 million; 2009 - £18,383 million).
(3) Impairment provisions individually assessed on balances of £10,889 million (2010 - £10,205 million; 2009 - £9,295 million).

13 Financial assets - impairments continued

The following tables show financial and non-financial assets, recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements.

	Group		
	2011 £m	2010 £m	2009 £m
Residential property	60	47	52
Other property	73	139	110
Cash	56	127	283
Other assets	2	28	42
	191	341	487

	Bank		
	2011 £m	2010 £m	2009 £m
Cash	23	19	242

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

	Group					Bank				
	Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m	Total £m	Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m	Total £m
2011	6,184	1,633	1,004	1,958	10,779	653	213	131	477	1,474
2010	7,179	2,087	1,162	2,839	13,267	944	368	206	1,003	2,521
2009	6,272	2,252	2,386	3,069	13,979	1,212	477	585	1,157	3,431

These balances include loans and advances to customers that are past due through administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

14 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk to within approval limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger ticket financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposure to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2011, variable rate financial assets of £48.5 billion for the Group and £37.1 billion for the Bank, and variable rate financial liabilities of £12.0 billion for the Group and £4.1 billion for the Bank were hedged in such cash flow hedge relationships.
For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap or by comparing the respective changes in the price value of a basis point. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk, the hedged items are typically government bonds, large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2011, fixed rate financial assets of £17.1 billion for the Group and £9.7 billion for the Bank, and fixed rate financial liabilities of £35.8 billion for the Group and £35.0 billion for the Bank were hedged by interest rate swaps in fair value hedge relationships.

The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap or by comparing the respective changes in the price value of a basis point. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

The following table shows the notional amounts and fair values of the Group's derivatives:

	Group								
	2011			2010			2009		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts									
Spot, forwards and futures	2,097	30,316	28,917	2,758	40,830	42,307	1,974	26,766	26,329
Currency swaps	1,044	24,482	34,499	963	28,344	35,584	960	29,310	30,815
Options purchased	640	19,098	—	505	14,938	—	436	16,768	—
Options written	641	—	18,597	546	—	13,763	472	—	15,603
Interest rate contracts									
Interest rate swaps	29,965	348,986	334,118	29,704	250,108	242,288	30,786	270,305	255,141
Options purchased	2,398	74,590	—	2,622	57,475	—	3,225	54,993	—
Options written	2,593	—	72,058	2,738	—	54,280	2,592	—	52,270
Futures and forwards	3,757	876	744	4,619	3,061	1,262	6,551	2,090	2,035
Credit derivatives	1,063	27,017	26,750	1,341	28,201	24,446	1,611	42,580	37,816
Equity and commodity contracts	127	7,442	12,153	81	6,048	7,039	95	3,541	4,535
		532,807	527,836		429,005	420,969		446,353	424,544

Certain derivative asset and liability balances with the London Clearing House, which meet the offset criteria in IAS 32 'Financial Instruments: Presentation', are shown net.

14 Derivatives continued

	Group					
	2011		2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Amounts above include:						
Due from/to holding company	79	1,502	231	1,475	446	1,169
Due from/to fellow subsidiaries	10,301	9,875	17,238	12,780	31,574	28,175

Included above are derivatives held for hedging purposes as follows:

	Group					
	2011		2010		2009	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging						
Exchange rate contacts	—	—	—	—	8	—
Interest rate swaps	2,968	2,524	1,722	1,412	1,598	1,122
Cash flow hedging						
Exchange rate contracts	—	—	—	—	2	—
Interest rate swaps	3,964	1,270	2,903	995	1,227	1,646
Net investment hedging						
Exchange rate contracts	120	5	—	13	—	11

Hedge ineffectiveness recognised in other operating income comprised:

	Group		
	2011 £m	2010 £m	2009 £m
Fair value hedging			
Gains/(losses) on the hedged items attributable to the hedged risk	212	(120)	628
(Losses)/gains on the hedging instruments	(193)	62	(571)
Fair value effectiveness	19	(58)	57
Cash flow hedging effectiveness	20	(37)	14
	39	(95)	71

The following tables show for the Group, when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

	Group								
2011	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	401	409	354	300	195	264	—	—	1,923
Forecast payable cash flows	(79)	(66)	(33)	(30)	(31)	(145)	(192)	(57)	(633)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	416	396	349	285	183	249	—	—	1,878
Forecast payable cash flows	(81)	(62)	(32)	(30)	(30)	(147)	(192)	(56)	(630)
2010									
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	280	254	219	161	120	169	30	—	1,233
Forecast payable cash flows	(47)	(41)	(33)	(30)	(30)	(137)	(176)	(54)	(548)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	281	250	214	157	112	161	28	—	1,203
Forecast payable cash flows	(46)	(41)	(33)	(30)	(29)	(137)	(175)	(54)	(545)

2009	Group 0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	389	384	357	212	117	202	40	—	1,701
Forecast payable cash flows	(356)	(345)	(269)	(217)	(170)	(480)	(444)	(84)	(2,365)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	389	385	356	200	117	194	40	—	1,681
Forecast payable cash flows	(356)	(341)	(262)	(213)	(168)	(469)	(444)	(83)	(2,336)

The following table shows the notional amounts and fair values of the Bank's derivatives.

	Bank 2011			2010			2009		
	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m	Notional amount £bn	Assets £m	Liabilities £m
Exchange rate contracts									
Spot, forwards and futures	2,110	30,432	29,168	2,776	41,097	42,530	1,991	26,972	26,687
Currency swaps	1,059	24,802	35,097	982	28,984	37,355	974	29,698	32,996
Options purchased	641	19,121	—	505	14,960	—	438	16,806	—
Options written	642	—	18,620	547	—	13,784	474	—	15,629
Interest rate contracts									
Interest rate swaps	29,988	353,177	336,267	29,840	252,931	243,498	31,095	273,894	257,731
Options purchased	2,405	74,487	—	2,628	57,320	—	3,183	54,859	—
Options written	2,592	—	72,091	2,751	—	54,315	2,555	—	52,342
Futures and forwards	3,703	862	735	4,533	3,051	1,265	6,519	2,085	2,038
Credit derivatives	1,063	27,017	26,682	1,343	28,268	24,455	1,618	42,809	37,893
Equity and commodity contracts	124	7,399	12,195	80	6,201	7,301	94	3,790	4,689
		537,297	530,855		432,812	424,503		450,913	430,005

Amounts above include:	Bank 2011 Assets £m	Liabilities £m	2010 Assets £m	Liabilities £m	2009 Assets £m	Liabilities £m
Due from/to holding company	79	1,502	231	1,475	446	1,169
Due from/to fellow subsidiaries	10,297	9,870	17,224	12,770	31,554	28,170
Due from/to subsidiaries	8,081	4,133	6,630	4,110	7,233	5,912

Included in the above are derivatives held for hedging purposes as follows:

	Bank 2011 Assets £m	Liabilities £m	2010 Assets £m	Liabilities £m	2009 Assets £m	Liabilities £m
Fair value hedging						
Exchange rate contracts	—	—	—	1	—	—
Interest rate contracts	2,711	1,248	1,559	702	1,458	550
Cash flow hedging						
Exchange rate contracts	—	—	—	—	2	—
Interest rate contracts	3,088	503	2,430	306	1,058	668

14 Derivatives continued

The following tables show for the Bank, when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

	Bank								
2011	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	311	318	276	228	136	174	—	—	1,443
Forecast payable cash flows	(22)	(22)	(10)	(7)	(8)	(37)	(73)	(23)	(202)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	321	308	271	214	127	162	—	—	1,403
Forecast payable cash flows	(25)	(20)	(9)	(7)	(7)	(39)	(73)	(22)	(202)
2010									
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	248	226	195	145	107	157	30	—	1,108
Forecast payable cash flows	(14)	(14)	(10)	(10)	(10)	(47)	(71)	(19)	(195)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	249	222	191	141	99	150	28	—	1,080
Forecast payable cash flows	(14)	(14)	(10)	(10)	(10)	(47)	(71)	(19)	(195)
2009									
Hedged forecast cash flows expected to occur									
Forecast receivable cash flows	320	315	287	166	73	106	—	—	1,267
Forecast payable cash flows	(105)	(100)	(87)	(79)	(73)	(308)	(404)	(84)	(1,240)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	320	316	286	153	73	99	—	—	1,247
Forecast payable cash flows	(105)	(98)	(86)	(79)	(73)	(308)	(404)	(84)	(1,237)

15 Debt securities

2011	UK central and local government £m	US central and local government £m	Other central and local government £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS (1) £m
	Group							
Held-for-trading	9,004	18,770	35,146	3,649	22,577	2,615	91,761	20,815
Designated as at fair value through profit or loss	1	—	—	53	457	9	520	418
Available-for-sale	10,654	18,769	13,987	4,624	22,907	451	71,392	25,996
Loans and receivables	10	—	—	32	5,093	333	5,468	5,057
	19,669	37,539	49,133	8,358	51,034	3,408	169,141	52,286
Available-for-sale								
Gross unrealised gains	1,312	967	700	3	874	9	3,865	952
Gross unrealised losses	—	—	—	(32)	(326)	(12)	(370)	(336)
2010								
Held-for-trading	5,092	15,619	39,971	3,657	23,086	4,346	91,771	21,988
Designated as at fair value through profit or loss	1	117	1	4	8	10	141	119
Available-for-sale	5,651	20,266	14,559	7,033	19,752	176	67,437	26,296
Loans and receivables	11	—	—	3	6,377	289	6,680	6,019
	10,755	36,002	54,531	10,697	49,223	4,821	166,029	54,422
Available-for-sale								
Gross unrealised gains	244	293	145	58	798	2	1,540	998
Gross unrealised losses	—	(2)	—	(13)	(317)	(43)	(375)	(334)
2009								
Held-for-trading (2)	8,120	9,147	47,022	5,404	28,779	4,667	103,139	26,246
Designated as at fair value through profit or loss	1	205	—	3	30	10	249	207
Available-for-sale	17,086	14,923	9,561	3,645	24,850	1,437	71,502	31,640
Loans and receivables (2)	1	—	—	—	7,564	2,726	10,291	7,562
	25,208	24,275	56,583	9,052	61,223	8,840	185,181	65,655
Available-for-sale								
Gross unrealised gains	72	217	32	8	491	11	831	674
Gross unrealised losses	(50)	(98)	(24)	(2)	(977)	(197)	(1,348)	(1,162)

Notes:

(1) Includes securities issued by US federal agencies, government sponsored entities and covered bonds.

(2) During 2009, the Group reclassified debt securities from the held-for-trading category into the loans and receivables category, and in 2008 from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category (see pages 206 and 207).

Gross gains of £786 million (2010 - £341 million; 2009 - £557 million) and gross losses of £58 million (2010 - £81 million; 2009 - £229 million) were realised on the sale of available-for-sale securities.

15 Debt securities continued

2011	UK central and local government £m	US central and local government £m	Other central and local government £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS (1) £m
	Bank							
Held-for-trading	9,004	2,266	31,410	2,473	4,862	1,655	51,670	3,563
Designated as at fair value through profit or loss	—	—	—	49	1,216	1	1,266	1,237
Available-for-sale	10,654	16,051	13,497	4,502	12,250	334	57,288	11,838
Loans and receivables	6	—	—	285	70,614	331	71,236	70,834
	19,664	18,317	44,907	7,309	88,942	2,321	181,460	87,472
Available-for-sale								
Gross unrealised gains	1,312	862	690	2	587	2	3,455	563
Gross unrealised losses	—	—	—	(29)	(267)	(11)	(307)	(277)
2010								
Held-for-trading	5,092	2,783	36,744	3,541	5,021	2,534	55,715	4,693
Designated as at fair value through profit or loss	—	—	—	—	1,011	—	1,011	1,011
Available-for-sale	5,651	15,585	13,301	6,527	11,990	771	53,825	13,503
Loans and receivables	11	—	—	254	78,106	286	78,657	77,531
	10,754	18,368	50,045	10,322	96,128	3,591	189,208	96,738
Available-for-sale								
Gross unrealised gains	244	111	130	50	644	—	1,179	660
Gross unrealised losses	—	—	—	(2)	(150)	(41)	(193)	(179)
2009								
Held-for-trading (2)	8,120	636	42,748	5,059	11,214	3,442	71,219	10,829
Designated as at fair value through profit or loss	—	—	—	—	—	1	1	1
Available-for-sale	17,086	8,928	7,994	3,041	14,413	2,065	53,527	15,274
Loans and receivables (2)	—	—	—	—	87,125	2,726	89,851	86,580
	25,206	9,564	50,742	8,100	112,752	8,234	214,598	112,684
Available-for-sale								
Gross unrealised gains	72	38	16	3	207	10	346	211
Gross unrealised losses	(50)	(87)	(24)	—	(662)	(197)	(1,020)	(846)

Notes:

(1) Includes securities issued by US federal agencies, government sponsored entities and covered bonds.

(2) During 2009, the Bank reclassified debt securities from the held-for-trading category into the loans and receivables category, and in 2008 from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category (see page 208).

16 Equity shares

Group	2011			2010			2009		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	9,779	65	9,844	416	66	482	349	7	356
Designated as at fair value through profit or loss	336	239	575	201	295	496	38	201	239
Available-for-sale	215	1,128	1,343	223	1,139	1,362	250	1,560	1,810
	10,330	1,432	11,762	840	1,500	2,340	637	1,768	2,405
Available-for-sale									
Gross unrealised gains	50	185	235	46	144	190	73	176	249
Gross unrealised losses	(18)	(21)	(39)	(11)	(34)	(45)	(10)	(57)	(67)

Gross gains of £139 million (2010 - £48 million; 2009 - £17 million) and gross losses of nil (2010 - £55 million; 2009 - £33 million) were realised on the sale of available-for-sale equity shares.

Dividend income from available-for-sale equity shares was £216 million (2010 - £176 million; 2009 - £50 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include capital stock (redeemable at cost) in the Federal Home Loan Bank and Federal Reserve Bank of £0.7 billion (2010 - £0.8 billion; 2009 - £0.8 billion), together with a number of individually small shareholdings. Disposals in the year generated gains of £2.3 million (2010 - £1.9 million losses; 2009 - £0.6 million losses).

Bank	2011			2010			2009		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	9,736	57	9,793	401	65	466	343	6	349
Designated as at fair value through profit or loss	300	29	329	162	35	197	—	7	7
Available-for-sale	190	174	364	186	167	353	218	451	669
	10,226	260	10,486	749	267	1,016	561	464	1,025
Available-for-sale									
Gross unrealised gains	40	76	116	28	54	82	53	72	125
Gross unrealised losses	(15)	(1)	(16)	(11)	—	(11)	(10)	(13)	(23)

17 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	Bank		
	2011 £m	2010 £m	2009 £m
At 1 January	27,504	29,385	26,814
Currency translation and other adjustments	21	364	(224)
Additional investments in Group undertakings	5,238	3,015	3,724
Additions	59	—	42
Redemption of investments in Group undertakings	(618)	(4,994)	(914)
Disposals	—	(78)	—
Impairment of investments	(40)	(188)	(57)
At 31 December	32,164	27,504	29,385

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest. All of the subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, and are all wholly-owned. All of these subsidiaries are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operation
National Westminster Bank Plc (1)	Banking	Great Britain
Citizens Financial Group, Inc. (3)	Banking	US
Coutts & Company (2, 3)	Private Banking	Great Britain
RBS Securities Inc (3)	Broker dealer	US
Ulster Bank Limited (3, 4)	Banking	Northern Ireland

Notes:
(1) The Bank does not hold any of the NatWest preference shares in issue.
(2) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.
(3) Shares are not directly held by the Bank.
(4) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

The above information is provided in relation to the principal related undertakings as permitted by section 410(2) of the Companies Act 2006. Full information on all related undertakings will be included in the Annual Return delivered to the Registrar of Companies for Scotland.

18 Intangible assets

	Group				
2011	Goodwill £m	Core deposit intangibles £m	Other purchased intangibles £m	Internally generated software £m	Total £m
Cost					
At 1 January	18,292	349	385	3,995	23,021
Transfers to disposal groups	(95)	—	—	—	(95)
Transfers to fellow subsidiary	—	—	—	(83)	(83)
Currency translation and other adjustments	9	16	1	73	99
Acquisition of subsidiaries	18	—	—	—	18
Additions	—	—	34	934	968
Disposals and write-off of fully amortised assets	—	—	—	(19)	(19)
At 31 December	18,224	365	420	4,900	23,909
Accumulated amortisation and impairment					
At 1 January	7,567	338	248	3,036	11,189
Transfers to disposal groups	(80)	—	—	—	(80)
Transfers to fellow subsidiary	—	—	—	(35)	(35)
Currency translation and other adjustments	(5)	—	4	15	14
Disposals and write-off of fully amortised assets	—	—	—	(17)	(17)
Charge for the year	—	3	65	325	393
Write down of goodwill and other intangible assets	80	—	—	—	80
At 31 December	7,562	341	317	3,324	11,544
Net book value at 31 December	10,662	24	103	1,576	12,365

2010	Goodwill £m	Core deposit intangibles £m	Other purchased intangibles £m	Internally generated software £m	Total £m
	Group				
Cost					
At 1 January	18,455	344	394	3,502	22,695
Currency translation and other adjustments	376	30	14	2	422
Additions	—	—	46	637	683
Disposals of subsidiaries	(539)	(25)	(69)	(63)	(696)
Disposals and write-off of fully amortised assets	—	—	—	(83)	(83)
At 31 December	18,292	349	385	3,995	23,021
Accumulated amortisation and impairment					
At 1 January	7,448	328	251	2,854	10,881
Currency translation and other adjustments	162	13	9	(4)	180
Disposal of subsidiaries	(44)	(23)	(55)	(37)	(159)
Disposals and write-off of fully amortised assets	—	—	—	(68)	(68)
Charge for the year	—	20	43	291	354
Write down of goodwill and other intangible assets	1	—	—	—	1
At 31 December	7,567	338	248	3,036	11,189
Net book value at 31 December	10,725	11	137	959	11,832
2009					
Cost					
At 1 January	19,636	401	380	3,216	23,633
Transfers to disposal groups	(238)	—	—	—	(238)
Currency translation and other adjustments	(969)	(55)	(39)	(11)	(1,074)
Acquisition of subsidiaries	26	—	—	—	26
Additions	—	—	53	350	403
Disposals and write-off of fully amortised assets	—	(2)	—	(53)	(55)
At 31 December	18,455	344	394	3,502	22,695
Accumulated amortisation and impairment					
At 1 January	7,804	309	250	2,679	11,042
Currency translation and other adjustments	(474)	(33)	(27)	(6)	(540)
Disposals and write-off of fully amortised assets	—	(1)	—	(37)	(38)
Charge for the year	—	53	28	218	299
Write down of goodwill and other intangible assets	118	—	—	—	118
At 31 December	7,448	328	251	2,854	10,881
Net book value at 31 December	11,007	16	143	648	11,814

18 Intangible assets continued

2011	Bank Goodwill £m	Internally generated software £m	Total £m
Cost			
At 1 January	41	1,471	1,512
Transfer from subsidiary	85	—	85
Transfer to subsidiaries	—	(91)	(91)
Additions	—	625	625
Disposals and write-off of fully amortised assets	—	(17)	(17)
At 31 December	126	1,988	2,114
Accumulated amortisation and impairment			
At 1 January	12	1,057	1,069
Transfer to subsidiaries	—	(39)	(35)
Disposals and write-off of fully amortised assets	—	(14)	(18)
Charge for the year	—	222	222
At 31 December	12	1,226	1,238
Net book value at 31 December	114	762	876
2010			
Cost			
At 1 January	39	1,148	1,187
Currency translation and other adjustments	2	1	3
Additions	—	441	441
Disposal of subsidiaries	—	(51)	(51)
Disposals and write-off of fully amortised assets	—	(68)	(68)
At 31 December	41	1,471	1,512
Accumulated amortisation and impairment			
At 1 January	12	965	977
Disposal of subsidiaries	—	(32)	(32)
Disposals and write-off of fully amortised assets	—	(68)	(68)
Charge for the year	—	192	192
At 31 December	12	1,057	1,069
Net book value at 31 December	29	414	443
2009			
Cost			
At 1 January	23	1,011	1,034
Transfers to disposal groups	(9)	—	(9)
Currency translation and other adjustments	(1)	—	(1)
Acquisition of subsidiaries	26	—	26
Additions	—	190	190
Disposals and write-off of fully amortised assets	—	(53)	(53)
At 31 December	39	1,148	1,187
Accumulated amortisation and impairment			
At 1 January	12	886	898
Currency translation and other adjustments	—	(2)	(2)
Disposals and write-off of fully amortised assets	—	(37)	(37)
Charge for the year	—	118	118
At 31 December	12	965	977
Net book value at 31 December	27	183	210

Impairment review

The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash generating unit (CGU) to which goodwill has been allocated with its carrying value.

The CGUs of the Group where the goodwill arising is significant, principally on the acquisitions of NatWest and Charter One, are as follows:

	Recoverable amount based on	Goodwill at 30 September 2011 £m	Goodwill at 30 September 2010 £m	Goodwill at 30 September 2009 £m
UK Retail	Value in use	2,697	2,697	2,697
UK Corporate	Value in use	2,693	2,693	2,693
Wealth	Value in use	611	611	611
Global Transaction Services	Value in use	1,473	1,464	1,777
US Retail & Commercial	Value in use	2,826	2,811	2,761

Goodwill is analysed by operating segment in Note 36.

Impairment testing involves the comparison of the carrying value of a CGU or group of CGUs with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the CGU or group of CGUs. Fair value is the amount obtainable from the sale of the CGU in an arm's length transaction between knowledgeable, willing parties.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to the more significant variables in each assessment are presented below.

The recoverable amounts for all CGUs at 30 September 2011 were based on the value in use test, using management's latest five-year forecasts. The long-term growth rates have been based on respective country GDP rates adjusted for inflation. The risk discount rates are based on observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The recoverable amount of UK Retail, based on a 3% (2010 - 3%; 2009 - 4%) terminal growth rate and a 14.0% (2010 - 15.7%; 2009 - 14.6%) pre tax discount rate, exceeded the carrying amount by £5.5 billion (2010 - £6.9 billion; 2009 - £0.7 billion). A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £1.1 billion (2010 - £1.5 billion; 2009 - £0.9 billion) and £0.6 billion (2010 - £0.9 billion; 2009 - £0.5 billion) respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.8 billion (2010 - £0.9 billion; 2009 - £0.4 billion).

The recoverable amount of UK Corporate, based on a 3% (2010 - 3%; 2009 - 4%) terminal growth rate and a 14.1% (2010 - 15.6%; 2009 - 15.1%) pre tax discount rate, exceeded its carrying value by £2.1 billion (2010 - £5.3 billion; 2009 - £6.1 billion). A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £1.1 billion (2010 - £1.6 billion; 2009 - £1.4 billion) and £0.5 billion (2010 and 2009 - £0.9 billion) respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.8 billion (2010 - £1.0 billion; 2009 - £0.8 billion).

The recoverable amount of Wealth, based on a 3% (2010 - 3%; 2009 - 4%) terminal growth rate and an 11.0% (2010 - 12.0%; 2009 - 15.3%) pre tax discount rate, exceeded its carrying value by more than 100% and was insensitive to a reasonably possible change in key assumptions.

The recoverable amount of Global Transaction Services, based on a 3% (2010 and 2009 - 3%) terminal growth rate and an 11.4% (2010 - 12.8%; 2009 - 16.7%) pre tax discount rate, exceeded its carrying value by more than 100% (2010 and 2009 - 100%) and was insensitive to a reasonably possible change in key assumptions.

The recoverable amount of US Retail & Commercial, based on a 5% (2010 and 2009 - 5%) terminal growth rate and a 14.4% (2010 - 14.9%; 2009 - 14.8%) pre tax discount rate, exceeded its carrying value by £0.2 billion (2010 - £1.6 billion; 2009 - £2.1 billion). A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £1.1 billion (2010 - £1.6 billion; 2009 - £1.0 billion) and £0.5 billion (2010 and 2009 - £0.8 billion) respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.6 billion (2010 and 2009 - £0.7 billion).

19 Property, plant and equipment

2011	Group Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation							
At 1 January	4,170	2,768	215	1,682	3,897	9,235	21,967
Transfers to disposal groups	—	(107)	(12)	(93)	(49)	(5,355)	(5,616)
Currency translation and other adjustments	(101)	7	(2)	(4)	(59)	3	(156)
Reclassifications	—	(8)	(20)	22	6	—	—
Additions	1,262	67	17	149	477	1,384	3,356
Expenditure on investment properties	14	—	—	—	—	—	14
Change in fair value of investment properties	(139)	—	—	—	—	—	(139)
Disposals and write-off of fully depreciated assets	(793)	(37)	(6)	(48)	(158)	(1,375)	(2,417)
At 31 December	4,413	2,690	192	1,708	4,114	3,892	17,009
Accumulated impairment, depreciation and amortisation							
At 1 January	—	664	102	729	2,480	1,849	5,824
Transfers to disposal groups	—	(43)	(6)	(66)	(26)	(730)	(871)
Currency translation and other adjustments	—	7	—	2	(9)	15	15
Reclassifications	—	1	(7)	7	—	(1)	—
Disposals and write-off of fully depreciated assets	—	(26)	—	(32)	(110)	(466)	(634)
Charge for the year	—	94	4	135	444	520	1,197
At 31 December	—	697	93	775	2,779	1,187	5,531
Net book value at 31 December	4,413	1,993	99	933	1,335	2,705	11,478

2010	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation							
At 1 January	4,883	2,678	213	1,634	3,707	9,171	22,286
Currency translation and other adjustments	—	43	2	48	216	249	558
Disposal of subsidiaries	—	(1)	—	(3)	(121)	—	(125)
Reclassifications	—	26	1	(41)	14	—	—
Additions	511	81	5	130	340	1,178	2,245
Expenditure on investment properties	2	—	—	—	—	—	2
Change in fair value of investment properties	(405)	—	—	—	—	—	(405)
Disposals and write-off of fully depreciated assets	(821)	(59)	(6)	(86)	(259)	(1,363)	(2,594)
At 31 December	4,170	2,768	215	1,682	3,897	9,235	21,967
Accumulated impairment, depreciation and amortisation							
At 1 January	—	530	87	606	2,124	1,630	4,977
Currency translation and other adjustments	—	20	2	40	189	27	278
Disposal of subsidiaries	—	—	—	(2)	(74)	—	(76)
Reclassifications	—	1	—	—	(1)	—	—
Write down of property, plant and equipment	—	32	4	—	—	—	36
Disposals and write-off of fully depreciated assets	—	(10)	(2)	(48)	(231)	(435)	(726)
Charge for the year	—	91	11	133	473	627	1,335
At 31 December	—	664	102	729	2,480	1,849	5,824
Net book value at 31 December	4,170	2,104	113	953	1,417	7,386	16,143

2009	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
	Group						
Cost or valuation							
At 1 January	3,868	2,613	223	1,771	3,843	8,982	21,300
Transfers to disposal groups	—	—	—	(57)	(73)	—	(130)
Currency translation and other adjustments	(85)	(67)	—	(62)	(128)	(535)	(877)
Reclassifications	1	18	1	(34)	14	—	—
Additions	1,634	156	8	114	422	2,113	4,447
Expenditure on investment properties	8	—	—	—	—	—	8
Change in fair value of investment properties	(117)	—	—	—	—	—	(117)
Disposals and write-off of fully depreciated assets	(426)	(42)	(19)	(98)	(371)	(1,389)	(2,345)
At 31 December	4,883	2,678	213	1,634	3,707	9,171	22,286
Accumulated impairment, depreciation and amortisation							
At 1 January	—	466	79	583	1,982	1,562	4,672
Transfers to disposal groups	—	—	—	(7)	(31)	—	(38)
Currency translation and other adjustments	—	(4)	—	(18)	(74)	(64)	(160)
Write down of property, plant and equipment	—	5	—	5	—	—	10
Disposals and write-off of fully depreciated assets	—	(19)	—	(78)	(267)	(431)	(795)
Charge for the year	—	82	8	121	514	563	1,288
At 31 December	—	530	87	606	2,124	1,630	4,977
Net book value at 31 December	4,883	2,148	126	1,028	1,583	7,541	17,309

Investment properties are valued to reflect fair value, that is, the market value of the Group's interest at the reporting date excluding any special terms or circumstances relating to the use or financing of the property and transaction costs that would be incurred in making a sale. Observed market data such as rental yield, replacement cost and useful life, reflect relatively few transactions involving property that is not necessarily identical to property owned by the Group.

Valuations are carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body. The valuation as at 31 December 2011 for a significant majority of the Group's investment properties was undertaken with the support of external valuers.

The fair value of investment properties includes £146 million of depreciation since purchase (2010 - £248 million depreciation; 2009 - £84 million appreciation).

Rental income from investment properties was £270 million (2010 - £279 million; 2009 - £233 million). Direct operating expenses of investment properties were £67 million (2010 - £42 million; 2009 - £16 million).

Property, plant and equipment, excluding investment properties, include £186 million (2010 - £298 million; 2009 - £213 million) assets in the course of construction.

There were no sales of freehold and long leasehold properties subject to operating leases during 2011 (2010 - £2 million; 2009 - £5 million).

19 Property, plant and equipment continued

	Bank					
2011	Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation						
At 1 January	1,093	54	754	2,177	—	4,078
Transfers to disposal groups	(80)	(9)	(90)	(40)	—	(219)
Reclassifications	1	—	(2)	1	—	—
Additions	7	3	71	398	—	479
Disposals and write-off of fully depreciated assets	(3)	—	(25)	(127)	—	(155)
At 31 December	1,018	48	708	2,409	—	4,183
Accumulated impairment, depreciation and amortisation						
At 1 January	226	27	254	1,270	—	1,777
Transfers to disposal groups	(33)	(4)	(63)	(23)	—	(123)
Currency translation and other adjustments	(2)	1	—	1	—	—
Disposals and write-off of fully depreciated assets	—	(2)	(13)	(91)	—	(106)
Charge for the year	41	2	54	294	—	391
At 31 December	232	24	232	1,451	—	1,939
Net book value at 31 December	786	24	476	958	—	2,244
2010						
Cost or valuation						
At 1 January	1,077	52	758	2,070	91	4,048
Currency translation and other adjustments	1	1	6	5	—	13
Reclassifications	4	—	(15)	11	—	—
Additions	13	1	34	235	11	294
Transfer from fellow subsidiary	2	—	2	7	3	14
Disposals and write-off of fully depreciated assets	(4)	—	(31)	(151)	(105)	(291)
At 31 December	1,093	54	754	2,177	—	4,078
Accumulated impairment, depreciation and amortisation						
At 1 January	187	25	218	1,109	62	1,601
Currency translation and other adjustments	(1)	—	4	4	—	7
Transfer from fellow subsidiary	—	—	—	—	3	3
Disposals and write-off of fully depreciated assets	(1)	—	(22)	(114)	(66)	(203)
Charge for the year	41	2	54	271	1	369
At 31 December	226	27	254	1,270	—	1,777
Net book value at 31 December	867	27	500	907	—	2,301
2009						
Cost or valuation						
At 1 January	1,065	53	633	1,991	110	3,852
Currency translation and other adjustments	(1)	—	(6)	(5)	—	(12)
Additions	24	—	169	310	20	523
Transfer from fellow subsidiary	—	—	—	18	—	18
Disposals and write-off of fully depreciated assets	(11)	(1)	(38)	(244)	(39)	(333)
At 31 December	1,077	52	758	2,070	91	4,048
Accumulated impairment, depreciation and amortisation						
At 1 January	159	24	203	1,008	90	1,484
Currency translation and other adjustments	—	—	(2)	—	—	(2)
Disposals and write-off of fully depreciated assets	(8)	(1)	(28)	(183)	(38)	(258)
Charge for the year	36	2	45	284	10	377
At 31 December	187	25	218	1,109	62	1,601
Net book value at 31 December	890	27	540	961	29	2,447

20 Prepayments, accrued income and other assets

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Prepayments	939	1,054	1,146	2,087	2,107	2,111
Accrued income	567	963	885	325	694	571
Deferred expenses	77	277	143	430	176	33
Pension schemes in net surplus (see Note 4)	24	39	28	8	7	9
Other assets	4,285	3,904	10,463	2,488	1,776	7,264
	5,892	6,237	12,665	5,338	4,760	9,988

21 Assets and liabilities of disposal groups

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Assets of disposal groups						
Cash and balances at central banks	100	—	—	94	—	—
Loans and advances to banks	25	629	314	1	273	78
Loans and advances to customers	18,723	2,884	306	18,110	2,329	43
Debt securities and equity shares	5	17	56	—	2	20
Derivatives	439	5,148	6,361	414	1,757	2,824
Intangible assets	15	—	238	—	—	9
Settlement balances	14	555	1,579	—	295	502
Property, plant and equipment	4,749	18	92	96	—	—
Other assets	18	291	5,257	—	109	3,674
	24,088	9,542	14,203	18,715	4,765	7,150
Liabilities of disposal groups						
Deposits by banks	—	266	560	—	140	464
Customer accounts	21,820	900	1,961	20,390	144	1,755
Derivatives	126	5,042	6,262	88	1,610	2,966
Settlement balances	8	907	950	—	391	—
Other liabilities	886	393	1,260	—	51	923
	22,840	7,508	10,993	20,478	2,336	6,108

The assets and liabilities of disposal groups at 31 December 2011 primarily comprise the RBS England and Wales and NatWest Scotland branch-based businesses (“UK branch-based businesses”) and the RBS Aviation Capital business both of which are expected to be sold in the second half of 2012. On being classified as held-for-sale, disposal groups are required to be measured at the lower of carrying amount and fair value less costs to sell. Accordingly, £80 million of allocated goodwill has been written off against other income in respect of the UK branch-based businesses. No adjustment has been made in respect of the RBS Aviation Capital business.

The disposal of the RBS Sempra Commodities JV was substantially completed in 2010. Certain contracts of the RBS Sempra Commodities JV were sold in risk transfer transactions prior to being novated to the purchaser, the majority of which completed during 2011.

22 Short positions

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Debt securities						
- Government	32,812	34,437	26,646	19,910	21,268	17,759
- Other issuers	5,972	6,412	9,825	3,288	4,120	6,051
Equity shares	1,662	281	1	1,660	299	1
	40,446	41,130	36,472	24,858	25,687	23,811

Note:
(1) All short positions are classified as held-for-trading.

23 Accruals, deferred income and other liabilities

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Notes in circulation	1,683	1,793	1,889	1,130	1,094	1,172
Current tax	209	561	150	525	755	295
Accruals	4,040	5,415	5,769	2,484	3,392	3,721
Deferred income	872	1,457	1,388	537	861	865
Other liabilities (1)	8,005	4,508	7,278	4,164	1,956	3,896
	14,809	13,734	16,474	8,840	8,058	9,949

Note:
(1) Other liabilities include £15 million (2010 - £18 million; 2009 - £10 million) in respect of share-based compensation.

Included in other liabilities are provisions for liabilities and charges as follows:

	Group			Bank		
	Payment Protection Insurance (1) £m	Other (2) £m	Total £m	Payment Protection Insurance (1) £m	Other (2) £m	Total £m
At 1 January 2011	—	584	584	—	457	457
Transfer from accruals and other liabilities	215	—	215	103	—	103
Currency translation and other movements	—	34	34	—	3	3
Charge to income statement	850	166	1,016	295	123	418
Releases to income statement	—	(53)	(53)	—	(41)	(41)
Provisions utilised	(320)	(166)	(486)	(144)	(144)	(288)
At 31 December 2011	745	565	1,310	254	398	652

Notes:
(1) The FSA published its final policy statement on Payment Protection Insurance (PPI) complaint handling and redress in August 2010. The new rules impose significant changes with respect to the handling of mis-selling PPI complaints. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the Financial Ombudsman Service (FOS). In April 2011, the High Court issued judgment in favour of the FSA and the FOS and in May 2011, the BBA announced that it would not appeal that judgment. During 2011, the RBS Group reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints following which it recorded a provision of £850 million in respect of PPI.

The principal assumptions underlying the PPI provision are: an assessment of the total number of complaints that the Group will receive; the proportion of these complaints that will result in redress; and the average cost of such redress. To determine the number of complaints that it expects to receive the Group has analysed the population of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld have been established based on historical experience, guidance set out in the FSA policy statements and on anticipated customer contact. A one percent rise in the take up rate across the entire population of PPI policies would increase the provision by £95 million; a one percent fall would reduce the provision by the same amount. Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. The Group expects the majority of the cash outflows associated with this provision to have occurred by the end of 2013. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, uphold rates and average redress costs; and in particular, the results of the past book review to be conducted in 2012 and any additional reviews that may be required.

(2) Includes property provisions and other provisions arising in the normal course of business.

24 Deferred tax

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Deferred tax liability	1,384	1,422	1,187	—	—	—
Deferred tax asset	(3,320)	(1,790)	(2,228)	(2,584)	(794)	(1,728)
Net deferred tax asset	(1,936)	(368)	(1,041)	(2,584)	(794)	(1,728)

Net deferred tax asset comprised:

	Group											
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Fair value of financial instruments £m	Available-for-sale financial assets £m	Intangibles £m	Cash flow hedging £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2010	(686)	2,818	(1,436)	115	(370)	(254)	(97)	44	275	(1,466)	16	(1,041)
Transfers to disposal groups	—	(120)	—	—	—	1	—	—	—	—	—	(119)
Charge/(credit) to income statement	94	(95)	94	(25)	76	263	77	45	(102)	162	(132)	457
Charge/(credit) to equity directly	73	—	—	(2)	—	—	102	—	(203)	397	(6)	361
Disposals	—	—	—	—	—	(1)	—	—	—	—	(18)	(19)
Other	2	49	(41)	—	—	(7)	(6)	2	(2)	(7)	3	(7)
At 1 January 2011	(517)	2,652	(1,383)	88	(294)	2	76	91	(32)	(914)	(137)	(368)
Transfers to disposal groups	—	(308)	—	—	—	16	—	—	—	159	—	(133)
Transfer from fellow subsidiary	—	—	—	—	—	—	—	—	—	(3,038)	—	(3,038)
Charge/(credit) to income statement	133	48	104	(21)	76	61	(25)	83	(6)	369	129	951
(Credit)/charge to equity directly	(88)	—	—	1	—	—	66	—	271	415	14	679
Disposals of subsidiaries	—	(35)	—	—	—	—	—	—	(1)	—	—	(36)
Currency translations and other adjustments	(4)	6	(6)	2	—	(4)	2	3	3	9	(2)	9
At 31 December 2011	(476)	2,363	(1,285)	70	(218)	75	119	177	235	(3,000)	4	(1,936)

Notes:

(1) Deferred tax assets are recognised depending on the availability of future taxable profits in excess of profits arising from the reversal of other temporary differences. Business projections prepared for impairment reviews (see Note 18) indicate it is probable that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within six years. In jurisdictions where doubt exists over the availability of future taxable profits, deferred tax assets of £743 million (2010 - £298 million; 2009 - £26 million) have not been recognised in respect of tax losses carried forward of £6,525 million (2010 - £2,422 million; 2009 - £100 million). Of these losses, £729 million will expire after five years. The balance of tax losses carried forward has no time limit.

(2) Deferred tax liabilities of £249 million (2010 and 2009 - £279 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further tax. No tax is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts overseas dividends received on or after 1 July 2009 from UK tax.

24 Deferred tax continued

	Bank								
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Cash flow hedging £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2010	(7)	(230)	(472)	49	(155)	231	(1,135)	(9)	(1,728)
Charge/(credit) to income statement	—	37	(48)	—	30	5	594	(13)	605
(Credit)/charge to equity directly	—	—	—	(5)	—	(59)	397	(4)	329
At 1 January 2011	(7)	(193)	(520)	44	(125)	177	(144)	(26)	(794)
Transfer from fellow subsidiary	—	—	—	—	—	—	(3,038)	—	(3,038)
Charge/(credit) to income statement	3	130	267	(7)	33	4	143	(4)	569
Charge to equity directly	—	—	—	—	—	259	416	4	679
At 31 December 2011	(4)	(63)	(253)	37	(92)	440	(2,623)	(26)	(2,584)

25 Subordinated liabilities

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Dated loan capital	20,931	21,645	22,067	19,815	20,115	19,688
Undated loan capital	7,959	7,039	9,427	7,079	6,157	7,940
Preference shares	3,434	3,339	3,223	3,120	3,027	2,885
	32,324	32,023	34,717	30,014	29,299	30,513

In a series of exchange and tender offers in April 2009 and May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability.

The RBS Group has undertaken that, unless otherwise agreed with the European Commission, neither the holding company nor any of its direct or indirect subsidiaries (excluding companies in the RBS Holdings N.V. Group, which are subject to different restrictions) will pay external investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier 2 instruments) from 30 April 2010 for a period of two years thereafter ("the Deferral Period"), or exercise any call rights in relation to these capital instruments between 24 November 2009 and the end of the Deferral Period, unless there is a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 will generally not be subject to the restriction on dividend or coupon payments or call options.

Certain preference shares are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

The following tables analyse the remaining contractual maturity of subordinated liabilities by (1) the final redemption date; and (2) the next call date.

2011 - final redemption	Group 2012 £m	2013 £m	2014-2016 £m	2017-2021 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	86	158	648	5,453	—	3,247	9,592
US dollar	325	555	2,976	1,316	—	6,145	11,317
Euro	244	1,299	1,106	4,075	418	1,551	8,693
Other	29	—	1,618	730	—	345	2,722
	684	2,012	6,348	11,574	418	11,288	32,324

2011 - call date	Group Currently £m	2012 £m	2013 £m	2014-2016 £m	2017-2021 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	—	140	218	855	7,093	176	1,110	9,592
US dollar	2,384	3,053	2,532	1,198	347	1,318	485	11,317
Euro	159	2,128	1,299	1,922	2,720	418	47	8,693
Other	9	1,407	—	1,306	—	—	—	2,722
	2,552	6,728	4,049	5,281	10,160	1,912	1,642	32,324

2010 - final redemption	Group 2011 £m	2012 £m	2013-2015 £m	2016-2020 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	78	—	817	5,063	361	2,290	8,609
US dollar	263	262	2,245	2,582	—	6,043	11,395
Euro	708	—	2,081	3,556	1,362	1,607	9,314
Other	27	—	1,612	728	—	338	2,705
	1,076	262	6,755	11,929	1,723	10,278	32,023

2010 - call date	Group Currently £m	2011 £m	2012 £m	2013-2015 £m	2016-2020 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	13	97	55	1,027	6,717	530	170	8,609
US dollar	2,379	2,016	1,228	3,721	328	1,240	483	11,395
Euro	613	689	1,521	2,387	3,631	424	49	9,314
Other	672	11	728	956	338	—	—	2,705
	3,677	2,813	3,532	8,091	11,014	2,194	702	32,023

2009 - final redemption	Group 2010 £m	2011 £m	2012-2014 £m	2015-2019 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	113	—	164	5,712	345	3,903	10,237
US dollar	380	196	1,457	3,306	77	5,946	11,362
Euro	851	443	1,414	4,336	1,379	2,036	10,459
Other	22	—	554	1,462	—	621	2,659
	1,366	639	3,589	14,816	1,801	12,506	34,717

2009 - call date	Group Currently £m	2010 £m	2011 £m	2012-2014 £m	2015-2019 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	174	200	194	496	7,499	1,504	170	10,237
US dollar	1,926	825	1,429	4,260	686	2,236	—	11,362
Euro	564	731	900	3,399	4,386	428	51	10,459
Other	419	572	—	618	878	172	—	2,659
	3,083	2,328	2,523	8,773	13,449	4,340	221	34,717

25 Subordinated liabilities continued

2011 - final redemption	Bank 2012 £m	2013 £m	2014-2016 £m	2017-2021 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	49	158	284	5,000	—	2,893	8,384
US dollar	61	555	2,976	1,316	—	5,523	10,431
Euro	242	1,299	1,106	4,075	418	1,346	8,486
Other	20	—	1,618	730	—	345	2,713
	372	2,012	5,984	11,121	418	10,107	30,014

2011 - call date	Bank Currently £m	2012 £m	2013 £m	2014-2016 £m	2017-2021 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	—	103	158	404	6,700	79	940	8,384
US dollar	1,759	2,792	2,532	1,198	347	1,318	485	10,431
Euro	—	2,127	1,299	1,922	2,720	418	—	8,486
Other	—	1,407	—	1,306	—	—	—	2,713
	1,759	6,429	3,989	4,830	9,767	1,815	1,425	30,014

2010 - final redemption	Bank 2011 £m	2012 £m	2013-2015 £m	2016-2020 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	46	—	454	5,000	—	1,938	7,438
US dollar	257	—	2,245	2,582	—	5,422	10,506
Euro	264	—	2,081	3,556	1,362	1,396	8,659
Other	18	—	1,612	728	—	338	2,696
	585	—	6,392	11,866	1,362	9,094	29,299

2010 - call date	Bank Currently £m	2011 £m	2012 £m	2013-2015 £m	2016-2020 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	2	76	55	514	6,717	74	—	7,438
US dollar	1,755	2,013	966	3,721	328	1,240	483	10,506
Euro	450	246	1,521	2,387	3,631	424	—	8,659
Other	663	11	728	956	338	—	—	2,696
	2,870	2,346	3,270	7,578	11,014	1,738	483	29,299

2009 - final redemption	Bank 2010 £m	2011 £m	2012-2014 £m	2015-2019 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	72	—	164	5,288	—	3,367	8,891
US dollar	65	196	1,202	3,306	77	5,177	10,023
Euro	271	—	1,414	4,336	1,379	1,541	8,941
Other	21	—	554	1,462	—	621	2,658
	429	196	3,334	14,392	1,456	10,706	30,513

2009 - call date	Bank Currently £m	2010 £m	2011 £m	2012-2014 £m	2015-2019 £m	Thereafter £m	Total £m
Sterling	—	171	194	430	7,141	955	8,891
US dollar	1,154	513	1,429	4,005	686	2,236	10,023
Euro	—	271	457	3,399	4,386	428	8,941
Other	419	571	—	618	878	172	2,658
	1,573	1,526	2,080	8,452	13,091	3,791	30,513

Dated loan capital	2011 £m	2010 £m	2009 £m
The Bank			
€1,000 million 6% subordinated notes 2013	921	989	1,014
US$50 million floating rate subordinated notes 2013	37	38	36
€500 million 6% subordinated notes 2013	426	439	452
£150 million 10.5% subordinated bonds 2013 (1)	171	177	177
AUD590 million 6% subordinated notes 2014 (callable July 2012)	392	391	330
AUD410 million floating rate subordinated notes 2014 (callable July 2012)	272	272	229
CAD700 million 4.25% subordinated notes 2015 (callable March 2015)	444	452	419
£250 million 9.625% subordinated bonds 2015	297	303	301
US$750 million floating rate subordinated notes 2015 (callable June 2012)	485	483	462
€750 million floating rate subordinated notes 2015	709	725	741
CHF400 million 2.375% subordinated notes 2015	295	287	244
CHF100 million 2.375% subordinated notes 2015	88	83	69
CHF200 million 2.375% subordinated notes 2015	136	136	117
US$500 million floating rate subordinated notes 2016 (callable January 2012)	324	322	308
US$1,500 million floating rate subordinated notes 2016 (callable January 2012)	971	967	926
€500 million 4.5% subordinated notes 2016 (callable January 2012)	420	450	476
CHF200 million 2.75% subordinated notes 2017 (callable December 2012)	138	138	120
€100 million floating rate subordinated notes 2017	84	86	89
€500 million floating rate subordinated notes 2017 (callable June 2012)	419	432	445
€750 million 4.35% subordinated notes 2017 (callable January 2017)	723	721	728
AUD450 million 6.5% subordinated notes 2017 (callable February 2012)	303	302	255
AUD450 million floating rate subordinated notes 2017 (callable February 2012)	298	295	250
US$1,500 million floating rate subordinated callable step-up notes 2017 (callable August 2012)	970	966	925
€2,000 million 6.93% subordinated notes 2018	2,023	1,999	2,017
US$125.6 million floating rate subordinated notes 2020	81	81	78
€1,000 million 4.625% subordinated notes 2021 (callable September 2016)	948	949	962
€300 million CMS linked floating rate subordinated notes 2022 (callable June 2022)	271	280	292
€144.4 million floating rate subordinated notes 2023	157	153	143
Due to the holding company			
US$300 million 6.375% subordinated notes 2011 (redeemed February 2011) (2)	—	199	201
US$750 million 5% subordinated notes 2013 (2)	523	533	504
US$750 million 5% subordinated notes 2014 (2)	562	562	522
US$250 million 5% subordinated notes 2014 (2)	159	158	151
US$675 million 5.05% subordinated notes 2015 (2)	495	493	469
US$350 million 4.7% subordinated notes 2018 (2)	271	252	232
£5,000 million 4.5% subordinated notes 2019 (2)	5,002	5,002	5,004
	19,815	20,115	19,688
National Westminster Bank Plc			
€600 million 6% subordinated notes 2010	—	—	564
€500 million 5.125% subordinated notes 2011 (redeemed June 2011)	—	442	455
£300 million 7.875% subordinated notes 2015	371	370	365
£300 million 6.5% subordinated notes 2021	400	367	351
Charter One Financial, Inc.			
US$400 million 6.375% subordinated notes 2012	261	265	255

25 Subordinated liabilities continued

Dated loan capital continued	2011 £m	2010 £m	2009 £m
RBS Holdings USA Inc.			
US$500 million subordinated loan capital floating rate notes 2010	—	—	311
First Active plc			
£60 million 6.375% subordinated bonds 2018 (callable April 2013)	64	66	66
Non-controlling interests subordinated issues	20	20	12
	20,931	21,645	22,067

Notes:
(1) Unconditionally guaranteed by The Royal Bank of Scotland Group plc.
(2) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
(3) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
(4) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.
(5) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Undated loan capital	2011 £m	2010 £m	2009 £m
The Bank			
£31 million (2010 - £31 million; 2009 - £96 million) 7.375% undated subordinated notes (callable December 2019) (1,2)	31	31	101
£51 million (2010 - £51 million; 2009 - £117 million) 6.25% undated subordinated notes (callable December 2012) (1,2)	53	55	126
£56 million (2010 - £56 million; 2009 - £138 million) 6% undated subordinated notes (callable September 2014) (1,2)	62	61	143
€176 million (2010 - €176 million; 2009 - €197 million) 5.125% undated subordinated notes (callable July 2014) (1,2)	161	166	194
€170 million (2010 - €170 million; 2009 - €243 million) floating rate undated subordinated notes (callable July 2014) (1,2)	141	145	214
£54 million (2010 - £54 million; 2009 - £178 million) 5.125% undated subordinated notes (callable March 2016) (1,2)	61	58	189
£200 million 5.125% subordinated upper tier 2 notes	—	—	210
£35 million (2010 - £35 million; 2009 - £260 million) 5.5% undated subordinated notes (callable December 2019) (1,2)	37	35	272
£21 million (2010 - £21 million; 2009 - £174 million) 6.2% undated subordinated notes (callable March 2022) (1,2)	45	43	206
£103 million (2010 - £103 million; 2009 - £145 million) 9.5% undated subordinated bonds (callable August 2018) (1,2,3)	137	130	176
£22 million (2010 - £22 million; 2009 - £83 million) 5.625% undated subordinated notes (callable September 2026) (1,2)	23	21	90
£19 million (2010 - £19 million; 2009 - £201 million) 5.625% undated subordinated notes (callable June 2032) (1,2)	13	20	199
£1 million (2010 - £1 million; 2009 - £190 million) 5% undated subordinated notes (callable September 2012) (1,2)	1	2	197
JPY25 billion 2.605% undated subordinated notes	—	—	173
CAD474 million (2010 - CAD474 million; 2009 - CAD700 million) 5.37% fixed rate undated subordinated notes (callable May 2016) (2)	347	340	452
Due to the holding company			
US$350 million undated floating rate primary capital notes (callable on any interest payment date) (4)	226	225	216
€1,250 million 6.467% perpetual regulatory tier one securities (callable June 2012) (4)	1,083	1,125	1,174
US$1,200 million 7.648% perpetual regulatory tier one securities (callable September 2031) (4,5)	785	783	748
£1,500 million floating rate perpetual subordinated notes (4)	1,510	1,500	1,500
US$600 million floating rate perpetual subordinated notes (4)	388	386	370
US$1,600 million floating rate perpetual subordinated notes (4)	1,034	1,031	990
£940 million floating rate perpetual subordinated notes (4)	941	—	—
	7,079	6,157	7,940

Undated loan capital continued	2011 £m	2010 £m	2009 £m
National Westminster Bank Plc			
US$193 million (2010 - US$193 million; 2009 - US$332 million) primary capital floating rate notes, Series A (callable on any interest payment date) (1,2)	124	124	205
US$229 million (2010 - US$229 million; 2009 - US$293 million) primary capital floating rate notes, Series B (callable on any interest payment date) (1,2)	148	148	182
US$285 million (2010 - US$285 million; 2009 - US$312 million) primary capital floating rate notes, Series C (callable on any interest payment date) (1,2)	184	184	192
€178 million (2010 - €178 million; 2009 - €400 million) 6.625% fixed/floating rate undated subordinated notes (callable on any interest payment date) (2)	150	154	359
€10 million (2010 - €10 million; 2009 - €100 million) floating rate undated step-up notes (callable on any interest payment date) (2)	9	9	90
£87 million (2010 - £87 million; 2009 - £162 million) floating undated subordinated step-up notes (callable January 2015) (1,2)	91	89	174
£53 million (2010 - £53 million; 2009 - £127 million) 7.125% undated subordinated step-up notes (callable October 2022) (1,2)	56	54	127
£35 million (2010 - £35 million; 2009 - £55 million) 11.5% undated subordinated notes (callable December 2022) (1,2,6)	42	42	79
First Active plc			
£20 million 11.75% perpetual tier two capital	26	26	26
€38 million 11.375% perpetual tier two capital	48	50	51
£1.3 million floating rate perpetual tier two capital	2	2	2
	7,959	7,039	9,427

Notes:
(1) Partially repurchased following completion of the exchange and tender offers in April 2009.
(2) Partially repurchased following completion of the exchange and tender offers in May 2010.
(3) Guaranteed by the company.
(4) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
(5) The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.
(6) Exchangeable at the option of the issuer into 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.
(7) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.
(8) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
(9) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Preference shares	2011 £m	2010 £m	2009 £m
The Bank			
Non-cumulative preference shares of US$0.01 (1)			
Series F US$200 million 7.65% (redeemable at option of issuer)	129	129	123
Series H US$300 million 7.25% (redeemable at option of issuer)	194	193	185
Series L US$750 million 6.8% (perpetual callable March 2008)	485	483	462
Series M US$850 million 4.709% (callable July 2013)	554	542	522
Series N US$650 million 6.425% (callable January 2034)	548	472	439
Series R US$850 million 5.75% (redeemable at option of issuer)	549	548	524
Series 1 US$1,000 million 9.118% (redeemable at option of issuer)	661	660	630
	3,120	3,027	2,885
National Westminster Bank Plc			
Non-cumulative preference shares of £1			
Series A £140 million 9% (non-redeemable)	145	144	145
Non-cumulative preference shares of US$25			
Series C US$246 million 7.7628% (2010 - US$246 million; 2009 - US$300 million) (2,3)	169	168	193
	3,434	3,339	3,223

Notes:
(1) Issued to the holding company on terms which, in general, mirror the original issues by the holding company.
(2) Partially repurchased following completion of the exchange and tender offers in May 2010.
(3) Series C preference shares each carry a gross dividend of 8.625% inclusive of associated tax credit. Redeemable at the option of the issuer at par.

26 Share capital and reserves

	Allotted, called up and fully paid			Authorised (1)
	2011 £m	2010 £m	2009 £m	2009 m
Ordinary shares of £1	6,609	6,609	6,609	£7,980
Non-cumulative preference shares of US$0.01	—	—	—	$5
Non-cumulative preference shares of €0.01	—	—	—	—
Perpetual zero coupon preference shares of £1	—	—	—	£100
Non-cumulative preference shares of £1	—	—	—	£2,200

	Allotted, called up and fully paid			Authorised (1)
Number of shares - millions	2011	2010	2009	2009
Ordinary shares of £1	6,609	6,609	6,609	7,980
Non-cumulative preference shares of US$0.01	59	59	59	549
Non-cumulative preference shares of €0.01	1	1	1	66
Perpetual zero coupon preference shares of £1	—	—	—	100
Non-cumulative preference shares of £1	—	—	—	2,200

Note:
(1) Prior to the Companies Act 2006, the authorised share capital of UK companies was divided between issued share capital and unissued share capital whose allotment was determined by the Articles of Association of a company and specific authorities granted to directors. Since 28 April 2010 when the company changed its constitution to reflect the Companies Act 2006, there is no authorised share capital.

Ordinary and preference shares

There were no changes in the issued ordinary or preference share capital during the year.

Reserves

The merger reserve comprises the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

In the year, the Group received a contribution of capital of £4,539 million (2010 - £1,000 million; 2009 - £12,500 million) from the parent company for which no additional share capital was issued. As such this has been recorded as a capital contribution in retained earnings.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

27 Leases

Minimum amounts receivable under non-cancellable leases:

Year in which receipt will occur	Finance lease contracts and hire purchase agreements Gross amount £m	Present value adjustments £m	Other movements £m	Present value £m	Operating lease assets: future minimum lease rentals £m
2011					
Within 1 year	3,996	(340)	(29)	3,627	406
After 1 year but within 5 years	6,806	(763)	(193)	5,850	605
After 5 years	5,822	(2,710)	(270)	2,842	359
Total	16,624	(3,813)	(492)	12,319	1,370
2010					
Within 1 year	3,559	(309)	(20)	3,230	997
After 1 year but within 5 years	7,833	(795)	(245)	6,793	2,388
After 5 years	7,843	(2,763)	(263)	4,817	998
Total	19,235	(3,867)	(528)	14,840	4,383
2009					
Within 1 year	3,863	(781)	(30)	3,052	763
After 1 year but within 5 years	8,768	(2,076)	(212)	6,480	2,348
After 5 years	11,258	(2,469)	(334)	8,455	947
Total	23,889	(5,326)	(576)	17,987	4,058

	Group 2011 £m	2010 £m	2009 £m
Nature of operating lease assets on the balance sheet			
Transportation	1,549	6,162	6,039
Cars and light commercial vehicles	995	1,016	1,249
Other	161	208	253
	2,705	7,386	7,541
Amounts recognised as income and expense			
Finance leases - contingent rental income	(133)	(160)	(139)
Operating leases - minimum rentals payable	409	411	435
Finance lease contracts and hire purchase agreements			
Accumulated allowance for uncollectable minimum receivables	347	401	313

27 Leases continued

Residual value exposures

The tables below give details of the unguaranteed residual values included in the carrying value of finance lease receivables (see pages 199 to 202) and operating lease assets (see pages 242 and 243).

	Year in which residual value will be recovered				
2011	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	Total £m
Operating leases					
- transportation	244	314	187	390	1,135
- cars and light commercial vehicles	458	75	105	2	640
- other	23	21	33	8	85
Finance lease contracts	26	48	147	270	491
Hire purchase agreements	—	—	1	—	1
	751	458	473	670	2,352
2010					
Operating leases					
- transportation	357	457	1,834	2,097	4,745
- cars and light commercial vehicles	503	109	100	9	721
- other	30	20	39	13	102
Finance lease contracts	20	41	131	263	455
Hire purchase agreements	—	3	70	—	73
	910	630	2,174	2,382	6,096
2009					
Operating leases					
- transportation	164	327	1,607	2,255	4,353
- cars and light commercial vehicles	624	134	113	7	878
- other	31	32	40	7	110
Finance lease contracts	23	35	96	313	467
Hire purchase agreements	7	20	61	21	109
	849	548	1,917	2,603	5,917

The Group provides asset finance to its customers through acting as a lessor. It purchases plant, equipment and intellectual property, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

28 Securitisations and asset transfers

Secured funding

The Group has access to secured funding markets through own-asset securitisation and covered bond funding programmes to complement existing wholesale funding programmes and access to the repo markets. The Group monitors and manages encumbrance levels related to these secured funding programmes. This includes the potential encumbrance of Group assets that could be used in own-asset securitisations and/or covered bonds that could be used as contingent liquidity.

Own-asset securitisations

The Group has a programme of own-asset securitisations where assets are transferred to bankruptcy remote SPEs funded by the issue of debt securities. The majority of the risks and rewards of the portfolio are retained by the Group and these SPEs are consolidated and all of the transferred assets retained on the Group's balance sheet. In some own-asset securitisations, the Group may purchase all the issued securities which are available to be pledged as collateral for repurchase agreements with major central banks.

Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of covered bonds by the Group. The Group retains all of the risks and rewards of these loans, the partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue.

The following table shows:

(i) the asset categories that have been pledged to secured funding structures, including assets backing publicly issued own-asset securitisations and covered bonds; and

(ii) any currently unencumbered assets that could be substituted into those portfolios or used to collateralise debt securities which may be retained by the Group for contingent liquidity purposes.

	Group											
	2011				2010				2009			
		Debt securities in issue				Debt securities in issue				Debt securities in issue		
Asset type (1)	Assets £m	Held by third parties (2) £m	Held by the Group (3) £m	Total £m	Assets £m	Held by third parties (2) £m	Held by the Group (3) £m	Total £m	Assets £m	Held by third parties (2) £m	Held by the Group (3) £m	Total £m
Mortgages												
- UK (RMBS)	49,269	10,732	47,324	58,056	52,767	12,713	50,028	62,741	54,423	9,444	53,356	62,800
- UK (covered bonds)	15,441	9,107	—	9,107	8,046	4,100	—	4,100	—	—	—	—
- Irish	12,660	3,472	8,670	12,142	15,034	5,101	11,152	16,253	14,540	5,799	6,905	12,704
UK credit cards	4,037	500	110	610	3,993	34	1,500	1,534	2,975	1,592	1,500	3,092
UK personal loans	5,168	—	4,706	4,706	5,795	—	5,383	5,383	8,411	—	8,160	8,160
Other loans (4)	19,778	4	20,577	20,581	25,193	974	23,186	24,160	28,037	1,010	25,290	26,300
	106,353	23,815	81,387	105,202	110,828	22,922	91,249	114,171	108,386	17,845	95,211	113,056
Cash deposits (5)	11,998				13,068				12,016			
	118,351				123,896				120,402			

Notes:

(1) Assets that have been pledged to the SPEs which itself is a subset of the total portfolio of eligible assets within a collateral pool.

(2) Debt securities that have been sold to third party investors and represents a source of external wholesale funding.

(3) Debt securities issued pursuant to own-asset securitisations where the debt securities are retained by the Group as a source of contingent liquidity where those securities can be used in repurchase agreements with central banks.

(4) Comprises corporate, social housing and student loans.

(5) At 31 December 2011, cash deposits comprised £11.2 billion from mortgage repayments and £0.8 billion from other loan repayments held in the SPEs, to repay debt securities issued by the own-asset securitisation vehicles (2010 - £12.3 billion and £0.8 billion; 2009 - £11.1 billion and £0.9 billion respectively).

28 Securitisations and asset transfers continued

The following table provides analysis of assets that have been transferred to SPEs but have failed the derecognition rules under IAS 39 and therefore continue to be recognised on the Bank's balance sheet.

	Bank		
Asset type	2011 £m	2010 £m	2009 £m
Mortgages			
- UK (RMBS)	22,140	26,829	28,529
- UK (covered bonds)	3,127	2,466	—
UK credit cards	1,560	1,819	1,526
UK personal loans	1,374	1,540	2,236
Other loans (1)	12,463	15,868	14,631
	40,664	48,522	46,922

Note:
(1) Comprises corporate, social housing and student loans.

Continuing involvement

In certain securitisations of US residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control, as defined by IFRS, of the assets and continues to recognise the assets to the extent of its continuing involvement which takes the form of retaining certain subordinated bonds issued by the securitisation SPEs. These bonds have differing rights and, depending on their terms, they may expose the Group to interest rate risk where they carry a fixed coupon or to credit risk depending on the extent of their subordination. Certain bonds entitle the Group to additional interest if the portfolio performs better than expected and others give the Group the right to prepayment penalties received on the securitised mortgages. At 31 December 2011, securitised assets were £0.6 billion (2010 - £2.3 billion; 2009 - £3.1 billion); retained interest £72 million (2010 - £286 million; 2009 - £102 million); subordinated assets £3 million (2010 - £4 million; 2009 - £91 million); and related liabilities £3 million (2010 - £4 million; 2009 - £33 million).

The Group retained interests in securitised financial assets take the form of senior or subordinated securities. These interests predominantly relate to mortgage-backed securities which were re-securitised. Retained interests are generally not held to maturity and are typically sold after settlement of the securitisation. Retained interests may be subordinated to other investors' interests. Third party investors and securitisation trusts have no recourse to the Group's other assets for failure of debtors to perform on the securitised loans or securities, effectively transferring the risk of future credit losses to the purchasers of the securities issued by the trust. The value of retained interest varies and is subject to credit, interest rate, prepayment, and other risks of the transferred assets. In the ordinary course of business, the Group does not provide any other financial support to the securitisation trusts other than holding these retained interests.

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice. Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included within debt securities on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

	Group			Bank		
Assets pledged in securities repurchase agreements and lending transactions	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Debt securities	72,652	79,558	65,589	37,166	41,203	30,070
Equity shares	5,256	77	12	5,245	77	12

Other collateral given

This primarily relates to cash collateral relating to derivative contracts as well as assets pledged for bank and other borrowings.

	Group			Bank		
Assets pledged against liabilities	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Loans and advances to banks	18,030	25,148	18,409	18,021	25,107	18,409
Loans and advances to customers	51,447	44,781	33,276	21,694	15,115	10,424
Debt securities	3,690	4,318	5,875	694	—	—
	73,167	74,247	57,560	40,409	40,222	28,833
Liabilities secured by assets						
Deposits by banks	6,346	7,684	12,724	3	—	—
Customer accounts	2,663	3,599	4,025	—	—	10
Debt securities in issue	—	—	1,237	—	—	148
Derivatives	75,513	78,989	42,707	74,481	78,512	42,307
	84,522	90,272	60,693	74,484	78,512	42,465

29 Capital resources

The Group's regulatory capital resources in accordance with Financial Services Authority (FSA) definitions were as follows:

Shareholders' equity (excluding non-controlling interests)	2011 £m	2010 £m	2009 £m
Shareholders' equity per balance sheet	61,726	57,010	55,051
Other equity instruments	(1,421)	(1,421)	(1,421)
	60,305	55,589	53,630
Non-controlling interests per balance sheet	128	597	1,146
Regulatory adjustments and deductions			
Own credit	(1,157)	(622)	(650)
Unrealised (gains)/losses on AFS debt securities	(2,114)	(843)	279
Unrealised gains on AFS equity shares	(106)	(74)	(111)
Cash flow hedging reserve	(1,018)	81	129
Other adjustments for regulatory purposes	(230)	(277)	(586)
Goodwill and other intangible assets	(12,365)	(11,832)	(11,814)
50% excess of expected losses over impairment provisions (net of tax)	(2,553)	(1,998)	(2,560)
50% of securitisation positions	(1,605)	(1,916)	(1,270)
50% of APS first loss	(2,763)	(4,225)	(4,654)
	(23,911)	(21,706)	(21,237)
Core Tier 1 capital	36,522	34,480	33,539
Other Tier 1 capital			
Preference shares - debt	2,857	2,890	2,883
Innovative/hybrid Tier 1 securities	3,645	3,638	3,542
	6,502	6,528	6,425
Tier 1 deductions			
50% of material holdings	(235)	(242)	(132)
Tax on excess of expected losses over impairment provisions	920	797	1,020
	685	555	888
Total Tier 1 capital	43,709	41,563	40,852

29 Capital resources continued

Qualifying Tier 2 capital	2011 £m	2010 £m	2009 £m
Undated subordinated debt	4,916	4,925	7,170
Dated subordinated debt - net of amortisation	17,272	18,067	18,860
Reserves arising on revaluation of property	—	—	73
Unrealised gains on AFS equity shares	106	74	111
Collectively assessed impairment provisions	584	672	796
Non-controlling Tier 2 capital	11	11	11
	22,889	23,749	27,021
Tier 2 deductions			
50% of securitisation positions	(1,605)	(1,916)	(1,270)
50% excess of expected losses over impairment provisions	(3,473)	(2,795)	(3,580)
50% of material holdings	(235)	(242)	(132)
50% of APS first loss	(2,763)	(4,225)	(4,654)
	(8,076)	(9,178)	(9,636)
Total Tier 2 capital	14,813	14,571	17,385
Supervisory deductions			
Unconsolidated investments	(111)	(116)	(121)
Other deductions	(184)	(267)	(93)
	(295)	(383)	(214)
Total regulatory capital	58,227	55,751	58,023

In the management of capital resources, the Group is governed by the RBS Group's policy which is to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the FSA. The FSA uses risk asset ratio (RAR) as a measure of capital adequacy for UK banks, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. The Group has complied with the FSA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas.

30 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2011. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Contingent liabilities						
Guarantees and assets pledged as collateral security	15,142	22,946	31,937	9,965	17,195	26,272
Other contingent liabilities	8,999	10,033	11,172	7,304	7,976	8,829
	24,141	32,979	43,109	17,269	25,171	35,101
Commitments						
Undrawn formal standby facilities, credit lines and other commitments to lend						
- less than one year	97,501	114,112	119,449	43,893	46,751	54,097
- one year and over	123,644	120,091	129,080	101,579	97,525	104,655
Other commitments	2,830	4,053	3,408	59	1,124	287
	223,975	238,256	251,937	145,531	145,400	159,039

Note:
(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Contingent liabilities

Guarantees - the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities - these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments

Commitments to lend - under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

Capital Support Deed

The Bank, together with other members of the RBS Group, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

30 Memorandum items continued

Contractual obligations for future expenditure not provided for in the accounts

The following table shows contractual obligations for future expenditure not provided for in the accounts at the year end.

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Operating leases						
Minimum rentals payable under non-cancellable leases (1)						
Within 1 year	394	409	399	164	171	165
After 1 year but within 5 years	1,321	1,327	1,301	585	595	612
After 5 years	2,489	2,651	2,729	1,523	1,621	1,674
	4,204	4,387	4,429	2,272	2,387	2,451
Property, plant and equipment						
Contracts to buy assets to be leased under operating leases (2)	2,607	2,590	2,724	—	—	—
Other capital expenditure	35	150	62	19	23	27
	2,642	2,740	2,786	19	23	27
Contracts to purchase goods or services (3)	1,130	938	971	1,044	871	762
	7,976	8,065	8,186	3,335	3,281	3,240
Included above are obligations to fellow subsidiaries						
Within 1 year	7	7	7	7	7	7
After 1 year but within 5 years	28	27	27	27	27	27
After 5 years	28	35	42	28	35	42
	63	69	76	62	69	76

Notes:
(1) Predominantly property leases.
(2) Of which due within 1 year: Group - £486 million (2010 - £263 million; 2009 - £370 million); Bank - 2011, 2010 and 2009 - nil. At 31 December 2011, £2,607 million related to RBS Aviation Capital business which is included in disposal groups.
(3) Of which due within 1 year: Group - £483 million (2010 - £435 million; 2009 - £540 million); Bank - £405 million (2010 - £374 million; 2009 - £338 million).

Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group’s financial statements. The Group earned fee income of £416 million (2010 - £407 million; 2009 - £415 million) from these activities.

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Financial Services Authority. In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund the compensation costs associated with Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki ‘Icesave’ and London Scottish Bank plc. These borrowings are on an interest-only basis until 31 March 2012. The annual limit on the FSCS interest and management expenses levy for the period September 2008 to March 2012 in relation to these institutions has been capped at £1 billion per annum.

The FSCS will receive funds from asset sales, surplus cash flow, or other recoveries in relation to these institutions which will be used to reduce the principal amount of the FSCS's borrowings. After the interest only period a schedule for repayment of any outstanding borrowings will be agreed between the FSCS and HM Treasury in the light of market conditions at that time and the FSCS will begin to raise compensation levies (principal repayments).

The Group has accrued £157 million for its share of FSCS levies for the 2011/12 and 2012/13 scheme years.

Litigation and investigations

The Bank and other members of the RBS Group are party to legal proceedings, investigations and regulatory matters in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of members of the RBS Group incurring a liability. The RBS Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation.

In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can be reasonably estimated for any claim. The RBS Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

While the outcome of the legal proceedings, investigations and regulatory matters in which the RBS Group are involved is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory matters as at 31 December 2011.

Other than as set out in these sections entitled ‘Litigation’ and ‘Investigations, reviews and proceedings’, no member of the Group is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Group is aware) during the 12 months prior to the date of this document which may have, or have had in the recent past, significant effects on the financial position or profitability of the Group taken as a whole.

In each of the material legal proceedings and investigations, reviews and proceedings described below, unless specifically noted otherwise, it is not possible to reliably estimate with any certainty the liability, if any, or the effect these proceedings investigations and reviews, and any related developments, may have on the Bank or other members of the Group. However, in the event that any such matters were resolved against the RBS Group, these matters could, individually or in the aggregate, have a material adverse effect on the Group’s consolidated net assets, operating results or cash flows in any particular period.

Litigation

Set out below are descriptions of the material legal proceedings involving the Group.

Shareholder litigation

RBSG and certain of its subsidiaries, together with certain current and former individual officers and directors have been named as defendants in purported class actions filed in the United States District Court for the Southern District of New York involving holders of RBSG preferred shares (the “Preferred Shares litigation”) and holders of American Depositary Receipts (the “ADR claims”).

In the Preferred Shares litigation, the consolidated amended complaint alleges certain false and misleading statements and omissions in public filings and other communications during the period 1 March 2007 to 19 January 2009, and variously asserts claims under Sections 11, 12 and 15 of the US Securities Act of 1933, as amended (the “Securities Act”). The putative class is composed of all persons who purchased or otherwise acquired RBSG Series Q, R, S, T and/or U non-cumulative dollar preference shares issued pursuant or traceable to the 8 April 2005 US Securities and Exchange Commission (the SEC) registration statement. Plaintiffs seek unquantified damages on behalf of the putative class. The defendants have moved to dismiss the complaint and briefing on the motions was completed in September 2011.

With respect to the ADR claims, a complaint was filed in January 2011 and a further complaint was filed in February 2011 asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934, as amended (the “Exchange Act”) on behalf of all persons who purchased or otherwise acquired the RBS Group’s American Depositary Receipts (ADRs) between 1 March 2007 and 19 January 2009. On 18 August 2011, these two ADR cases were consolidated and lead plaintiff and lead counsel were appointed. On 1 November 2011, the lead plaintiff filed a consolidated amended complaint asserting ADR-related claims under Sections 10 and 20 of the Exchange Act and Sections 11, 12 and 15 of the Securities Act. The defendants moved to dismiss the complaint in January 2012 and briefing is ongoing.

The RBS Group has also received notification of similar prospective claims in the United Kingdom and elsewhere but no court proceedings have been commenced in relation to these claims.

The RBS Group considers that it has substantial and credible legal and factual defences to the remaining and prospective claims and will defend itself vigorously.

30 Memorandum items continued

Other securitisation and securities related litigation in the United States

Recently, the level of litigation activity in the financial services industry focused on residential mortgage and credit crisis related matters has increased. As a result, the RBS Group has become and expects that it may further be the subject of additional claims for damages and other relief regarding residential mortgages and related securities in the future.

To date, RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the individual and class action cases involve the issuance of more than US$83 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007. Although the allegations vary by claim, in general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued. RBS Group companies have been named as defendants in more than 30 lawsuits brought by purchasers of MBS, including five purported class actions. Among the lawsuits are six cases filed on 2 September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The primary FHFA lawsuit pending in the federal court in Connecticut, relates to approximately US$32 billion of AAA rated MBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter.

FHFA has also filed five separate lawsuits (against Ally Financial Group, Countrywide Financial Corporation, J.P. Morgan, Morgan Stanley and Nomura respectively) in which RBS Securities Inc. is named as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue.

Other lawsuits against RBS Group companies include two cases filed by the National Credit Union Administration Board (on behalf of US Central Federal Credit Union and Western Corporate Federal Credit Union) and eight cases filed by the Federal Home Loan Banks of Boston, Chicago, Indianapolis, Seattle and San Francisco.

The purported MBS class actions in which RBS Group companies are defendants include New Jersey Carpenters Vacation Fund et al. v. The Royal Bank of Scotland plc et al.; New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al.; In re IndyMac Mortgage-Backed Securities Litigation; Genesee County Employees' Retirement System et al. v. Thornburg Mortgage Securities Trust 2006-3, et al.; and Luther v. Countrywide Financial Corp. et al. and related cases.

Certain other institutional investors have threatened to bring claims against the RBS Group in connection with various mortgage-related offerings. The RBS Group cannot predict with any certainty whether any of these individual investors will pursue these threatened claims (or their outcome), but expects that several may. If such claims are asserted and were successful, the amounts involved may be material.

In many of these actions, the RBS Group has or will have contractual claims to indemnification from the issuers of the securities (where an RBS Group company is underwriter) and/or the underlying mortgage originator (where an RBS Group company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party.

With respect to the current claims described above, the RBS Group considers that it has substantial and credible legal and factual defences to these claims and will continue to defend them vigorously.

Unarranged overdraft charges

In the US, Citizens Financial Group, Inc ("Citizens") in common with other US banks, has been named as a defendant in a class action asserting that Citizens charges excessive overdraft fees. The plaintiffs claim that overdraft fees resulting from point of sale and automated teller machine (ATM) transactions violate the duty of good faith implied in Citizens' customer account agreement and constitute an unfair trade practice. The RBS Group considers that it has substantial and credible legal and factual defences to these claims and will defend them vigorously.

London Interbank Offered Rate (LIBOR)

Certain members of the RBS Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR. The complaints are substantially similar and allege that certain members of the RBS Group and other panel banks individually and collectively violated US commodities and antitrust laws and state common law by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means. The RBS Group considers that it has substantial and credible legal and factual defences to these and prospective claims.

Summary of other disputes, legal proceedings and litigation

In addition to the matters described above, members of the RBS Group are engaged in other legal proceedings in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The RBS Group has reviewed these other actual, threatened and known potential claims and proceedings and, after consulting with its legal advisers, do not expect that the outcome of any of these other claims and proceedings will have a significant effect on the consolidated net assets, operating results or cash flows of the Group in any particular period.

Investigations, reviews and proceedings

The Group's businesses and financial condition can be affected by the fiscal or other policies and actions of various governmental and regulatory authorities in the United Kingdom, the European Union, the United States and elsewhere. Members of the RBS Group have engaged, and will continue to engage, in discussions with relevant regulators, including in the United Kingdom and the United States, on an ongoing and regular basis regarding operational, systems and control evaluations and issues including those related to compliance with applicable anti-bribery, anti-money laundering and sanctions regimes. It is possible that any matters discussed or identified may result in investigatory or other action being taken by the regulators, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of business activities or fines. Any of these events or circumstances could have a significant effect on the RBS Group, their respective businesses, authorisations and licences, reputation, results of operations or the price of securities issued by any of them.

Political and regulatory scrutiny of the operation of retail banking and consumer credit industries in the United Kingdom, United States and elsewhere continues. The nature and impact of future changes in policies and regulatory action are not predictable and are beyond the control of the RBS Group but could have a significant effect on their respective consolidated net assets, operating results or cash flows in any particular period.

Relevant members of the RBS Group are cooperating fully with the investigations and proceedings described below.

Retail banking

In the European Union, regulatory actions included an inquiry into retail banking initiated on 13 June 2005 in all of the then 25 member states by the European Commission's Directorate General for Competition. The inquiry examined retail banking in Europe generally. On 31 January 2007, the European Commission (EC) announced that barriers to competition in certain areas of retail banking, payment cards and payment systems in the European Union had been identified. The EC indicated that it will consider using its powers to address these barriers and will encourage national competition authorities to enforce European and national competition laws where appropriate. In addition, in late 2010, the EC launched an initiative pressing for increased transparency in respect of bank fees. The EC is currently proposing to legislate for the increased harmonisation of terminology across Member States, with proposals expected in 2012. The RBS Group cannot predict the outcome of these actions at this stage and is unable reliably to estimate the effect, if any, that these may have on the Group's consolidated net assets, operating results or cash flows in any particular period.

Multilateral interchange fees

In 2007, the EC issued a decision that while interchange is not illegal per se, MasterCard's current multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the European Union are in breach of competition law. MasterCard was required by the decision to withdraw the relevant cross-border MIF (i.e. set these fees to zero) by 21 June 2008.

MasterCard appealed against the decision to the European Court of First Instance (subsequently re-named the General Court) on 1 March 2008, and the RBS Group has intervened in the appeal proceedings. In addition, in summer 2008, MasterCard announced various changes to its scheme arrangements. The EC was concerned that these changes might be used as a means of circumventing the requirements of the infringement decision. In April 2009, MasterCard agreed an interim settlement on the level of cross-border MIF with the EC pending the outcome of the appeal process and, as a result, the EC has advised it will no longer investigate the non-compliance issue (although MasterCard is continuing with its appeal). The appeal was heard on 8 July 2011 by the General Court and judgment is expected on 24 May 2012.

Visa's cross-border MIFs were exempted in 2002 by the EC for a period of five years up to 31 December 2007 subject to certain conditions. On 26 March 2008, the EC opened a formal inquiry into Visa's current MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the European Union and on 6 April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. At the same time Visa announced changes to its interchange levels and introduced some changes to enhance transparency. There is no deadline for the closure of the inquiry. However, on 26 April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions.

In the UK, the Office of Fair Trading (OFT) has carried out investigations into Visa and MasterCard domestic credit card interchange rates. The decision by the OFT in the MasterCard interchange case was set aside by the Competition Appeal Tribunal (CAT) in June 2006. The OFT's investigations in the Visa interchange case and a second MasterCard interchange case are ongoing. On 9 February 2007, the OFT announced that it was expanding its investigation into domestic interchange rates to include debit cards. In January 2010 the OFT advised that it did not anticipate issuing a Statement of Objections prior to the General Court's judgment, although it has reserved the right to do so if it considers it appropriate.

The outcome of these investigations is not known, but they may have a significant effect on the consumer credit industry in general and, therefore, on RBS Group's business in this sector.

30 Memorandum items continued

Payment Protection Insurance

Having conducted a market study relating to Payment Protection Insurance (PPI), in February 2007 the OFT referred the PPI market to the Competition Commission (CC) for an in-depth inquiry. The CC published its final report in January 2009 and announced its intention to order a range of remedies, including a prohibition on actively selling PPI at point of sale of the credit product (and for 7 days thereafter), a ban on single premium policies and other measures to increase transparency (in order to improve customers' ability to search and improve price competition). Barclays Bank PLC subsequently appealed certain CC findings to the CAT. In October 2009, the CAT handed down a judgment remitting the matter back to the CC for review. Following further review, in October 2010, the CC published its final decision on remedies following the remittal which confirmed the point of sale prohibition. In March 2011, the CC made a final order setting out its remedies with a commencement date of 6 April 2011. The key remedies come into force in two parts. A number came into force in October 2011, and the remainder come into force in April 2012.

The FSA conducted a broad industry thematic review of PPI sales practices and in September 2008, the FSA announced that it intended to escalate its level of regulatory intervention. Substantial numbers of customer complaints alleging the mis-selling of PPI policies have been made to banks and to the Financial Ombudsman Service (FOS) and many of these are being upheld by the FOS against the banks.

Following unsuccessful negotiations with the industry, the FSA issued consultation papers on PPI complaint handling and redress in September 2009 and in March 2010. The FSA published its final policy statement in August 2010. The new rules imposed significant changes with respect to the handling of mis-selling PPI complaints. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. In April 2011 the High Court issued judgment in favour of the FSA and the FOS and in May 2011 the BBA announced that it would not appeal that judgment. The RBS Group then recorded an additional provision of £850 million in respect of PPI. During 2011, the RBS Group reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints.

Personal current accounts

On 16 July 2008, the OFT published the results of its market study into Personal Current Accounts (PCAs) in the United Kingdom. The OFT found evidence of competition and several positive features in the PCA market but believed that the market as a whole was not working well for consumers and that the ability of the market to function well had become distorted.

On 7 October 2009, the OFT published a follow-up report summarising the initiatives agreed between the OFT and PCA providers to address the OFT's concerns about transparency and switching, following its market study. PCA providers will take a number of steps to improve transparency, including providing customers with an annual summary of the cost of their account and making charges prominent on monthly statements. To improve the switching process, a number of steps are being introduced following work with Bacs, the payment processor, including measures to reduce the impact on consumers of any problems with transferring direct debits.

On 22 December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the PCA market in the United Kingdom, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes are required for the market to work in the best interests of bank customers. The OFT stated that it would discuss these issues intensively with banks, consumer groups and other organisations, with the aim of reporting on progress by the end of March 2010. On 16 March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives, namely minimum standards on the operation of opt-outs from unarranged overdrafts, new working groups on information sharing with customers, best practice for PCA customers in financial difficulties and incurring charges, and PCA providers to publish their policies on dealing with PCA customers in financial difficulties. The OFT also announced its plan to conduct six-monthly ongoing reviews, fully to review the market again in 2012 and to undertake a brief analysis on barriers to entry.

The first six-monthly ongoing review was completed in September 2010. The OFT noted progress in the areas of switching, transparency and unarranged overdrafts for the period March to September 2010, as well as highlighting further changes the OFT expected to see in the market. On 29 March 2011, the OFT published its update report in relation to PCA. This noted further progress in improving consumer control over the use of unarranged overdrafts. In particular, the Lending Standards Board had led on producing standards and guidance to be included in a revised Lending Code. The OFT stated it would continue to monitor the market and would consider the need for, and appropriate timing of, further update reports in light of other developments, in particular the work of the UK Government's Independent Commission on Banking (ICB). The OFT has indicated its intention to conduct a more comprehensive review of the market in 2012.

On 26 May 2010, the OFT announced its review of barriers to entry. The review concerned retail banking for individuals and small and medium size enterprises (up to £25 million turnover) and looked at products which require a banking licence to sell mortgages, loan products and, where appropriate, other products such as insurance or credit cards where cross-selling may facilitate entry or expansion. The OFT published its report in November 2010. It advised that it expected its review to be relevant to the ICB, the FSA, HM Treasury and the Department for Business, Innovation and Skills and to the devolved governments in the United Kingdom. The OFT did not indicate whether it would undertake any further work. The report maintained that barriers to entry remain, in particular regarding switching, branch networks and brands. At this stage, it is not possible to estimate the effect of the OFT's report and recommendations regarding barriers to entry upon the RBS Group.

Independent Commission on Banking

Following an interim report published on 11 April 2011, the ICB published its final report to the Cabinet Committee on Banking Reform on 12 September 2011 (the “Final Report”). The Final Report makes a number of recommendations, including in relation to (i) the implementation of a ring-fence of retail banking operations, (ii) loss-absorbency (including bail-in) and (iii) competition.

On 19 December 2011 the UK Government published a response to the Final Report (the “Response”), reaffirming its intention to accept the majority of the ICB’s recommendations. The Government agreed that “vital banking services - in particular the taking of retail deposits - should only be provided by ‘ring-fenced banks’, and that these banks should be prohibited from undertaking certain investment banking activities.” It also broadly accepted the ICB’s recommendations on loss absorbency and on competition.

The UK Government has now embarked on an extensive consultation on how exactly the general principles outlined by the ICB should be implemented, and intends to bring forward a White Paper in the spring of 2012. Its intention is to complete primary and secondary legislation before the end of the current Parliamentary term in May 2015 and to implement the ring-fencing measures as soon as practicable thereafter and the loss absorbency measures by 2019. The Government also stated its determination that changes to the account switching process should be completed by September 2013, as already scheduled.

With regard to the competition aspects, the Government recommended a number of initiatives aimed at improving transparency and switching in the market and ensuring a level playing field for new entrants. In addition, the Government has recommended that HM Treasury should consult on regulating the UK Payments Council and has confirmed that the Financial Conduct Authority's remit will include competition.

Until the UK Government consultation is concluded and significantly more detail is known on how the precise legislative and regulatory framework is to be implemented it is impossible to estimate the potential impact of these measures with any level of precision.

The RBS Group will continue to participate in the debate and to consult with the UK Government on the implementation of the recommendations set out in the Final Report and the Response, the effects of which could have a negative impact on the Group’s consolidated net assets, operating results or cash flows in any particular period.

Securitisation and collateralised debt obligation business

In the United States, the RBS Group is also involved in other reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations relating to, among other things, mortgage-backed securities, collateralised debt obligations (CDOs), and synthetic products. In connection with these inquiries, Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, and repurchase requests.

By way of example, in September and October 2010, the SEC requested voluntary production of information concerning residential mortgage-backed securities underwritten by subsidiaries of the RBS Group during the period from September 2006 to July 2007 inclusive. In November 2010, the SEC commenced a formal investigation and requested testimony from a former RBS Group employee. The investigation is in its preliminary stages and it is difficult to predict any potential exposure that may result.

Also in October 2010, the SEC commenced an inquiry into document deficiencies and repurchase requests with respect to certain securitisations, and in January 2011, this was converted to a formal investigation. Among other matters, the investigation seeks information related to document deficiencies and remedial measures taken with respect to such deficiencies. The investigation also seeks information related to early payment defaults and loan repurchase requests.

In June 2009, in connection with an investigation into the role of investment banks in the origination and securitisation of sub-prime loans in Massachusetts, the Massachusetts Attorney General issued subpoenas to various banks, including an RBSG subsidiary, seeking information related to residential mortgage lending practices and sales and securitisation of residential mortgage loans. On 28 November 2011, an Assurance of Discontinuance between RBS Financial Products Inc. and the Massachusetts Attorney General was filed in Massachusetts State Court which resolves the Massachusetts Attorney General's investigation as to RBSG. The Assurance of Discontinuance required RBS Financial Products Inc. to make payments totalling approximately US$52 million.

30 Memorandum items continued

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The RBS Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction. In May 2011, at the New York State Attorney General's request, representatives of the RBS Group attended an informal meeting to provide additional information about the RBS Group's mortgage securitisation business. The investigation is ongoing and the RBS Group continues to provide requested information.

In September 2010, the RBS Group received a request from the Nevada State Attorney General requesting information related to securitisations of mortgages issued by three specific originators. The investigation by the Nevada State Attorney General is in the early stages and therefore it is difficult to predict the potential exposure from any such investigation.

US mortgages - Loan Repurchase Matters

The RBS Group's Global Banking & Markets N.A. (GBM N.A.), has been a purchaser of non-agency US residential mortgages in the secondary market, and an issuer and underwriter of non-agency residential mortgage-backed securities (RMBS). GBM N.A. did not originate or service any US residential mortgages and it was not a significant seller of mortgage loans to government sponsored enterprises (GSEs) (e.g., the Federal National Mortgage Association and the Federal Home Loan Mortgage Association).

In issuing RMBS, GBM N.A. generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, GBM N.A. made such representations and warranties itself. Where GBM N.A. has given those or other representations and warranties (whether relating to underlying loans or otherwise), GBM N.A. may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. In certain instances where it is required to repurchase loans or related securities, GBM N.A. may be able to assert claims against third parties who provided representations or warranties to GBM N.A. when selling loans to it; although the ability to recover against such parties is uncertain. From the start of 2009 until the end of 2011, GBM N.A. received approximately US$75 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by GBM N.A.. However, repurchase demands presented to GBM N.A. are subject to challenge and, to date, GBM N.A. has rebutted a significant percentage of these claims.

Citizens has not been an issuer or underwriter of non-agency RMBS. However, Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. From the start of 2009 until the end of 2011, Citizens received approximately US$41.2 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to Citizens are subject to challenge and, to date, Citizens has rebutted a significant percentage of these claims.

Although there has been disruption in the ability of certain financial institutions operating in the United States to complete foreclosure proceedings in respect of US mortgage loans in a timely manner (or at all) over the last year (including as a result of interventions by certain states and local governments), to date, Citizens has not been materially impacted by such disruptions and the RBS Group has not ceased making foreclosures.

The RBS Group cannot estimate what the future level of repurchase demands or ultimate exposure of GBM N.A. or Citizens may be, and cannot give any assurance that the historical experience will continue in the future. It is possible that the volume of repurchase demands will increase in the future. Furthermore, the RBS Group is unable to estimate the extent to which the matters described above will impact it and future developments may have an adverse impact on the Group's consolidated net assets, operating results or cash flows in any particular period.

LIBOR

The RBS Group continues to receive requests from various regulators investigating the setting of LIBOR and other interest rates, including the US Commodity Futures Trading Commission, the US Department of Justice, the European Commission, the FSA and the Japanese Financial Services Agency. The authorities are seeking documents and communications related to the process and procedures for setting LIBOR and other interest rates, together with related trading information. In addition to co-operating with the investigations as described above, the RBS Group is also keeping relevant regulators informed. It is not possible to estimate with any certainty what effect these investigations and any related developments may have on the Group.

Other investigations

The Federal Reserve and state banking supervisors have been reviewing the RBS Group's US operations and the RBS Group has been required to make improvements with respect to various matters, including enterprise-wide governance, US Bank Secrecy Act and anti-money laundering compliance, risk management and asset quality. The RBS Group is in the process of implementing measures for matters identified to date.

On 27 July 2011, the RBS Group consented to the issuance of a Cease and Desist Order ("the Order") setting forth measures required to address deficiencies related to governance, risk management and compliance systems and controls identified by the Federal Reserve and state banking supervisors during examinations of the RBS plc and RBS N.V. branches in 2010. The Order requires the RBS Group to strengthen its US corporate governance structure, to develop an enterprise-wide risk management programme, and to develop and enhance its programmes to ensure compliance with US law, particularly the US Bank Secrecy Act and anti-money laundering laws, rules and regulations.The RBS Group has established a strategic and remedial programme of change to address the identified concerns and is committed to working closely with the US bank regulators to implement the remedial measures required by the Order.

The RBS Group's operations include businesses outside the United States that are responsible for processing US dollar payments. The RBS Group is conducting a review of its policies, procedures and practices in respect of such payments and has initiated discussions with UK and US authorities to discuss its historical compliance with applicable laws and regulations, including US economic sanctions regulations. Although the RBS Group cannot currently determine when the review of its operations will be completed or what the outcome of its discussions with UK and US authorities will be, the investigation costs, remediation required or liability incurred could have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

The RBS Group may become subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. Any limitations or conditions placed on the activities of the RBS Group in the United States, as well as the terms of any supervisory action applicable to the Group, could have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

In April 2009, the FSA notified the RBS Group that it was commencing a supervisory review of the acquisition of ABN AMRO Holding N.V. in 2007 and the 2008 capital raisings and an investigation into conduct, systems and controls within the Global Banking & Markets division of the RBS Group. RBSG and its subsidiaries co-operated fully with this review and investigation. On 2 December 2010, the FSA confirmed that it had completed its investigation and had concluded that no enforcement action, either against the RBS Group or against individuals, was warranted. On 12 December 2011, the FSA published its report 'The Failure of the Royal Bank of Scotland', on which the RBS Group engaged constructively with the FSA.

In July 2010, the FSA notified the RBS Group that it was commencing an investigation into the sale by Coutts & Co of the ALICO (American Life Insurance Company) Premier Access Bond Enhanced Variable Rate Fund (EVRF) to customers between 2001 and 2008 as well as its subsequent review of those sales. Subsequently, on 11 January 2011, the FSA revised the investigation start date to December 2003.

On 8 November 2011, the FSA published its Final Notice having reached a settlement with Coutts & Co, under which Coutts & Co agreed to pay a fine of £6.3 million. The FSA did not make any findings on the suitability of advice given in individual cases. Nonetheless, Coutts & Co has agreed to undertake a past business review of its sales of the product. This review will be overseen by an independent third party and will consider the advice given to customers invested in the EVRF as at the date of its suspension, 15 September 2008. For any sales which are found to be unsuitable, redress will be paid to the customers to ensure that they have not suffered financially.

During March 2008, the RBS Group was advised by the SEC that it had commenced a non-public, formal investigation relating to the RBS Group's United States sub-prime securities exposures and United States residential mortgage exposures. In December 2010, the SEC contacted the RBS Group and indicated that it would also examine valuations of various RBS N.V. structured products, including CDOs.

31 Net cash inflow from operating activities

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Operating (loss)/profit before tax	(864)	(171)	(3)	1,867	384	(1,142)
Decrease/(increase) in prepayments and accrued income	700	(247)	28	137	(261)	295
Interest on subordinated liabilities	1,034	816	959	947	647	672
Decrease in accruals and deferred income	(1,821)	(471)	(36)	(1,318)	(922)	(395)
Provisions for impairment losses	7,176	9,400	12,174	1,533	3,571	5,924
Loans and advances written-off net of recoveries	(3,675)	(4,015)	(5,409)	(1,477)	(2,392)	(2,635)
Unwind of discount on impairment losses	(479)	(444)	(356)	(135)	(113)	(96)
(Profit)/loss on sale of property, plant and equipment	(11)	(50)	(40)	7	1	(2)
Loss/(profit) on sale of subsidiaries and associates	67	(675)	16	(3)	305	69
(Profit)/loss on sale of securities	(867)	(253)	(312)	(741)	11	(228)
Charge for defined benefit pension schemes	329	489	389	2	8	(4)
Pension scheme curtailment gains	—	(78)	(2,148)	—	—	(1,603)
Cash contribution to defined benefit pension schemes	(975)	(641)	(744)	(3)	(3)	(1)
Other provisions utilised	(486)	(207)	(148)	(288)	(156)	(119)
Depreciation and amortisation	1,590	1,689	1,587	613	561	495
Gain on redemption of own debt	(255)	(502)	(2,694)	—	(345)	(2,255)
Write-down of goodwill and other intangible assets	80	1	118	—	—	—
Elimination of foreign exchange differences	1,743	(3,107)	5,715	2,331	(1,745)	3,623
Other non-cash items	2,895	768	1,335	1,656	116	(113)
Net cash inflow/(outflow) from trading activities	6,181	2,302	10,431	5,128	(333)	2,485
(Increase)/decrease in loans and advances to banks and customers	(5)	13,305	81,038	(22,151)	(16,018)	(11,118)
(Increase)/decrease in securities	(1,779)	13,077	(3,742)	1,576	14,914	(5,430)
Decrease/(increase) in other assets	2,552	1,830	(6,029)	4,065	10,248	(6,291)
(Increase)/decrease in derivative assets	(97,225)	16,967	484,743	(97,891)	17,721	484,768
Changes in operating assets	(96,457)	45,179	556,010	(114,401)	26,865	461,929
Increase/(decrease) in deposits by banks and customers	34,932	(11,297)	(63,163)	47,429	15,042	50,027
(Decrease)/increase in debt securities in issue	(42,618)	(9,609)	(9,213)	(32,597)	(3,148)	13,201
Increase/(decrease) in other liabilities	2,099	3,560	637	(363)	(5,316)	738
Increase/(decrease) in derivative liabilities	99,895	(3,554)	(478,299)	99,351	(5,481)	(478,203)
(Decrease)/increase in settlement balances and short positions	(1,496)	5,640	(474)	(2,120)	1,308	(335)
Changes in operating liabilities	92,812	(15,260)	(550,512)	111,700	2,405	(414,572)
Total income taxes (paid)/received	(98)	771	(785)	(343)	507	2
Net cash inflow from operating activities	2,438	32,992	15,144	2,084	29,444	49,844

32 Analysis of the net investment in business interests and intangible assets

	Group			Bank		
Acquisitions and disposals	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Fair value given for businesses acquired	(38)	(195)	(73)	(129)	(169)	(31)
Value recognised for business transferred from fellow subsidiary	7,440	—	—	7,440	—	—
Additional and new investments in Group undertakings	—	—	—	(5,297)	(3,015)	(3,766)
Net inflow/(outflow) of cash in respect of purchases	7,402	(195)	(73)	2,014	(3,184)	(3,797)
Other assets sold	94	2,790	78	—	(3)	1
Repayment of investments	—	—	—	618	5,072	914
Non-cash consideration	—	—	—	—	899	—
(Loss)/profit on disposal	(67)	675	(16)	3	(305)	(69)
Net inflow of cash in respect of disposals	27	3,465	62	621	5,663	846
Dividends received from joint ventures	5	5	—	2	2	—
Cash expenditure on intangible assets	(918)	(668)	(386)	(570)	(441)	(174)
Net inflow/(outflow)	6,516	2,607	(397)	2,067	2,040	(3,125)

33 Interest received and paid

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
Interest received	19,258	19,531	23,120	14,819	14,029	12,375
Interest paid	(7,481)	(6,985)	(12,508)	(11,064)	(9,707)	(8,242)
	11,777	12,546	10,612	3,755	4,322	4,133

34 Analysis of changes in financing during the year

	Group					
	Share capital, share premium and merger reserve			Subordinated liabilities		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
At 1 January	42,865	42,865	42,539	32,023	34,717	39,951
Issue of ordinary shares	—	—	8,151	—	—	—
Redemption of preference shares	—	—	(7,825)	—	—	—
Issue of subordinated liabilities	—	—	—	940	—	5,000
Repayment of subordinated liabilities	—	—	—	(624)	(880)	(3,200)
Net cash inflow/(outflow) from financing	—	—	326	316	(880)	1,800
Currency translation and other adjustments	—	—	—	(15)	(1,814)	(7,034)
At 31 December	42,865	42,865	42,865	32,324	32,023	34,717

	Bank					
	Share capital and share premium			Subordinated liabilities		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
At 1 January	31,984	31,984	31,658	29,299	30,513	33,698
Issue of ordinary shares	—	—	8,151	—	—	—
Redemption of preference shares	—	—	(7,825)	—	—	—
Issue of subordinated liabilities	—	—	—	940	—	5,000
Repayment of subordinated liabilities	—	—	—	(193)	(8)	(2,235)
Net cash inflow/(outflow) from financing	—	—	326	747	(8)	2,765
Currency translation and other adjustments	—	—	—	(32)	(1,206)	(5,950)
At 31 December	31,984	31,984	31,984	30,014	29,299	30,513

35 Analysis of cash and cash equivalents

	Group			Bank		
	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
At 1 January						
- cash	88,622	57,954	47,223	79,621	47,039	39,093
- cash equivalents	40,555	34,984	33,191	34,758	31,677	34,356
	129,177	92,938	80,414	114,379	78,716	73,449
Net cash inflow	6,659	36,239	12,524	10,953	35,663	5,267
At 31 December	135,836	129,177	92,938	125,332	114,379	78,716
Comprising:						
Cash and balances at central banks	68,487	49,423	26,627	64,261	44,584	20,744
Treasury bills and debt securities	1,148	3,937	13,626	677	3,439	13,626
Loans and advances to banks	66,201	75,817	52,685	60,394	66,356	44,346
Cash and cash equivalents	135,836	129,177	92,938	125,332	114,379	78,716

The Bank and certain subsidiary undertakings are required to maintain balances with the Bank of England which, at 31 December 2011, amounted to £415 million (2010 - £415 million; 2009 - £433 million). Certain subsidiary undertakings are required by law to maintain reserve balances with the Federal Reserve Bank in the US. Such reserve balances were $1.2 billion at 31 December 2011 (2010 and 2009 - $1.0 billion).

36 Segmental analysis

(a) Divisions

The directors manage the Group primarily by class of business and present the segmental analysis on that basis. This includes the review of net interest income for each class of business - interest receivable and payable for all reportable segments is therefore presented net. Segments charge market prices for services rendered to other parts of the Group. The segment measure is operating profit/(loss) before tax.

The Group's reportable segments are on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile.

UK Corporate is a leading provider of banking, finance, and risk management services to the corporate and SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes asset finance through the Lombard brand.

Wealth provides private banking and investment services in the UK through Coutts & Co and Adam & Company, offshore banking through RBS International, NatWest Offshore and Isle of Man Bank, and international private banking through Coutts & Co Ltd.

Global Transaction Services (GTS) ranks among the top tier of global transaction banks, offering payments, cash and liquidity management, trade finance and commercial card products and services. Through the network and extensive partner bank agreements, GTS are able to support and connect customers across 128 countries.

Ulster Bank is the leading retail and business bank in Northern Ireland and the third largest banking group on the island of Ireland. It provides a comprehensive range of financial services. The Retail Markets division which has a network of 236 branches, operates in the personal and financial planning sectors. The Corporate Markets division provides services to SME business customers, corporates and institutional markets.

US Retail & Commercial provides financial services primarily through the Citizens and Charter One brands. US Retail & Commercial is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states.

Global Banking & Markets (GBM) is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. The division is organised along six principal business lines: money markets; rates flow trading; currencies; equities; credit and mortgage markets and portfolio management and origination.

Central items comprises Group and corporate functions, such as treasury, funding and finance, risk management, legal, communications and human resources. The Centre manages the Group's capital resources and Group-wide regulatory projects and provides services to the operating divisions.

Non-Core Division manages separately assets that the Group intends to run off or dispose of. The division contains a range of businesses and asset portfolios primarily from the GBM division, linked to proprietary trading, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also includes a number of other portfolios and businesses, including regional markets businesses, that the Group has concluded are no longer strategic.

2011	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses) recoveries/ £m	Operating profit/(loss) £m
UK Retail	4,320	1,126	5,446	(2,490)	—	(788)	2,168
UK Corporate	2,724	1,274	3,998	(1,362)	(172)	(784)	1,680
Wealth	645	457	1,102	(767)	(11)	(25)	299
Global Transaction Services	442	842	1,284	(740)	(7)	(11)	526
Ulster Bank	713	211	924	(503)	(1)	(1,384)	(964)
US Retail & Commercial	1,925	1,004	2,929	(1,899)	(117)	(325)	588
Global Banking & Markets	496	4,221	4,717	(3,059)	(181)	10	1,487
Central items	(1,195)	818	(377)	(298)	(670)	—	(1,345)
Core	10,070	9,953	20,023	(11,118)	(1,159)	(3,307)	4,439
Non-Core	1,228	532	1,760	(595)	(353)	(3,869)	(3,057)
Managed basis	11,298	10,485	21,783	(11,713)	(1,512)	(7,176)	1,382
Reconciling items							
Fair value of own debt	—	731	731	—	—	—	731
Asset Protection Scheme	—	(906)	(906)	—	—	—	(906)
Payment Protection Insurance costs	—	—	—	(850)	—	—	(850)
Amortisation of purchased intangible assets	—	—	—	—	(68)	—	(68)
Integration and restructuring costs	—	—	—	(883)	(10)	—	(893)
Gain on redemption of own debt	—	255	255	—	—	—	255
Strategic disposals	—	(57)	(57)	(80)	—	—	(137)
Bank levy	—	—	—	(300)	—	—	(300)
Bonus tax	—	—	—	(78)	—	—	(78)
Statutory basis	11,298	10,508	21,806	(13,904)	(1,590)	(7,176)	(864)

2010	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment (losses) recoveries/ £m	Operating profit/(loss) £m
UK Retail	4,082	1,128	5,210	(2,573)	(1)	(1,160)	1,476
UK Corporate	2,584	1,323	3,907	(1,392)	(173)	(761)	1,581
Wealth	554	445	999	(683)	(11)	(18)	287
Global Transaction Services	421	1,325	1,746	(863)	(5)	(14)	864
Ulster Bank	860	214	1,074	(535)	(2)	(1,161)	(624)
US Retail & Commercial	1,948	1,029	2,977	(1,934)	(99)	(517)	427
Global Banking & Markets	901	5,519	6,420	(2,792)	(104)	(289)	3,235
Central items	(850)	383	(467)	(103)	(735)	(4)	(1,309)
Core	10,500	11,366	21,866	(10,875)	(1,130)	(3,924)	5,937
Non-Core	1,611	661	2,272	(1,051)	(480)	(5,476)	(4,735)
Managed basis	12,111	12,027	24,138	(11,926)	(1,610)	(9,400)	1,202
Reconciling items							
Fair value of own debt	—	(31)	(31)	—	—	—	(31)
Asset Protection Scheme	—	(1,550)	(1,550)	—	—	—	(1,550)
Amortisation of purchased intangible assets	—	—	—	—	(63)	—	(63)
Integration and restructuring costs	—	—	—	(809)	(16)	—	(825)
Gain on redemption of own debt	—	502	502	—	—	—	502
Strategic disposals	—	645	645	—	—	—	645
Bonus tax	—	—	—	(50)	—	—	(50)
Write-down of goodwill and other intangible assets	—	—	—	(1)	—	—	(1)
Statutory basis	12,111	11,593	23,704	(12,786)	(1,689)	(9,400)	(171)

36 Segmental analysis continued

2009	Net interest income £m	Non-interest income £m	Total income £m	Operating expenses £m	Depreciation and amortisation £m	Impairment losses £m	Operating profit/(loss) £m
UK Retail	3,535	1,295	4,830	(2,851)	(2)	(1,679)	298
UK Corporate	2,249	1,290	3,539	(1,294)	(154)	(927)	1,164
Wealth	564	445	1,009	(607)	(11)	(33)	358
Global Transaction Services	447	1,292	1,739	(880)	(12)	(16)	831
Ulster Bank	829	254	1,083	(710)	(5)	(649)	(281)
US Retail & Commercial	1,907	949	2,856	(1,988)	(72)	(702)	94
Global Banking & Markets	1,088	7,276	8,364	(2,429)	(59)	(317)	5,559
Central items	(941)	85	(856)	(117)	(734)	—	(1,707)
Core	9,678	12,886	22,564	(10,876)	(1,049)	(4,323)	6,316
Non-Core	1,865	(2,282)	(417)	(947)	(439)	(7,851)	(9,654)
Managed basis	11,543	10,604	22,147	(11,823)	(1,488)	(12,174)	(3,338)
Reconciling items							
Fair value of own debt	—	(298)	(298)	—	—	—	(298)
Amortisation of purchased intangible assets	—	—	—	—	(81)	—	(81)
Integration and restructuring costs	—	—	—	(841)	(18)	—	(859)
Gain on redemption of own debt	—	2,694	2,694	—	—	—	2,694
Bonus tax	—	—	—	(151)	—	—	(151)
Gains on pensions curtailment	—	—	—	2,148	—	—	2,148
Write-down of goodwill and other intangible assets	—	—	—	(118)	—	—	(118)
Statutory basis	11,543	13,000	24,543	(10,785)	(1,587)	(12,174)	(3)

	2011			2010			2009		
Total revenue	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m
UK Retail	6,756	409	7,165	6,665	358	7,023	6,766	550	7,316
UK Corporate	4,450	107	4,557	4,348	126	4,474	4,557	116	4,673
Wealth	1,026	729	1,755	956	616	1,572	812	818	1,630
Global Transaction Services	962	42	1,004	2,330	6	2,336	2,282	60	2,342
Ulster Bank	1,299	103	1,402	1,386	133	1,519	1,605	103	1,708
US Retail & Commercial	3,342	199	3,541	3,660	286	3,946	4,080	378	4,458
Global Banking & Markets	6,403	4,913	11,316	7,824	4,331	12,155	10,630	7,971	18,601
Central items	3,052	13,920	16,972	2,228	12,251	14,479	29	9,289	9,318
Core	27,290	20,422	47,712	29,397	18,107	47,504	30,761	19,285	50,046
Non-Core	3,352	198	3,550	4,107	194	4,301	2,975	1,254	4,229
	30,642	20,620	51,262	33,504	18,301	51,805	33,736	20,539	54,275
Eliminations	—	(20,620)	(20,620)	—	(18,301)	(18,301)	—	(20,539)	(20,539)
Managed basis	30,642	—	30,642	33,504	—	33,504	33,736	—	33,736
Reconciling items									
Fair value of own debt	731	—	731	(31)	—	(31)	(298)	—	(298)
Asset Protection Scheme	(906)	—	(906)	(1,550)	—	(1,550)	—	—	—
Gain on redemption of own debt	255	—	255	502	—	502	2,694	—	2,694
Strategic disposals	(57)	—	(57)	645	—	645	—	—	—
Statutory basis	30,665	—	30,665	33,070	—	33,070	36,132	—	36,132

Total income	2011 External £m	2011 Inter segment £m	2011 Total £m	2010 External £m	2010 Inter segment £m	2010 Total £m	2009 External £m	2009 Inter segment £m	2009 Total £m
UK Retail	5,484	(38)	5,446	5,254	(44)	5,210	4,922	(92)	4,830
UK Corporate	4,510	(512)	3,998	4,361	(454)	3,907	4,379	(840)	3,539
Wealth	495	607	1,102	507	492	999	310	699	1,009
Global Transaction Services	1,254	30	1,284	1,749	(3)	1,746	1,748	(9)	1,739
Ulster Bank	962	(38)	924	962	112	1,074	1,049	34	1,083
US Retail & Commercial	2,739	190	2,929	2,703	274	2,977	2,513	343	2,856
Global Banking & Markets	4,471	246	4,717	6,132	288	6,420	7,819	545	8,364
Central items	(942)	565	(377)	(1,063)	596	(467)	(2,731)	1,875	(856)
Core	18,973	1,050	20,023	20,605	1,261	21,866	20,009	2,555	22,564
Non-Core	2,810	(1,050)	1,760	3,533	(1,261)	2,272	2,138	(2,555)	(417)
Managed basis	21,783	—	21,783	24,138	—	24,138	22,147	—	22,147
Reconciling items									
Fair value of own debt	731	—	731	(31)	—	(31)	(298)	—	(298)
Asset Protection Scheme	(906)	—	(906)	(1,550)	—	(1,550)	—	—	—
Gain on redemption of own debt	255	—	255	502	—	502	2,694	—	2,694
Strategic disposals	(57)	—	(57)	645	—	645	—	—	—
Statutory basis	21,806	—	21,806	23,704	—	23,704	24,543	—	24,543

Group	2011 Assets £m	2011 Liabilities £m	2011 Cost to acquire fixed assets and intangible assets £m	2010 Assets £m	2010 Liabilities £m	2010 Cost to acquire fixed assets and intangible assets £m	2009 Assets £m	2009 Liabilities £m	2009 Cost to acquire fixed assets and intangible assets £m
UK Retail	114,403	104,028	—	112,070	100,341	—	107,136	88,011	—
UK Corporate	111,743	103,575	712	114,008	101,740	381	114,205	89,306	598
Wealth	21,770	39,022	65	21,178	37,071	63	18,104	36,278	11
Global Transaction Services	17,051	56,511	18	14,652	45,032	22	10,286	41,192	17
Ulster Bank	34,843	27,792	45	40,090	34,512	101	44,031	40,621	—
US Retail & Commercial	74,558	65,512	271	71,200	66,089	197	75,384	72,408	179
Global Banking & Markets	861,236	835,673	370	726,124	711,654	508	731,379	749,190	540
Central items	102,351	125,490	1,892	68,970	126,751	897	40,795	116,787	603
Core	1,337,955	1,357,603	3,373	1,168,292	1,223,190	2,169	1,141,320	1,233,793	1,948
Non-Core	94,826	13,324	955	139,038	26,533	761	191,661	42,991	2,910
Group	1,432,781	1,370,927	4,328	1,307,330	1,249,723	2,930	1,332,981	1,276,784	4,858

Assets and liabilities held for sale included in the divisional segments above:

	2011 Assets £m	2011 Liabilities £m	2010 Assets £m	2010 Liabilities £m	2009 Assets £m	2009 Liabilities £m
UK Retail	7,048	8,808	—	—	—	—
UK Corporate	11,661	12,976	—	—	—	—
Global Transaction Services	66	—	251	549	—	—
Global Banking & Markets	431	117	—	—	9	—
Centre	136	2	—	—	—	—
Non-Core	4,746	937	9,291	6,959	14,194	10,993
	24,088	22,840	9,542	7,508	14,203	10,993

36 Segmental analysis continued

Segmental analysis of goodwill is as follows:

	UK Retail £m	UK Corporate £m	Wealth £m	Global Transaction Services £m	US Retail & Commercial £m	Global Banking & Markets £m	Central items £m	Non-Core £m	Total £m
At 1 January 2009	2,790	2,695	800	2,065	3,023	38	24	397	11,832
Transfer to disposal groups	—	—	—	—	—	—	—	(238)	(238)
Currency translation and other adjustments	—	—	(12)	(168)	(302)	—	—	(13)	(495)
Acquisitions	—	—	—	—	—	26	—	—	26
Write-down of goodwill	—	—	—	—	—	—	—	(118)	(118)
At 1 January 2010	2,790	2,695	788	1,897	2,721	64	24	28	11,007
Currency translation and other adjustments	—	—	25	62	122	4	—	1	214
Disposals	—	—	—	(481)	—	—	—	(14)	(495)
Write-down of goodwill	—	—	(1)	—	—	—	—	—	(1)
At 1 January 2011	2,790	2,695	812	1,478	2,843	68	24	15	10,725
Transfer to disposal groups	—	—	—	—	—	—	—	(15)	(15)
Currency translation and other adjustments	—	—	—	3	9	2	—	—	14
Acquisitions	—	—	—	—	—	18	—	—	18
Write-down of goodwill	(20)	(60)	—	—	—	—	—	—	(80)
At 31 December 2011	2,770	2,635	812	1,481	2,852	88	24	—	10,662

(b) Geographical segments

The geographical analyses in the tables below have been compiled on the basis of location of office where the transactions are recorded.

	Group				
2011	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
Total revenue	17,995	6,516	3,655	2,499	30,665
Net interest income	7,727	2,336	1,112	123	11,298
Net fees and commissions	3,059	1,331	329	132	4,851
Income from trading activities	385	1,318	297	14	2,014
Other operating income/(loss)	2,664	192	803	(16)	3,643
Total income	13,835	5,177	2,541	253	21,806
Operating (loss)/profit before tax	(454)	1,748	(1,682)	(476)	(864)
Total assets	979,164	349,206	44,146	60,265	1,432,781
Of which assets held for sale	19,332	53	4,660	43	24,088
Total liabilities	946,864	331,976	32,311	59,776	1,370,927
Of which liabilities held for sale	21,903	104	833	—	22,840
Net assets attributable to equity shareholders and non-controlling interests	32,300	17,230	11,835	489	61,854
Contingent liabilities and commitments	123,886	90,305	27,980	5,945	248,116
Cost to acquire property, plant and equipment and intangible assets	2,399	499	1,393	37	4,328
2010					
Total revenue	19,692	8,096	3,474	1,808	33,070
Net interest income	8,205	2,508	1,147	251	12,111
Net fees and commissions	3,524	1,510	366	131	5,531
Income from trading activities	1,298	1,928	23	112	3,361
Other operating income/(loss)	1,761	222	786	(68)	2,701
Total income	14,788	6,168	2,322	426	23,704
Operating profit/(loss) before tax	583	1,596	(2,237)	(113)	(171)
Total assets	869,662	333,946	43,499	60,223	1,307,330
Of which assets held for sale	2,855	6,686	1	—	9,542
Total liabilities	839,747	316,515	33,906	59,555	1,249,723
Of which liabilities held for sale	570	6,938	—	—	7,508
Net assets attributable to equity shareholders and non-controlling interests	29,915	17,431	9,593	668	57,607
Contingent liabilities and commitments	142,909	86,482	33,872	7,972	271,235
Cost to acquire property, plant and equipment and intangible assets	1,219	336	1,320	55	2,930

2009	Group UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
Total revenue	20,806	9,908	3,832	1,586	36,132
Net interest income	7,306	2,798	1,150	289	11,543
Net fees and commissions	3,893	1,501	322	46	5,762
Income/(loss) from trading activities	445	2,376	(37)	223	3,007
Other operating income/(loss)	3,575	186	530	(60)	4,231
Total income	15,219	6,861	1,965	498	24,543
Operating profit/(loss) before tax	752	487	(959)	(283)	(3)
Total assets	866,845	316,900	87,032	62,204	1,332,981
Of which assets held for sale	—	14,203	—	—	14,203
Total liabilities	834,524	301,102	79,175	61,983	1,276,784
Of which liabilities held for sale	—	10,993	—	—	10,993
Net assets attributable to equity shareholders and non-controlling interests	32,321	15,798	7,857	221	56,197
Contingent liabilities and commitments	176,961	77,635	32,648	7,802	295,046
Cost to acquire property, plant and equipment and intangible assets	1,933	389	2,478	58	4,858

37 Directors' and key management remuneration

The directors of the Bank are also directors of the holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

Compensation of key management

The aggregate remuneration of directors and other members of key management during the year, borne by the RBS Group, was as follows:

	2011 £000	2010 £000
Short-term benefits	36,371	35,654
Post-employment benefits	3,547	(503)
Share-based payments	21,062	21,551
	60,980	56,702

38 Transactions with directors and key management

(a) At 31 December 2011, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £3,550,864 in respect of loans to eight persons who were directors of the Bank at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of the Group Management Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2011 £000	2010 £000
Loans and advances to customers	19,366	10,970
Customer accounts	33,149	10,641

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the holding company.

39 Related parties

UK Government

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Group.

The Group enters into transactions with many of these bodies on an arm's length basis. The principal transactions during 2011, 2010 and 2009 were: the Asset Protection Scheme, Bank of England facilities and the issue of debt guaranteed by the UK Government discussed below.

Other transactions include the payment of: taxes principally UK corporation tax (page 197) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (page 189) and FSCS levies (page 262)); together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

Asset protection scheme

On 22 December 2009, the Group entered into an agreement (the Asset Protection Scheme (APS) with HM Treasury, acting on behalf of the UK Government, under which the Group purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HM Treasury with a par value of approximately £282 billion; including £49 billion of covered assets held by fellow subsidiaries of The Royal Bank of Scotland Group plc. The protection is subject to a first loss of £60 billion and covers 90% of subsequent losses net of recoveries. Once the first loss has been exhausted, losses and recoveries in respect of assets for which a trigger event - failure to pay, bankruptcy or restructuring - has occurred are included in the balance receivable under the APS. Receipts from HM Treasury will, over time, amount to 90% of cumulative losses (net of 90% of cumulative recoveries) on the portfolio of covered assets less the first loss amount.

The Group has a right to terminate the APS at any time provided that the Financial Services Authority has confirmed in writing to HM Treasury that it has no objection. On termination the Group must pay HM Treasury the higher of the regulatory capital relief received and £2.5 billion less premiums paid plus the aggregate of amounts received from the UK Government under the APS.

HM Treasury has the right to appoint step-in managers to carry out any oversight, management or additional functions on behalf of HM Treasury to ensure that the covered assets are managed and administered in compliance with the agreed terms and conditions. This right is exercisable if certain step-in triggers occur. These include:

- losses on covered assets in total exceed 125% of the first loss amount or losses on an individual covered asset class exceed specified thresholds;
- a breach of specified obligations in the APS rules or the accession agreement;
- the Group has failed or is failing to comply with any of the conditions in the APS rules in relation to asset management, monitoring and reporting, and governance and oversight and such failure is persistent and material or it is evidence of a systematic problem; and
- material or systematic data deficiencies in the information provided to HM Treasury in accordance with the terms of APS.

HM Treasury may at any time elect to cease to exercise its step-in rights in whole or part when it is satisfied that the step-in triggers have been remedied.

The Group has paid APS premiums totalling £2,225 million (2011 - £125 million; 2010 - £700 million; 2009 - £1,400 million). From 31 December 2011 premiums of £125 million are payable quarterly until the earlier of 2099 and the date the Group leaves the Scheme.

The APS is a single contract providing credit protection in respect of a portfolio of financial assets. Under IFRS, credit protection is treated either as a financial guarantee contract or as a derivative financial instrument depending on the terms of the agreement and the nature of the protected assets and exposures. The Group has concluded, principally because the covered portfolio includes significant exposure in the form of derivatives, that the APS does not meet the criteria to be treated as a financial guarantee contract. The contract has been accounted for as a derivative financial instrument and is recognised as a fair value liability of £231 million (2010 - asset £550 million; 2009 - asset £1,400 million) and included within the Derivative liability balance sheet caption. Changes in fair value of £906 million (2010 - £1,550 million; 2009 - nil) were recognised in profit or loss within Income from trading activities. Details of the valuation methodology for the APS are set out in Note 11 Financial instruments - valuation on pages 218 and 219.

There is no change in the recognition and measurement of the covered assets as a result of the APS. Impairment provisions on covered assets measured at amortised cost are assessed and charged in accordance with the Group's accounting policy; held-for-trading assets, assets designated at fair value and available-for-sale assets within the APS portfolio continue to be measured at fair value with no adjustments to reflect the protection provided by the APS. There is no change in how gains and losses on the covered assets are recognised in the income statement or in other comprehensive income.

The Bank has also entered into two agreements with RBS Holdings N.V., a fellow subsidiary, under which it has sold credit protection over the exposures held by RBS Holdings N.V. and its subsidiaries that are subject to the APS. These agreements cover 100% of losses on these assets. One agreement provides protection over a portfolio that includes significant exposure in the form of derivatives; the other covers assets that are measured at amortised cost. The former agreement is accounted for as a credit derivative. The second agreement meets the definition of a financial guarantee contract and is accounted for as such.

Bank of England facilities

The Group also participates in a number of schemes operated by the Bank of England available to eligible banks and building societies.

- Open market operations - these provide market participants with funding at market rates on a tender basis in the form of short and long-term repos on a wide range of collateral and outright purchases of high-quality bonds to enable them to meet the reserves that they must hold at the Bank of England.

- The special liquidity scheme - this was launched in April 2008 to allow financial institutions to swap temporarily illiquid assets for treasury bills, with fees charged based on the spread between 3-month LIBOR and the 3-month gilt repo rate. The scheme officially closed on 30 January 2012.

At 31 December 2011, the Group had no amounts outstanding under these facilities (2010 - £16.1 billion; 2009 - £21.4 billion).

Government credit and asset-backed securities guarantee schemes

These schemes guarantee eligible debt issued by qualifying institutions for a fee. The fee, payable to HM Treasury is based on a per annum rate of 25 (asset-backed securities guarantee scheme) and 50 (credit guarantee scheme) basis points plus 100% of the institution's median five-year credit default swap spread during the twelve months to 1 July 2008. The asset-backed securities scheme closed to new issuance on 31 December 2009 and the credit guarantee scheme on 28 February 2010.

At 31 December 2011, the Group had issued debt guaranteed by the Government totalling £21.3 billion (2010 - £41.5 billion; 2009 - £51.5 billion).

Other related parties

(a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm’s length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.

(b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.

(c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.

(d) The captions in the primary financial statements of the Bank include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements. The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

	2011 £m	2010 £m	2009 £m
Income			
Interest receivable	122	89	1
Interest payable	896	907	751
Fees and commissions receivable	109	148	88
Fees and commissions payable	108	484	99
Expenses			
Premises and equipment	7	7	7

40 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. As at 31 December 2011, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 66.9% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

41 Post balance sheet events

There have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Five year summary

Summary consolidated income statement	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Net interest income	11,298	12,111	11,543	13,509	11,116
Non-interest income (1, 2, 3)	10,508	11,593	13,000	2,348	11,191
Total income	21,806	23,704	24,543	15,857	22,307
Operating expenses (4, 5, 6, 7, 8)	(15,494)	(14,475)	(12,372)	(20,367)	(11,287)
Profit/(loss) before impairment losses	6,312	9,229	12,171	(4,510)	11,020
Impairment losses	(7,176)	(9,400)	(12,174)	(4,706)	(1,865)
Operating (loss)/profit before tax	(864)	(171)	(3)	(9,216)	9,155
Tax (charge)/credit	(731)	(713)	523	505	(1,903)
(Loss)/profit for the year	(1,595)	(884)	520	(8,711)	7,252
(Loss)/profit attributable to:					
Non-controlling interests	(8)	29	235	208	53
Preference shareholders	58	60	523	638	331
Ordinary shareholders	(1,645)	(973)	(238)	(9,557)	6,868

Notes:
(1) Includes loss on strategic disposals of £57 million (2010 - £645 million gain; 2009 - nil; 2008 - £442 million gain; 2007 - nil).
(2) Includes gain on redemption of own debt of £255 million (2010 - £502 million; 2009 - £2,694 million).
(3) Includes movements in fair value of own debt of £731 million gain (2010 - £31 million loss; 2009 - £298 million loss; 2008 - £920 million gain).
(4) Includes Payment Protection Insurance costs of £850 million.
(5) Includes integration and restructuring costs of £893 million (2010 - £825 million; 2009 - £859 million; 2008 - £647 million; 2007 - £92 million).
(6) Includes amortisation of purchased intangibles of £68 million (2010 - £63 million; 2009 - £81 million; 2008 - £100 million; 2007 - £124 million).
(7) Includes write-down of goodwill and other intangible assets of nil (2010 - £1 million; 2009 - £118 million; 2008 - £8,144, million).
(8) Includes gains on pensions curtailment of £2,148 million in 2009.

Summary consolidated balance sheet	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Loans and advances	586,539	605,826	604,610	698,890	647,795
Debt securities and equity shares	180,903	168,369	187,586	180,457	169,941
Derivatives and settlement balances	539,709	437,753	455,506	948,328	211,301
Other assets	125,630	95,382	85,279	50,255	42,701
Total assets	1,432,781	1,307,330	1,332,981	1,877,930	1,071,738
Owners' equity	61,726	57,010	55,051	45,958	47,683
Non-controlling interests	128	597	1,146	1,292	152
Subordinated liabilities	32,324	32,023	34,717	39,951	27,796
Deposits	581,485	557,545	569,440	635,111	594,490
Derivatives, settlement balances and short positions	575,060	470,600	468,938	955,062	256,921
Other liabilities	182,058	189,555	203,689	200,556	144,696
Total liabilities and equity	1,432,781	1,307,330	1,332,981	1,877,930	1,071,738

Other contractual cash obligations

The tables below summarise other contractual cash obligations by payment date.

	Group					
2011	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Operating leases	106	288	719	602	1,015	1,474
Contractual obligations to purchase goods or services	111	372	548	93	6	—
	217	660	1,267	695	1,021	1,474
2010						
Operating leases	110	299	723	604	1,078	1,573
Contractual obligations to purchase goods or services	102	333	478	25	—	—
	212	632	1,201	629	1,078	1,573

	Bank					
2011	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Operating leases	68	96	311	274	585	938
Contractual obligations to purchase goods or services	102	303	541	92	6	—
	170	399	852	366	591	938
2010						
Operating leases	49	122	314	281	602	1,019
Contractual obligations to purchase goods or services	96	278	472	25	—	—
	145	400	786	306	602	1,019

Risk factors

Set out below are certain risk factors which could adversely effect the Group's future results and cause them to be materially different from expected results. The Group's results could also be affected by competition and other factors. The factors discussed in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

RBS plc is a principal operating subsidiary of RBSG and accounts for a substantial proportion of the consolidated assets, liabilities and operating profits of RBSG. Accordingly, risk factors below which relate to RBSG and the RBS Group will also be of relevance to the Bank and the Group.

The RBS Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions and by other geopolitical risks

The RBS Group's businesses and performance are affected by local and global economic conditions and perceptions of those conditions and future economic prospects. The outlook for the global economy over the near to medium-term remains challenging and many forecasts predict at best only stagnant or modest levels of gross domestic product (GDP) growth across a number of the RBS Group's key markets over that period. In the UK, latest estimates suggest the economy grew by only 1% in 2011, while the current consensus of forecasts predicts GDP growth of just 0.5% in 2012. GDP in the European Monetary Union (EMU) in 2011 was estimated to have grown by 1.6% in 2011 (although this was mainly boosted by Germany, the EMU's largest economy, which grew by 3%). While the German economy has proven to be relatively robust, austerity measures in many EMU economies, initiated in response to increased sovereign debt risk, have resulted in weak economic and GDP growth. Economic growth in the EMU is predicted to fall in 2012 by 0.3% (source: Consensus Economics Inc, Eurostat, ONS). Despite significant interventions by governments and other non-governmental bodies during and since the financial crisis in 2008/2009, capital and credit markets around the world continue to be volatile and be subject to intermittent and prolonged disruptions. In particular, increasingly during the second half of 2011, a heightened risk of sovereign default relating to certain EU member states has had a negative impact on capital and credit markets. Such challenging economic and market conditions have exerted downward pressure on asset prices and on credit availability, and upward pressure on funding costs, and continue to impact asset recovery rates and the credit quality of the RBS Group's businesses, customers and counterparties, including sovereigns. In particular, the RBS Group has significant exposure to customers and counterparties within the EU (including the UK and Ireland), which includes sovereign debt exposures that have been, and may in the future be, affected by restructuring of their terms, principal, interest and maturity. These exposures have resulted in the RBS Group making significant provisions and recognising significant write-downs in prior periods, which may also occur in future periods. These conditions, alone or in combination with regulatory changes or actions of market participants, may also cause the RBS Group to experience reduced activity levels, additional write-downs and impairment charges and lower profitability, and may restrict the ability of the RBS Group to access funding and liquidity. In particular, should the scope and severity of the adverse economic conditions currently experienced by some EU member states and elsewhere worsen, the risks faced by the RBS Group would be exacerbated. Developments relating to the current economic conditions and unfavourable financial environment, including those discussed above, could have a material adverse effect on the RBS Group's business, results of operations, financial condition and prospects and could have a negative impact on the value of any securities issued by the RBS Group.

In Europe, countries such as Ireland, Italy, Greece, Portugal and Spain have been particularly affected by the recent financial and economic conditions. The perceived risk of default on the sovereign debt of those countries intensified in the latter part of 2011, particularly in relation to Greece and has continued into 2012. This raised concerns about the contagion effect such a default would have on other EU economies as well as the ongoing viability of the euro currency and the EMU. Yields on the sovereign debt of most EU member states have recently been volatile and trended upward. The EU, the European Central Bank and the International Monetary Fund have prepared rescue packages for some of the affected countries and a number of European states, including Ireland, Italy and Spain, are taking actions to stabilise their economies and reduce their debt burdens. The EU has also taken policy initiatives intended to address systemic stresses in the eurozone. Despite these actions, the long-term ratings of a majority of eurozone countries have recently been downgraded and further downgrades are possible. Furthermore, the effectiveness of these actions is not assured and the possibility remains that the euro could be abandoned as a currency by countries that have already adopted its use, or in an extreme scenario, abandonment of the euro could result in the dissolution of the EMU. This would lead to the re-introduction of individual currencies in one or more EMU member states.

The effects on the European and global economies of the potential dissolution of the EMU, exit of one or more EU member states from the EMU and the redenomination of financial instruments from the euro to a different currency, are impossible to predict fully. However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk;
- affect adversely the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities; and
- have a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

By virtue of the RBS Group's global presence, the RBS Group is also exposed to risks arising out of geopolitical events, such as the existence of trade barriers, the implementation of exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the response to them by governments could also adversely affect levels of economic activity and have an adverse effect upon the RBS Group's business, financial condition and results of operations.

Risk factors continued

The RBS Group's ability to meet its obligations including its funding commitments depends on the RBS Group's ability to access sources of liquidity and funding

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide have experienced severe reductions in liquidity and term-funding during prolonged periods in recent years. In particular, funding in the interbank markets, a traditional source of unsecured short-term funding, has been severely disrupted. Although credit markets generally improved during the first half of 2011, wholesale funding markets have continued to suffer, particularly for European banks as the sovereign debt crisis worsened during the second half of 2011. As a result, a number of banks were reliant on central banks as their principal source of liquidity and central banks increased their support provisions to banks with the European Central Bank providing significant liquidity in the last few months of 2011 (including long-term refinancing operations facilities (offering loans with a term of up to three years) and broader access to US dollar funding). Although these efforts appear to be having a positive impact, global credit markets remain disrupted. The market perception of bank credit risk has changed significantly recently and banks that are deemed by the market to be riskier have had to issue debt at a premium to the equivalent cost of debt for other banks that are perceived by the market as being less risky. Any uncertainty regarding the perception of credit risk across financial institutions may lead to further reductions in levels of interbank lending and associated term maturities and may restrict the RBS Group's access to traditional sources of liquidity.

The RBS Group's liquidity management focuses, among other things, on maintaining a diverse and appropriate funding strategy for its assets in line with the RBS Group's wider Strategic Plan. At certain times during periods of liquidity stress, the RBS Group has been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase its recourse to liquidity schemes provided by central banks. Such schemes require the pledging of assets as collateral, the eligibility and valuation of which is determined by the applicable central bank. Changes to these valuations or eligibility criteria can negatively impact the available assets and reduce available liquidity access particularly during periods of stress when such lines may be needed most. Further tightening of credit markets could have a materially adverse impact on the RBS Group and the Group. There is also a risk that corporate and financial institution counterparties may seek to reduce their credit exposures to banks and other financial institutions, which may cause funding from these sources to no longer be available. There is also likely to be increased competition for funding due to the significant levels of refinancing expected to be required by financial institutions during 2012, which may also reduce the level of funding available from these sources. Under such circumstances, the RBS Group may need to seek funds from alternative sources, potentially at higher costs than has previously been the case or may be required to consider disposals of other assets not previously identified for disposal to reduce its funding commitments. In the context of its liquidity management efforts, the RBS Group has sought to increase the average maturity of its wholesale funding, which has had the effect of increasing the RBS Group's overall cost of funding. In addition, the RBS Group expects to proportionately increase its reliance on longer-term secured funding, such as covered bonds.

Like many banking groups, the RBS Group relies increasingly on customer deposits to meet a considerable portion of its funding and it is actively seeking to increase the proportion of its funding represented by customer deposits. However, such deposits are subject to fluctuation due to certain factors outside the RBS Group's control, such as a loss of confidence, increasing competitive pressures for retail customer deposits or the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors, which could result in a significant outflow of deposits within a short period of time. There is currently heavy competition among UK banks for retail customer deposits, which has increased the cost of procuring new deposits and impacted the RBS Group's ability to grow its deposit base and such competition is expected to continue. An inability to grow, or any material decrease in, the RBS Group's deposits could, particularly if accompanied by one of the other factors described above, have a materially adverse impact on the Group's ability to satisfy its liquidity needs.

The occurrence of any of the risks described above could have a material adverse impact on the RBS Group's financial conditions and results of operations and/or result in a loss of value in its securities.

The Independent Commission on Banking has published its final report on competition and possible structural reforms in the UK banking industry. The UK Government has indicated that it supports and intends to implement the recommendations substantially as proposed, which could have a material adverse effect on the RBS Group

The Independent Commission on Banking (ICB) was appointed by the UK Government in June 2010 to review possible structural measures to reform the UK banking system in order to promote, amongst other things, stability and competition. The ICB published its final report to the Cabinet Committee on Banking Reform on 12 September 2011 which set out the ICB's views on possible reforms to improve stability and competition in UK banking. The final report made a number of recommendations, including in relation to (i) the implementation of a ring-fence of retail banking operations, (ii) increased loss absorbency (including bail-in i.e. the ability to write-down debt or convert it into an issuer's ordinary shares in certain circumstances) and (iii) promotion of competition. On 19 December 2011 the UK Government published its response to the final report and indicated its support and intention to implement the recommendations set out in the final report substantially as proposed. The UK Government indicated that it will work towards putting in place the necessary legislation by May 2015, requiring compliance as soon as practicable thereafter and a final deadline for full implementation of 2019. The RBS Group will continue to participate in the debate and to consult with the UK Government on the implementation of the recommendations set out in the final report and in the UK Government's response, the effects of which could have a material adverse effect on the RBS Group's structure, results of operations, financial condition and prospects.

The RBS Group's ability to implement its strategic plan depends on the success of the RBS Group's refocus on its core strengths and its balance sheet reduction programme

As a result of the global economic and financial crisis that began in 2008 and the changed global economic outlook, the RBS Group is engaged in a financial and core business restructuring which is focused on achieving appropriate risk-adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital-intensive businesses. A key part of this restructuring is the programme announced in February 2009 to run-down and sell the RBS Group's Non-Core assets and businesses and the continued review of the RBS Group's portfolio to identify further disposals of certain Non-Core assets and businesses. Assets identified for this purpose and allocated to the RBS Group's Non-Core division totalled £258 billion, excluding derivatives, at 31 December 2008. At 31 December 2011, this total had reduced to £93.7 billion (31 December 2010 - £137.9 billion), excluding derivatives, as further progress was made in business disposals and portfolio sales during the course of 2011. This balance sheet reduction programme continues alongside the disposals under the State Aid restructuring plan approved by the European Commission. As part of its Core business restructuring, in January 2012 the RBS Group announced changes to its wholesale banking operations, including the reorganisation of its wholesale businesses and the exit and downsizing of selected existing activities (including cash equities, corporate banking, equity capital markets, and mergers and acquisitions).

Because the ability to dispose of assets and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain challenging, there is no assurance that the RBS Group will be able to sell or run-down (as applicable) those remaining businesses it is seeking to exit either on favourable economic terms to the RBS Group or at all. In addition, material tax liabilities could arise on the disposal of assets. Furthermore, there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner, or at all. There is consequently a risk that the RBS Group may fail to complete such disposals by any agreed longstop date.

The RBS Group may be liable for any deterioration in businesses being sold between the announcement of the disposal and its completion, which period may be lengthy and may span many months. In addition, the RBS Group may be exposed to certain risks until completion, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction related costs.

The planned reorganisation, exit and downsizing of business activities announced in January 2012 will be time intensive and costly, the extent to which is not fully ascertainable. The process of implementing these changes may result in further disruption to the RBS Group and the businesses it is trying to exit or downsize.

The occurrence of any of the risks described above could negatively affect the RBS Group's ability to implement its strategic plan and could have a material adverse effect on the RBS Group's business, results of operations, financial condition, capital ratios and liquidity and could result in a loss of value in its securities.

The occurrence of a delay in the implementation of (or any failure to implement) the approved proposed transfers of a substantial part of the business activities of RBS N.V. to RBS may have a material adverse effect on RBS

As part of the restructuring of its businesses, operations and assets, on 19 April 2011, the RBS Group announced the proposed transfers of a substantial part of the business activities of RBS N.V. to RBS. Subject to, among other matters, regulatory and other approvals it is expected that the proposed transfers will be implemented on a phased basis over a period ending on 31 December 2013. A large part of the proposed transfers is expected to have taken place by the end of 2012. On 17 October 2011, the RBS Group completed the transfer of a substantial part of the UK activities of RBS N.V. to RBS pursuant to Part VII of FSMA.

The process for implementing the proposed transfers is complex and any failure to satisfy any conditions or complete any preliminary steps to each proposed transfer may cause a delay in its completion (or result in its non-completion). If any of the proposed transfers are delayed (or are not completed) for any reason, such as a failure to secure required regulatory approvals, it is possible that the relevant regulatory authorities could impose sanctions which could adversely impact the minimum regulatory requirements for capital and liquidity of the Group. In addition, the FSA may impose additional capital and liquidity requirements in relation to RBS Group to the extent that such a delay in implementation (or non-completion) of any of the proposed transfers has consequential financial implications for RBS (for example increased intra-group large exposures). A delay in implementation of (or any failure to implement) any of the proposed transfers may therefore adversely impact RBS Group's capital and liquidity resources and requirements, with consequential adverse impacts on its funding resources and requirements.

The occurrence of a delay in the implementation of (or any failure to implement) any of the proposed transfers may therefore have a material adverse effect on the RBS Group's business, results of operations, financial condition, and could result in a loss of value in its securities.

Risk factors continued

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan and is prohibited from making discretionary dividend or coupon payments on existing hybrid capital instruments (including preference shares and B Shares) which may impair the RBS Group's ability to raise new Tier 1 capital

The RBS Group was required to obtain State Aid approval for the aid given to the Group by HM Treasury as part of the placing and open offer undertaken by RBSG in December 2008, the issuance to HM Treasury of £25.5 billion of B shares in the capital of RBSG which are, subject to certain terms and conditions, convertible into ordinary shares in the share capital of RBSG and a contingent commitment by HM Treasury to subscribe for up to an additional £8 billion of B Shares if certain conditions are met and the RBS Group's participation in the Asset Protection Scheme (APS). In that context, as part of the terms of the State Aid approval, RBSG, together with HM Treasury, agreed the terms of a restructuring plan (the "State Aid restructuring plan").

As part of the State Aid restructuring plan, there is a prohibition on the making of discretionary dividend (including on preference shares and B shares) or coupon payments on existing hybrid capital instruments for a two year period which ends on 30 April 2012. These restrictions prevent RBSG, RBS and other RBS Group companies (other than companies in the RBS Holdings N.V. group (which was renamed from ABN AMRO Holding N.V. on 1 April 2010), which are subject to different restrictions) from paying discretionary dividends on their preference shares and discretionary coupons on other Tier 1 securities, and RBSG from paying dividends on its ordinary shares, for the same duration, and it may impair the RBS Group's ability to raise new capital through the issuance of ordinary shares of RBSG and other securities issued by the RBSG or other Group companies.

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan, including required asset disposals. In particular, the RBS Group agreed to undertake a series of measures to be implemented over a four year period from December 2009, including the disposal of all or a controlling portion of RBS Insurance (with disposal of its entire interest in RBS Insurance required by 31 December 2014), Global Merchant Services (GMS), its interest in RBS Sempra Commodities LLP, and the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct and other small and medium-size enterprise customers and certain mid-corporate customers across the UK. While the disposal of GMS is completed and the disposal of RBS Sempra Commodities is largely completed, the sale processes in respect of the Royal Bank and NatWest branch-based businesses and RBS Insurance, continue to progress. There is no assurance that the price that the RBS Group receives or has received for any assets sold pursuant to the State Aid restructuring plan will be or has been at a level the RBS Group considers adequate or which it could obtain in circumstances in which the RBS Group was not required to sell such assets in order to implement the State Aid restructuring plan or if such sale were not subject to the restrictions contained in the terms thereof. Further, if the RBS Group fails to complete any of the required disposals within the agreed timeframes for such disposals, under the terms of the State Aid approval, a divestiture trustee may be empowered to conduct the disposals, with the mandate to complete the disposal at no minimum price.

Furthermore, if the RBS Group is unable to comply with the terms of the State Aid approval, it could constitute a misuse of aid. In circumstances where the European Commission doubts that the RBS Group is complying with the terms of the State Aid approval, it may open a formal investigation. At the conclusion of any such investigation, if the European Commission decided that there had been misuse of aid, it could issue a decision requiring HM Treasury to recover the misused aid, which could have a material adverse impact on the RBS Group.

In implementing the State Aid restructuring plan, the RBS Group has lost, and will continue to lose, existing customers, deposits and other assets (both directly through the sale and potentially through the impact on the rest of the RBS Group's business arising from implementing the State Aid restructuring plan) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals. Further, the loss of such revenues and related income may extend the time period over which the RBS Group may pay any amounts owed to HM Treasury under the APS or otherwise. The implementation of the State Aid restructuring plan may also result in disruption to the retained business and give rise to significant strain on management, employee, operational and financial resources, impacting customers and employees and giving rise to separation costs which could be substantial.

The implementation of the State Aid restructuring plan may result in the emergence of one or more new viable competitors or a material strengthening of one or more of the RBS Group's existing competitors in the RBS Group's markets. The effect of this on the RBS Group's future competitive position, revenues and margins is uncertain and there could be an adverse effect on the RBS Group's operations and financial condition and its business generally.

The occurrence of any of the risks described above could have a material adverse effect on the RBS Group's business, results of operations, financial condition, capital position and competitive position.

RBSG and its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures under the Banking Act 2009 which may result in various actions being taken in relation to any securities

Under the Banking Act 2009, substantial powers have been granted to HM Treasury, the Bank of England and the FSA (together, the "Authorities") as part of a special resolution regime. These powers enable the Authorities to deal with and stabilise UK incorporated institutions with permission to accept deposits pursuant to Part IV of the FSMA (each, a "relevant entity") that are failing, or are likely to fail, to satisfy the threshold conditions (within the meaning of section 41 of the FSMA, which are the conditions that a relevant entity must satisfy in order to obtain its authorisation to perform regulated activities). The special resolution regime consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity and/or the securities of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a "bridge bank" wholly-owned by the Bank of England; and (iii) temporary public ownership (nationalisation) of the relevant entity. HM Treasury may also take a holding company of the relevant entity into temporary public ownership where certain conditions are met. The Banking Act also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify (including imposing additional obligations) and cancel certain contractual arrangements in certain circumstances.

If the stabilisation options were to be exercised in respect of the RBS Group, HM Treasury or the Bank of England may exercise extensive share and property transfer powers which could involve taking various actions in relation to any securities without the consent of holders of the securities. These could include: (i) transferring its securities free from any trust, liability or other encumbrance and free from any contractual, legislative or other restrictions on transfer; (ii) extinguishing any rights to acquire securities; (iii) delisting its securities; (iv) converting its securities into another form or class; or (v) disapplying any termination or acceleration rights or events of default under the terms of its securities which would be triggered by the transfer or certain related events.

Where HM Treasury makes a share transfer order in respect of securities issued by a holding company of a relevant entity, HM Treasury may make an order providing for the property, rights or liabilities of the holding company or of any relevant entity in the holding company group to be transferred and where such property is held on trust, removing or altering the terms of such trust.

Although the Banking Act includes provisions related to compensation in respect of transfer instruments and orders made under it (including securities that are transferred with respect to a relevant entity) there can be no assurance that compensation would be assessed to be payable or that any compensation would be recovered promptly and/or would equal any loss actually incurred. HM Treasury is also empowered by order to amend the law (including with retrospective effect) for the purpose of enabling the powers under the special resolution regime to be used effectively. In general, there is considerable uncertainty about the scope of the powers afforded to the Authorities under the Banking Act and how the Authorities may choose to exercise them. However, potential impacts may include full nationalisation of the RBS Group, the total loss of value in its securities and the inability of RBS Group to perform its obligations under its securities.

The financial performance of the RBS Group has been, and continues to be, materially affected by deteriorations in borrower and counterparty credit quality and further deteriorations could arise due to prevailing economic and market conditions and legal and regulatory developments

The RBS Group has exposure to many different industries and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and counterparties are inherent in a wide range of the RBS Group's businesses. In particular, the RBS Group has significant exposure to certain individual counterparties in weakened business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe (particularly Ireland) and within certain business sectors, namely personal finance, financial institutions and commercial real estate. For a discussion of the Group's exposure to country risk see pages 127 to 143. Furthermore, the RBS Group expects its exposure to the UK to increase proportionately as its business becomes more concentrated in the UK, with exposures generally being reduced in other parts of its business as it implements its strategy, including the reduction of and exit from certain businesses in its GBM business.

The RBS Group may continue to see adverse changes in the credit quality of its borrowers and counterparties, for example as a result of their inability to refinance their debts, with increasing delinquencies, defaults and insolvencies across a range of sectors and in a number of geographic markets. Since the credit quality of the RBS Group's borrowers and counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets, a significant deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the RBS Group's ability to enforce contractual security rights. In addition, the RBS Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the RBS Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. Any such losses could have an adverse effect on the Group's results of operations and financial condition or result in a loss of value in its securities.

Financial services institutions that deal with each other are inter-related as a result of trading, investment, clearing, counterparty and other relationships. Within the financial services industry, the default of any one institution could lead to defaults by other institutions. Concerns about, or a default by, one institution could lead to significant liquidity problems and losses or defaults by other institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of this credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by the RBS Group. This systemic risk may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the RBS Group interacts on a daily basis, all of which could have a material adverse effect on the RBS Group's access to liquidity or could result in losses which could have a material adverse effect on the RBS Group's financial condition, results of operations and prospects or result in a loss of value in its securities.

Risk factors continued

In the US during recent years, there has been disruption in the ability of certain financial institutions to complete foreclosure proceedings in a timely manner (or at all), including as a result of interventions by certain states and local governments. This disruption has lengthened the time to complete foreclosures, increased the backlog of repossessed properties and, in certain cases, has resulted in the invalidation of purported foreclosures. In addition, a number of other financial institutions have experienced increased repurchase demands in respect of US mortgage loans or other related securities originated and sold. However, the RBS Group has not experienced a significant volume of repurchase demands in respect of similar loans or related securities it originated or sold and has not ceased any of its US foreclosure activities.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the RBS Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the RBS Group, including the Group, and an inability to engage in routine funding transactions, and may result in a loss of value in its securities.

The RBS Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions

Financial markets continue to be subject to significant stress conditions, where steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by losses arising out of asset-backed collateralised debt obligations, residential mortgage-backed securities and the leveraged loan market. In dislocated markets, hedging and other risk management strategies may not be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties. Severe market events have resulted in the RBS Group recording large write-downs on its credit market exposures in recent years. Any deterioration in economic and financial market conditions could lead to further impairment charges and write-downs. Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the RBS Group's exposures. Valuations in future periods, reflecting, among other things, then prevailing market conditions and changes in the credit ratings of certain of the RBS Group's assets, may result in significant changes in the fair values of the RBS Group's exposures, even in respect of exposures, such as credit market exposures, for which the RBS Group has previously recorded write-downs. In addition, the value ultimately realised by the RBS Group may be materially different from the current or estimated fair value. Any of these factors could require the RBS Group, including the Group, to recognise further significant write-downs in addition to those already recorded or realised or realise increased impairment charges, which may have a material adverse effect on their respective financial condition, results of operations and capital ratios or result in a loss of value in its securities.

The value or effectiveness of any credit protection that the RBS Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties

The RBS Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDS), and other credit derivatives, such as the APS, each of which are carried at fair value. The fair value of these CDSs, as well as the RBS Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Market counterparties have been adversely affected by their exposure to residential mortgage linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the RBS Group and the Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The RBS Group and the Group also recognise any fluctuations in the fair value of other credit derivatives, such as the APS. If market conditions improve and credit spreads for assets covered by the APS narrow, the value of the protection decreases and a loss is recognised. If credit spreads widen, the protection is more valuable, giving rise to a gain. Any such adjustments or fair value changes may have a material adverse impact on the Group's financial condition and results of operations.

Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect the RBS Group's business and results of operations

Some of the most significant market risks the RBS Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity prices and basis, volatility and correlation risks. Changes in interest rate levels (or extended periods of low interest rates), yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of RBSG's non-UK subsidiaries and may affect RBSG's reported consolidated financial condition or its income from foreign exchange dealing. For accounting purposes, the RBS Group and the Group value some of their issued debt, such as debt securities, at the current market price. Factors affecting the current market price for such debt, such as the credit spreads of the RBS Group and the Group, may result in a change to the fair value of such debt, which is recognised in their respective income statements as a profit or loss.

The performance of financial markets affects bond, equity and commodity prices, which has caused, and may in the future cause, changes in the value of the Group's investment and trading portfolios. As part of its ongoing derivatives operations, the Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above. While the Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult, particularly in the current environment, to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group's financial performance and business operations.

The RBS Group's borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its and the UK Government's credit ratings

The credit ratings of RBSG, RBS and other Group members have been subject to change and may change in the future, which could impact their cost of, access to and sources of financing and liquidity. A number of UK and other European financial institutions, including RBSG, RBS Group and other Group members, were downgraded during the course of 2011 in connection with a review of systemic support assumptions incorporated into bank ratings and the likelihood, in the case of UK banks, that the UK Government is more likely in the future to make greater use of its resolution tools to allow burden sharing with bondholders, and in connection with a general review of rating agencies' methodologies. Rating agencies continue to evaluate the rating methodologies applicable to UK and European financial institutions and any change in such rating agencies' methodologies could materially adversely affect the credit ratings of Group companies. Any further reductions in the long-term or short-term credit ratings of the RBS Group or one of its principal subsidiaries would increase its borrowing costs, require the RBS Group, including the Group, to replace funding lost due to the downgrade, which may include the loss of customer deposits, and may also limit the RBS Group's access to capital and money markets and trigger additional collateral requirements in derivatives contracts and other secured funding arrangements. At 31 December 2011, a one notch downgrade in the Group's credit rating would have required the Group to post an estimated additional £12.5 billion of collateral without taking into account mitigating action by management. Furthermore, given the extent of the UK Government ownership of the RBSG, any downgrade in the UK Government's credit ratings could materially adversely affect the credit ratings of Group companies and may have the effects noted above. Credit ratings of RBSG, RBS Group, RBS N.V., Ulster Bank Limited and Citizens Financial Group Inc. are also important to the Group when competing in certain markets, such as over-the-counter derivatives. As a result, any further reductions in RBSG's long-term or short-term credit ratings or those of its principal subsidiaries, including RBS, could adversely affect the Group's access to liquidity and its competitive position, increase its funding costs and have a material adverse impact on the Group's earnings, cash flow and financial condition or result in a loss of value in its securities.

The RBS Group's business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements

Effective management of the RBS Group's capital is critical to its ability to operate its businesses and to pursue its strategy of returning to standalone strength. The RBS Group is required by regulators in the UK, the US and other jurisdictions in which it undertakes regulated activities to maintain adequate capital resources. The maintenance of adequate capital is also necessary for the RBS Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK, US and European markets. Accordingly, the purpose of the issuance of the £25.5 billion of B shares and the grant of the Contingent Subscription in 2009 and the previous placing and open offers completed in 2008 and 2009 was to allow the RBS Group to strengthen its capital position.

The package of reforms to the regulatory capital framework published by the Basel Committee on Banking Supervision in December 2010 and January 2011 includes materially increasing the minimum common equity requirement and the total Tier 1 capital requirement. In addition, banks will be required to maintain, in the form of common equity (after the application of deductions), a capital conservation buffer to withstand future periods of stress, bringing the total common equity requirements to 7%. If there is excess credit growth in any given country resulting in a system wide build-up of risk, a countercyclical buffer within a range of 0% to 2.5% of common equity is to be applied as an extension of the conservation buffer. In addition, a leverage ratio will be introduced, together with a liquidity coverage ratio and a net stable funding ratio. Further measures may include bail-in debt (which could be introduced by statute, possibly impacting existing as well as future issues of debt and exposing them to the risk of conversion into equity and/or write-down of principal amount). Such measures would be in addition to proposals for the write-off of Tier 1 and Tier 2 debt (and its possible conversion into ordinary shares) if a bank becomes non-viable.

In November 2011, the Basel Committee proposed that global systemically important banks be subject to an additional common equity Tier 1 capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance. To provide a disincentive for banks facing the highest charge to increase materially their global systemic importance in the future, an additional 1% surcharge would be applied in such circumstances.

On 4 November 2011 the Financial Stability Board published its policy framework for addressing the systemic risks associated with global systemically important financial institutions (GSIFI). In this paper the RBS Group was identified as a GSIFI. As a result the RBS Group will be required to meet resolution planning requirements by the end of 2012 as well as have additional loss absorption capacity of 2.5% of risk-weighted assets which will need to be met with common equity as described above. In addition, GSIFIs are to be subjected to more intensive and effective supervision. The additional capital requirements are to be applied to GSIFIs identified in 2014 (the Financial Stability Board will update its list every three years) and phased in beginning in 2016.

Risk factors continued

The implementation of the Basel III reforms will begin on 1 January 2013; however, the requirements are subject to a series of transitional arrangements and will be phased in over a period of time, to be fully effective by 2019.

The Basel III rules have not yet been approved by the EU and their incorporation into European and national law has, accordingly, not yet taken place. On 20 July 2011, the European Commission published a legislative package of proposals (known as CRD IV) to implement the changes through the replacement of the existing Capital Requirements Directive with a new Directive and Regulation. As with Basel III, the proposals contemplate the entry into force of the new legislation from 1 January 2013, with full implementation by 1 January 2019; however the proposals allow the UK to implement the stricter definition and/or level of capital more quickly than is envisaged under Basel III.

The ICB recommendations and the UK Government's response supporting such recommendations includes proposals to increase capital and loss absorbency to levels that exceed the proposals under Basel III/CRD IV. These requirements, as well as the other recommendations of the ICB, are expected to be phased in between 2015 and 2019. As the implementation of the ICB recommendations will be the subject of legislation not yet adopted, the RBS Group cannot predict the impact such rules will have on the RBS Group's overall capital requirements or how they will affect the RBS Group's compliance with capital and loss absorbency requirements of Basel III/CRD IV.

To the extent the RBS Group has estimated the indicative impact that Basel III reforms may have on its risk-weighted assets and capital ratios, such estimates are preliminary and subject to uncertainties and may change. In particular, the estimates assume mitigating actions will be taken by the RBS Group (such as deleveraging of legacy positions and securitisations, including non-core, as well as other actions being taken to de-risk market and counterparty exposures), which may not occur as anticipated, in a timely manner, or at all.

The Basel Committee changes and other future changes to capital adequacy and liquidity requirements in the UK and in other jurisdictions in which the RBS Group operates, including any application of increasingly stringent stress case scenarios by the regulators in the UK, the US and other jurisdictions in which the RBS Group undertakes regulated activities, may require the RBS Group to raise additional Tier 1 (including Core Tier 1) and Tier 2 capital by way of further issuances of securities, and will result in existing Tier 1 and Tier 2 securities issued by the RBS Group ceasing to count towards the RBS Group's regulatory capital, either at the same level as present or at all. The requirement to raise additional Core Tier 1 capital could have a number of negative consequences for RBSG and its shareholders, including impairing RBSG's ability to pay dividends on or make other distributions in respect of ordinary shares and diluting the ownership of existing shareholders of RBSG. If the RBS Group is unable to raise the requisite Tier 1 and Tier 2 capital, it may be required to further reduce the amount of its risk-weighted assets and engage in the disposal of Core and other Non-Core businesses, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the RBS Group. In addition, pursuant to the State Aid approval, should the RBS Group's Core Tier 1 capital ratio decline to below 5% at any time before 31 December 2014, or should the RBS Group fall short of its funded balance sheet target level (after adjustments) for 31 December 2013 by £30 billion or more, the RBS Group will be required to reduce its risk-weighted assets by a further £60 billion in excess of its plan through further disposals of identifiable businesses and their associated assets.

Pursuant to the acquisition and contingent capital agreement entered into between the Royal Bank and HM Treasury on 29 November 2009, the RBS Group will also be subject to restrictions on payments on its hybrid capital instruments should its Core Tier 1 ratio fall below 6% or if it would fall below 6% as a result of such payment. At 31 December 2011, the RBS Group's Tier 1 and Core Tier 1 capital ratios were 11.0% and 9.2%, respectively, calculated in accordance with FSA requirements. Any change that limits the RBS Group's ability to manage effectively its balance sheet and capital resources going forward (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, delays in the disposal of certain assets or the inability to syndicate loans as a result of market conditions, a growth in unfunded pension exposures or otherwise) or to access funding sources, could have a material adverse impact on its financial condition and regulatory capital position or result in a loss of value in its securities.

The RBS Group is and may be subject to litigation and regulatory investigations that may have a material impact on its business

The RBS Group's operations are diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory investigation and other regulatory risk. As a result, the RBS Group is, and may in the future be, involved in various disputes, legal proceedings and regulatory investigations in the UK, the EU, the US and other jurisdictions, including class action litigation, LIBOR related litigation and investigations and anti-money laundering, sanctions and compliance related investigations. The RBS Group may also incur the risk of civil suits, criminal liability or regulatory actions as a result of its disclosure obligations to HM Treasury under the APS. In addition, the RBS Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with new and existing corporate governance, employee compensation, conduct of business, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Disputes, legal proceedings and regulatory investigations are subject to many uncertainties, and their outcomes are often difficult to predict, particularly in the early stages of a case or investigation. Adverse regulatory action or adverse judgments in litigation could result in restrictions or limitations on the Group's operations or have a significant effect on the Group's reputation or results of operations or result in a loss of value in securities.

The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate

Under International Financial Reporting Standards, the RBS Group recognises at fair value: (i) financial instruments classified as held-for-trading or designated as at fair value through profit or loss; (ii) financial assets classified as available-for-sale; and (iii) derivatives. Generally, to establish the fair value of these instruments, the RBS Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the RBS Group's internal valuation models require it to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. These assumptions, judgements and estimates will need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group's earnings and financial condition or result in a loss of value in its securities.

The RBS Group operates in markets that are highly competitive and its business and results of operations may be adversely affected

The competitive landscape for banks and other financial institutions in the UK, the US and throughout the rest of Europe is subject to rapid change and recent regulatory and legal changes are likely to result in new market participants and changed competitive dynamics in certain key areas, such as in retail banking in the UK. The competitive landscape in the UK will be particularly influenced by the recommendations on competition included in the ICB's final report, and the UK Government's implementation of the recommendations, as discussed above. In order to compete effectively, certain financial institutions may seek to consolidate their businesses or assets with other parties. This consolidation, in combination with the introduction of new entrants into the markets in which the RBS Group operates, is likely to increase competitive pressures on the RBS Group.

In addition, certain competitors may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the RBS Group and may have stronger and more efficient operations. Furthermore, the RBS Group's competitors may be better able to attract and retain clients and key employees, which may have a negative impact on the Group's relative performance and future prospects. In addition, future disposals and restructurings by the RBS Group and the compensation structure and restrictions imposed on the RBS Group may also have an impact on its ability to compete effectively. These and other changes to the competitive landscape could adversely affect the Group's business, margins, profitability, financial condition and prospects or result in a loss of value in its securities.

The RBS Group could fail to attract or retain senior management, which may include members of the Board, or other key employees, and it may suffer if it does not maintain good employee relations

The RBS Group's ability to implement its strategy and its future success depends on its ability to attract, retain and remunerate highly skilled and qualified personnel, including its senior management, which include directors and other key employees, competitively with its peers. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and heightened scrutiny of, and (in some cases) restrictions placed upon, management and employee compensation arrangements, in particular those in receipt of Government support (such as the RBS Group).

In addition to the effects of such measures on the Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is becoming more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of appropriately skilled personnel could place the Group at a significant competitive disadvantage and prevent the Group from successfully implementing its strategy, which could have a material adverse effect on the Group's financial condition and results of operations or result in a loss of value in its securities.

In addition, certain of the RBS Group's employees in the UK, continental Europe and other jurisdictions in which the RBS Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the RBS Group and a breakdown of these relationships could adversely affect the Group's business, reputation and results. As the RBS Group implements cost-saving initiatives and disposes of, or runs-down, certain assets or businesses (including as part of its restructuring plans), it faces increased risk in this regard and there can be no assurance that the Group will be able to maintain good relations with its employees or employee representative bodies in respect of all matters. As a result, the Group may experience strikes or other industrial action from time to time, which could have an adverse effect on its business and results of operations and could cause damage to its reputation.

Each of the RBS Group's businesses is subject to substantial regulation and oversight. Significant regulatory developments, including changes in tax law, could have an adverse effect on how the RBS Group conducts its business and on its results of operations and financial condition

The RBS Group is subject to extensive financial services laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. All of these are subject to change, particularly in the current regulatory and market environment, where there have been unprecedented levels of government intervention (including nationalisations and injections of government capital), changes to the regulations governing financial institutions and reviews of the industry, in the UK, the US and many European countries. In recent years, there has also been increasing focus in the UK, US and other jurisdictions in which the RBS Group operates on compliance with anti-bribery, anti-money laundering, anti-terrorism and other similar sanctions regimes.

Risk factors continued

As a result of the environment in which the RBS Group operates, increasing regulatory focus in certain areas and ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the RBS Group's participation in government or regulator-led initiatives), the RBS Group is facing greater regulation and scrutiny in the UK, the US and other countries in which it operates.

Although it is difficult to predict with certainty the effect that recent regulatory developments and heightened levels of public and regulatory scrutiny will have on the RBS Group, the enactment of legislation and regulations in the UK, the other parts of Europe in which the RBS Group operates and the US (such as the bank levy in the UK or the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US) is likely to result in increased capital and liquidity requirements and changes in regulatory requirements relating to the calculation of capital and liquidity metrics or other prudential rules relating to capital adequacy frameworks, and may result in an increased number of regulatory investigations and actions. Any of these developments could have an adverse impact on how the Group conducts its business, applicable authorisations and licences, the products and services it offers, its reputation, the value of its assets, its funding costs and its results of operations and financial condition or result in a loss of value in its securities.

Areas in which, and examples of where, governmental policies, regulatory changes and increased public and regulatory scrutiny could have an adverse impact on the RBS Group include those set out above as well as the following:

- the transition in the UK of regulatory and supervisory powers from the FSA to the new Financial Conduct Authority for conduct of business supervision and the Prudential Regulatory Authority for capital and liquidity supervision in 2013;
- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- requirements to separate retail banking from investment banking, and restrictions on proprietary trading and similar activities within a commercial bank and/or a group which contains a commercial bank;
- the design and potential implementation of government mandated resolution or insolvency regimes;
- the imposition of government imposed requirements with respect to lending to the UK SME market and larger commercial and corporate entities and residential mortgage lending;
- requirements to operate in a way that prioritises objectives other than shareholder value creation;
- changes to financial reporting standards (including accounting standards), corporate governance requirements, corporate structures and conduct of business rules;
- the imposition of restrictions on the RBS Group's ability to compensate its senior management and other employees;
- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- other requirements or policies affecting the RBS Group's profitability, such as the imposition of onerous compliance obligations, further restrictions on business growth or pricing;
- the introduction of, and changes to, taxes, levies or fees applicable to the RBS Group's operations (such as the imposition of financial activities taxes and changes in tax rates that reduce the value of deferred tax assets); and
- The regulation or endorsement of credit ratings used in the EU (whether issued by agencies in EU member states or in other countries, such as the US).

The RBS Group's results could be adversely affected in the event of goodwill impairment

The RBS Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the RBS Group tests goodwill for impairment annually or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. At 31 December 2011, the RBS Group carried goodwill of £12.4 billion on its balance sheet. The value in use and fair value of the Group's cash generating units are affected by market conditions and the performance of the economies in which the RBS Group operates. Where the RBS Group is required to recognise a goodwill impairment, it is recorded in the RBS Group's income statement, although it has no effect on the RBS Group's regulatory capital position. Any significant write-down of goodwill could have a material adverse effect on the Group's results of operations and the value of its securities.

The RBS Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations

The RBS Group maintains a number of defined benefit pension schemes for past and a number of current employees. Pensions risk is the risk that the assets of the RBS Group's various defined benefit pension schemes which are long term in nature do not fully match the timing and amount of the schemes' liabilities, as a result of which the RBS Group is required or chooses to make additional contributions to the schemes. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in applicable legislation. The schemes' assets comprise investment portfolios that are held to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of these asset portfolios, returns from them and any additional future contributions to the schemes may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In these circumstances, the RBS Group could be obliged, or may choose, to make additional contributions to the schemes, and during recent periods, the RBS Group has voluntarily made such contributions to the schemes. Given the recent economic and financial market difficulties and the prospect that they may continue over the near and medium term, the RBS Group may experience increasing pension deficits or be required or elect to make further contributions to its pension schemes and such deficits and contributions could be significant and have an adverse impact on the Group's results of operations or financial condition or result in a loss of value in its securities. The most recent funding valuation at 31 March 2010 was agreed during 2011. It showed the value of liabilities exceeded the value of assets by £3.5 billion at 31 March 2010, a ratio of assets to liabilities of 84%.

In order to eliminate this deficit, the RBS Group will pay additional contributions each year over the period 2011 until 2018. These contributions started at £375 million per annum in 2011, will increase to £400 million per annum in 2013 and from 2016 onwards be further increased in line with price inflation. These contributions are in addition to the regular contributions of around £300 million for future accrual of benefits.

Operational risks are inherent in the RBS Group's businesses

The RBS Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The RBS Group has complex and geographically diverse operations and operational risk and losses can result from internal and external fraud, errors by employees or third parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-bribery, anti-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, business continuity and data security system failures, natural disasters or the inadequacy or failure of systems and controls, including those of the RBS Group's suppliers or counterparties. Although the RBS Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures, to identify and rectify weaknesses in existing procedures and to train staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the RBS Group. Any weakness in these systems or controls, or any breaches or alleged breaches of such laws or regulations, could result in increased regulatory supervision, enforcement actions and other disciplinary action, and have an adverse impact on the Group's business, applicable authorisations and licences, reputation, results of operations and the price of its securities. Notwithstanding anything contained in this risk factor, it should not be taken as implying that RBS will be unable to comply with its obligations as a company with securities admitted to the Official List of the UK Listing Authority (the "Official List") nor that it, or its relevant subsidiaries, will be unable to comply with its or their obligations as supervised firms regulated by the FSA.

HM Treasury (or UK Financial Investments Limited (UKFI) on its behalf) may be able to exercise a significant degree of influence over the RBS Group and any proposed offer or sale of its interests may affect the price of securities issued by the RBS Group

The UK Government, through HM Treasury, currently holds 66.9% of the issued ordinary share capital of RBSG. On 22 December 2009, RBSG issued £25.5 billion of B Shares to the UK Government. The B Shares are convertible, at the option of the holder at any time, into ordinary shares. The UK Government has agreed that it shall not exercise the rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75% of the total issued shares in RBSG. Any breach of this agreement could result in the delisting of RBSG from the Official List and potentially other exchanges where its securities are currently listed and traded. HM Treasury (or the UKFI on its behalf) may sell all or a part of the ordinary shares that it owns at any time. Any offers or sale of a substantial number of ordinary shares or securities convertible or exchangeable into ordinary shares by or on behalf of HM Treasury, or an expectation that it may undertake such an offer or sale, could negatively affect prevailing market prices for the securities.

In addition, UKFI manages HM Treasury's shareholder relationship with RBSG and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group will continue to have its own independent board of directors and management team determining its own strategy, should its current intentions change, HM Treasury's position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI may be able to exercise a significant degree of influence over, among other things, the election of directors and the appointment of senior management. In addition, as the provider of the APS, HM Treasury has a range of rights that other shareholders do not have. These include rights under the terms of the APS over the RBS Group's remuneration policy and practice. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder or in which HM Treasury exercises its rights under the APS could give rise to conflict between the interests of HM Treasury and the interests of other shareholders. The Board has a duty to promote the success of RBSG for the benefit of its members as a whole.

Risk factors continued

The RBS Group's operations have inherent reputational risk

Reputational risk, meaning the risk to earnings and capital from negative public opinion, is inherent in the RBS Group's business. Negative public opinion can result from the actual or perceived manner in which the RBS Group conducts its business activities, from the RBS Group's financial performance, from the level of direct and indirect government support or from actual or perceived practices in the banking and financial industry. Negative public opinion may adversely affect the Group's ability to keep and attract customers and, in particular, corporate and retail depositors. The Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In the UK and in other jurisdictions, the RBS Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable or likely to be unable, to pay claims against it and may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under the Banking Act. The FSCS is funded by levies on firms authorised by the FSA, including the Group. In the event that the FSCS raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the Group may have an adverse impact on its results of operations and financial condition. At 31 December 2011, the Group had accrued £157 million for its share of FSCS levies for the 2011/2012 and 2012/2013 scheme years.

In addition, to the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the US with the Federal Deposit Insurance Corporation), the Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on its financial condition and results of operations or result in a loss of value in its securities.

The recoverability and regulatory capital treatment of certain deferred tax assets recognised by the RBS Group depends on the RBS Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation, regulatory requirements or accounting standards

In accordance with IFRS, the RBS Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. In April 2011, the UK Government commenced a staged reduction in the rate of UK corporation tax from 28% to 23% over a four year period. Such a change in the applicable tax rate will reduce the recoverable amount of the recognised deferred tax assets.

There is currently no restriction in respect of deferred tax assets recognised by the RBS Group for regulatory purposes. Changes in regulatory capital rules may restrict the amount of deferred tax assets that can be recognised and such changes could lead to a reduction in the RBS Group's Core Tier 1 capital ratio. In particular, on 16 December 2010, the Basel Committee published the Basel III rules setting out certain changes to capital requirements which include provisions limiting the ability of certain deferred tax assets to be recognised when calculating the common equity component of Tier 1 capital. CRD IV which will implement Basel III in the EU includes similar limitations. The implementation of the Basel III restrictions on recognition of deferred tax assets within the common equity component of Tier 1 are subject to a phased-in deduction starting on 1 January 2014, to be fully effective by 1 January 2018.

The RBS Group's participation in the APS is costly and may not produce the benefits expected and the occurrence of associated risks may have a material adverse impact on the RBS Group's business, capital position, financial condition and results of operations

On 22 December 2009, the RBS Group acceded to the APS with HM Treasury acting on behalf of the UK Government. Under the APS, the RBS Group purchased credit protection over a portfolio of specified assets and exposures of RBS and certain members of the RBS Group (covered assets) from HM Treasury in return for an annual fee. If losses on assets covered by the APS exceed £60 billion (net of recoveries), HM Treasury will bear 90% of further losses. The costs of participating in the APS include, among others, a fee of £700 million per annum, payable in advance to HM Treasury for each of the first three years of the APS and £500 million per annum thereafter until the earlier of (i) the date of termination of the APS and (ii) 31 December 2099. In order to terminate the RBS Group's participation in the APS, the RBS Group must have FSA approval and must pay an exit fee.

Ultimately, there is a risk that the amounts received under the APS may be less than the costs of participation. In addition, the aggregate effect of the joining, establishment, operational and exit costs and fees and expenses of, and associated with, the APS may significantly reduce or even eliminate the aggregate benefit of the APS to the RBS Group.

The RBS Group's choice of assets or exposures to be covered by the APS was based on certain predictions and assumptions at the time of its accession to the APS. There is therefore, a risk that the Covered Assets will not be those with the greatest future losses or with the greatest need for protection and the RBS Group's financial condition, income from operations and the value of any securities may still suffer due to further impairments and credit write-downs. Notwithstanding the RBS Group's participation in the APS, the RBS Group remains exposed to a substantial first loss amount of £60 billion (net of recoveries) in respect of the Covered Assets and for 10% of Covered Assets losses after the first loss amount. There is therefore, no assurance that the RBS Group's participation in the APS will achieve the RBS Group's goals of improving and maintaining the RBS Group's capital ratios in the event of further losses. Moreover, the RBS Group continues to carry the risk of losses, impairments and write-downs with respect to assets not covered by the APS.

The APS is a unique form of credit protection over a complex range of diversified assets and exposures in a number of jurisdictions. Due to the complexity, scale and unique nature of the APS and the uncertainty resulting from the recent economic recession, there may be unforeseen issues and risks that are relevant in the context of the RBS Group's participation in the APS and in the impact of the APS on the RBS Group's business, operations and financial condition. Such risks may have a material adverse effect on the RBS Group. The RBS Group may also be subject to further tax liabilities in the UK and overseas in connection with the APS and the associated intra-group arrangements which would not otherwise have arisen.

As a result of the significant volume, variety and complexity of assets and exposures and the resulting complexity and extensive governance, asset management, disclosure and information requirements of the APS documents, there is a risk that the RBS Group may have included assets or exposures within the Covered Assets which are, or may later become (including by reason of failure to comply with the requirements of the APS or resulting from the disposal of an asset or exposure), ineligible for protection under the APS or for which the protection is limited, which would reduce the anticipated benefits to the RBS Group of the APS. Further, there is no ability to nominate additional or alternative assets or exposures in place of any which may turn out not to be covered under the APS. In addition, HM Treasury may, following consultation with the RBS Group, modify or replace certain of the UK APS terms and conditions (the "Scheme conditions") in such a manner as it considers necessary (acting reasonably) in certain circumstances. Such modifications or replacements may be retrospective and may have a material adverse effect on the expected benefits of the APS and, therefore, the RBS Group's financial condition and results of operations.

Lastly, the APS is treated as a credit derivative accounted for at fair value, which exhibits counter-cyclical behaviour. As a result, improving market conditions result in a charge to the income statement, and vice versa. Therefore, changes in the fair value of the APS can have a significant adverse impact on the RBS Group's results of operations.

The extensive governance, asset management and information requirements under the Scheme Conditions may have an adverse impact on the RBS Group and the expected benefits of the APS

There are extensive governance, asset management and information requirements under the Scheme Conditions in relation to the Covered Assets, other assets and the operations of the RBS Group and HM Treasury also has the right to require the appointment of one or more step-in managers to exercise certain step-in rights in certain circumstances. The step-in rights are extensive and include certain oversight, investigation, approval and other rights, the right to require the modification or replacement of any of the systems, controls, processes and practices of the RBS Group and extensive rights in relation to the direct management and administration of the Covered Assets.

If HM Treasury seeks to exercise its right to appoint one or more step-in managers in relation to the management and administration of Covered Assets held by RBS Holdings N.V. or its wholly-owned subsidiaries, RBS Holdings N.V. will, in certain circumstances, need to seek consent from the Dutch Central Bank to allow it to comply with such step-in. If this consent is not obtained by the date on which the step-in rights must be effective, and other options to effect compliance are not possible, those assets would need to be withdrawn by the RBS Group from the APS where possible. If the RBS Group cannot withdraw such Covered Assets from the APS, it would be likely to lose protection in respect of these assets under the APS and/or may be liable under its indemnity to HM Treasury.

Additionally pursuant to the accession agreement between HM Treasury and RBSG relating to the accession to the APS, HM Treasury has the right to require RBS to appoint one or more Special Advisers ("SOC Special Advisers") to exercise oversight functions over certain assets in the APS. On 18 June 2010, the Asset Protection Agency required that RBS appoint SOC Special Advisers in relation to certain assets and business areas in order to provide additional support to the Senior Oversight Committee of RBS. There have been four such appointments to date granting certain oversight rights in relation to certain specified assets and the work of each of the SOC Special Advisers is now substantially completed.

The obligations of the RBS Group and the rights of HM Treasury may, individually or in the aggregate, impact the way the RBS Group runs its business and may serve to limit the RBS Group's operations with the result that the RBS Group's business, results of operations and financial condition will suffer. In addition, the market's reaction to such controls and limitations may have an adverse impact on the price of the securities.

Risk factors continued

Any changes to the expected regulatory capital treatment of the APS, the B Shares or the Contingent B Shares may have a material adverse impact on the RBS Group

One of the key objectives of the APS and the issuance of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares was to improve capital ratios at a consolidated level for RBSG and at an individual level for certain relevant RBS Group members. In that context, the RBS Group has entered and may in the future enter into further back-to-back arrangements with RBS Group members holding assets or exposures to be covered by the APS in order to ensure the capital ratios of these entities are also improved by virtue of the APS. However, there is a risk that the regulatory capital treatment applied by relevant regulators may differ from that assumed by the RBS Group in respect of the APS (including any back-to-back arrangements), the treatment of the B Share issuance and the £8 billion Contingent B Shares (if required).

If participation in the APS and the issuance of £25.5 billion of B Shares and, if required, the £8 billion Contingent B Shares are not sufficient to maintain the RBS Group's capital ratios as expected, this could cause the RBS Group's business, results of operations and financial condition to suffer, its credit ratings to drop, its ability to lend and access to funding to be further limited and its cost of funding to increase, and may result in intervention by the Authorities, which could include full nationalisation or other resolution procedures under the Banking Act as described above. The occurrence of any or all of such events may cause the price of its securities to decline.

RBS has entered into a credit derivative and a financial guarantee contract with RBS N.V. which may adversely affect the Group's results

RBS has entered into a credit derivative and a financial guarantee contract with RBS N.V., which is a subsidiary of RBSG, under which it has sold credit protection over the exposures held by RBS N.V. and its subsidiaries that are subject to the APS. These agreements may adversely affect the Group's results as: (a) they cover 100% of losses on these assets whilst the APS provides 90% protection if losses on the whole APS portfolio exceed the first loss; and (b) the basis of valuation of the APS and the financial guarantee contract are asymmetrical: the one measured at fair value and the other at the higher of cost less amortisation and the amount determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

If the RBS Group is unable to issue the Contingent B Shares to HM Treasury, it may have a material adverse impact on the RBS Group's capital position, liquidity, operating results and future prospects

In the event that the RBS Group's Core Tier 1 capital ratio declines to below 5%, HM Treasury is committed to subscribe for up to an additional £8 billion of Contingent B Shares if certain conditions are met. If such conditions are not met and are not waived by HM Treasury, and RBSG is unable to issue the Contingent B Shares, the RBS Group will be required to find alternative methods for achieving the requisite capital ratios. There can be no assurance that any of these alternative methods will be available or would be successful in increasing the RBS Group's capital ratios to the desired or requisite levels. If RBSG is unable to issue the Contingent B Shares, the RBS Group's capital position, liquidity, operating results and future prospects will suffer, its credit ratings may drop, its ability to lend and access funding will be further limited and its cost of funding may increase. The occurrence of any or all of such events may cause the price of its securities to decline.

Glossary of terms

Adjustable rate mortgage (ARM) - in the US, a variable-rate mortgage. ARMs include: hybrid ARMs which typically have a fixed-rate period followed by an adjustable-rate period; interest-only ARMs where interest only is payable for a specified number of years, typically for three to ten years; and payment-option ARMs that allow the borrower to choose periodically between various payment options.

Alt-A (Alternative A-paper) - a US description for mortgage loans with a higher credit quality than sub-prime loans but with features that disqualify the borrower from a traditional prime loan. Alt-A lending characteristics include limited documentation; high loan-to-value ratio; secured on non-owner occupied properties; and debt-to-income ratio above normal limits.

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made. When a customer is in arrears, the entire outstanding balance is said to be delinquent (see Delinquency).

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset-backed securities (ABS) - securities that represent interests in specific portfolios of assets. They are issued by a special purpose entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised bond obligations, collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

Asset Protection Scheme credit default swap - in 2009, the Group became party to the Asset Protection Scheme under which it purchased credit protection over a portfolio of specified assets and exposures (covered assets) from Her Majesty's Treasury acting on behalf of the UK Government. The contract is accounted for as a derivative financial instrument. It is recognised at fair value and included in Derivatives on the balance sheet. Changes in its fair value are recognised in profit or loss within Income from trading activities.

Assets under management - assets managed by the Group on behalf of clients.

Bank levy - a levy that applies to certain UK banks, building societies and the UK operations of foreign banks from 1 January 2011. The levy is payable based on a percentage of the chargeable equity and liabilities of the bank as at the balance sheet date.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'. These strengthened global regulatory standards on bank capital adequacy and liquidity and will be phased in from 2013 with full implementation by 1 January 2019.

Basis point - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

Certificates of deposit (CDs) - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

Collateralised bond obligations (CBOs) - asset-backed securities for which the underlying asset portfolios are bonds, some of which may be sub-investment grade.

Collateralised debt obligations (CDOs) - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

Collateralised debt obligation squared (CDO-squared) - a type of collateralised debt obligation where the underlying asset portfolio includes tranches of other CDOs.

Collateralised loan obligations (CLOs) - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

Collectively assessed loan impairment provisions - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

Commercial mortgage backed securities (CMBS) - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

Commercial paper (CP) - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

Glossary of terms continued

Commercial paper conduit - a special purpose entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Commercial real estate - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

Constant proportion portfolio insurance notes (CPPI notes) - CPPI is the name given to a trading strategy that is designed to ensure that a fixed minimum return is achieved either at all times or more typically, at a set date in the future. Essentially the strategy involves continuously re-balancing the portfolio of investments during the term of the product between performance assets and safe assets using a pre-set formula. CPPI notes provide investors with a return linked to a CPPI portfolio.

Contractual maturity - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

Core Tier 1 capital - called-up share capital and eligible reserves plus equity non-controlling interests, less intangible assets and other regulatory deductions.

Core Tier 1 capital ratio - core Tier 1 capital as a percentage of risk-weighted assets.

Cost:income ratio - operating expenses as a percentage of total income.

Coverage ratio - impairment provisions as a percentage of impaired loans.

Covered bonds - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

CRD III - the CRD III package came into force on 1 January 2011. It requires higher capital requirements for re-securitisations; upgrades disclosure standards for securitisation exposures; strengthens capital requirements for the trading book; and introduces new remuneration rules.

CRD IV - in July 2011, the European Commission published its proposed legislation for a Capital Requirements Directive and a Capital Requirements Regulation, which together form the CRD IV package. The package implements the Basel III capital proposals and also includes new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. It is due to be implemented from 1 January 2013 with transitional arrangements for some of its requirements.

Credit default swap (CDS) - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit derivative product company (CDPC) - a special purpose entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. Sometimes they can also buy credit protection. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

Credit derivatives - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence, if any, of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

Credit enhancements - techniques that improve the credit standing of financial obligations; generally those issued by an SPE in a securitisation. External credit enhancements include financial guarantees and letters of credit from third-party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation - on securitisation, the value of the underlying portfolio is greater than the securities issued.

Credit risk - the risk that the Group will incur losses owing to the failure of customers to meet their financial obligations to the Group.

Credit risk assets - loans and advances (including overdraft facilities), instalment credit, finance lease receivables and other traded instruments across all customer types.

Credit risk mitigation - techniques such as the taking of collateral or obtaining a guarantee or other form of credit protection from a related or third party that reduce the credit risk associated with an exposure.

Credit risk spread - the difference between the coupon on a debt instrument and the benchmark or the risk-free interest rate for the instrument's maturity structure. It is the premium over the risk-free rate required by the market for the credit quality of a particular debt instrument.

Credit valuation adjustments - adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty.

Currency swap - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.

Customer accounts - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.

Debt restructuring - see Renegotiated loans.

Debt securities - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

Debt securities in issue - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

Deferred tax asset - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

Deferred tax liability - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

Defined benefit plan - pension or other post-retirement benefit plan other than a defined contribution plan.

Defined contribution plan - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

Delinquency - a debt or other financial obligation is considered delinquent when one or more contractual payments are overdue. Delinquency is usually defined in terms of days past due. Delinquent and in arrears are synonymous.

Deposits by banks - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

Derivative - a contract or agreement whose value changes with changes in an underlying index such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

Discontinued operation - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

Effective interest rate method - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Equity risk - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

Exposure at default (EAD) - an estimate of the expected level of utilisation of a credit facility at the time of a borrower's default. The EAD may be higher than the current utilisation (e.g. in the case where further drawings may be made under a revolving credit facility prior to default) but will not typically exceed the total facility limit.

Fannie Mae (Federal National Mortgage Association) - a US Government Sponsored Enterprise. It buys mortgages, principally issued by banks, on the secondary market, pools them, and sells them as residential mortgage-backed securities to investors on the open market. Its obligations are not explicitly guaranteed by the full faith and credit of the US Government.

Federal Agencies - US federal agencies are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including Ginnie Mae, issue or guarantee publicly traded debt securities.

Federal Home Loan Mortgage Corporation - see Freddie Mac.

Federal National Mortgage Association - see Fannie Mae.

FICO score - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

Glossary of terms continued

Financial Services Compensation Scheme (FSCS) - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

First/second lien - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

Forbearance - the term generally applied to an agreement, principally in relation to secured loans with retail customers experiencing temporary financial difficulty, to a payment moratorium, to reduced repayments or to roll up arrears. Forbearance loans are a subset of Renegotiated loans.

Forward contract - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

Freddie Mac (Federal Home Loan Mortgage Corporation) - a US Government Sponsored Enterprise. It buys mortgages, principally issued by thrifts, on the secondary market, pools them, and sells them as residential mortgage-backed securities to investors on the open market. Its obligations are not explicitly guaranteed by the full faith and credit of the US Government.

Funding and liquidity risk - the risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost.

Futures contract - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

G10 - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund’s (IMF's) General Arrangements to Borrow.

Ginnie Mae (Government National Mortgage Association) - a US Government Agency that guarantees investors the timely payment of principal and interest on mortgage-backed securities for which the underlying asset portfolios comprise federally insured or guaranteed loans - mainly loans insured by the Federal Housing Administration or guaranteed by the Department of Veterans Affairs. Ginnie Mae obligations are fully and explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the US Government.

Government Sponsored Enterprises (GSEs) - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include Fannie Mae and Freddie Mac.

Gross yield - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

Guaranteed mortgages - mortgages guaranteed by a government or government agency. In the US, government loan guarantee programmes are offered by the Federal Housing Administration, the Department of Veterans Affairs and the Department of Agriculture's Rural Housing Service. In the Netherlands, the Gemeentegarantie programme is run partly by the central government and partly by the municipalities.

Hedge funds - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

Home equity loan - a type of loan in which the borrower uses the equity in their home as collateral. A home equity loan creates a charge against the borrower's house.

Impaired loans - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Impairment allowance - see Loan impairment provisions.

Impairment losses - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

Individually assessed loan impairment provisions - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

Insurance risk - the risk of financial loss through fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations at the time of underwriting.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group’s own assessment, as part of Basel II requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

International Accounting Standards Board (IASB) - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

Interest rate swap - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

Interest spread - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

Internal funding of trading business - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

Investment grade - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

Key management - directors of RBSG and members of the Group Management Committee.

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified as impaired at the balance sheet date. The Group has developed methodologies to estimate latent loss provisions that reflect historical loss experience (adjusted for current economic and credit conditions) and the period between an impairment occurring and a loan being identified and reported as impaired.

Level 1: quoted price - level 1 financial instruments are valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.

Level 2: valuation technique using observable inputs - level 2 financial instruments are valued using techniques based significantly on observable market data. Instruments in this category are valued using: (a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or (b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

Level 3: valuation technique with significant unobservable inputs - level 3 financial instruments are valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input. Level 3 financial instruments include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine CDOs, other mortgage-based products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives.

Leveraged finance - funding (leveraged finance) provided to a business resulting in an overall level of debt in relation to cash flow that exceeds that which would be considered usual for the business or for the industry in which it operates. Leveraged finance is commonly employed to achieve a specific, often temporary, objective: to make an acquisition, to effect a buy-out or to repurchase shares.

Liquidity coverage ratio (LCR) - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High-quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, be central bank eligible. These include, for example, cash and claims on central governments and central banks. The Basel III rules require this ratio to be at least 100% and it is expected to apply from 2015.

Liquidity enhancements - make funds available to ensure that the issuer of securities, usually a commercial paper conduit, can redeem the securities at maturity. They typically take the form of a committed facility from a third-party bank.

Loan impairment provisions - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

Loan-to-deposit ratio - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

Loan-to-value ratio - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

Glossary of terms continued

Loss given default (LGD) - the economic loss that may occur in the event of default i.e. the actual loss - that part of the exposure that is not expected to be recovered - plus any costs of recovery.

Market risk - the risk that the value of an asset or liability may change as a result of a change in market factors such as foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices.

Master netting agreement - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Medium term notes (MTNs) - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

Monoline insurers - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Mortgage-backed securities - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

Mortgage servicing rights - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

Mortgage vintage - the year in which a mortgage loan was made to the customer.

Negative equity mortgages - mortgages where the value of the property mortgaged is less than the outstanding balance on the loan.

Net interest income - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

Net interest margin - net interest income as a percentage of average interest-earning assets.

Net stable funding ratio (NSFR) - introduced by Basel III, the NSFR is the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. The ratio is required to be over 100% with effect from 2015. Available stable funding would include such items as equity capital, preferred stock with a maturity of over one year, and liabilities with a maturity of over one year. The required amount of stable funding is calculated as the sum of the value of the assets held and funded by the institution, multiplied by a specific required stable funding factor assigned to each particular asset type, added to the amount of potential liquidity exposure multiplied by the associated required stable funding factor. The NSFR is subject to an observation period and to review to address any unintended consequences.

Non-conforming mortgages - mortgage loans that do not meet the requirements for sale to US Government agencies or US Government sponsored enterprises. These requirements include limits on loan-to-value ratios, loan terms, loan amounts, borrower creditworthiness and other requirements.

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Option - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of the underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

Over-the-counter (OTC) derivatives - are derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives that have standardised terms and conditions.

Own credit adjustment - the effect of the Group's own credit standing on the fair value of financial liabilities.

Past due - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment provision is required. This category is used for fully collateralised advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

Prime - prime mortgage loans generally have low default risk and are made to borrowers with good credit records and a monthly income that is at least three to four times greater than their monthly housing expense (mortgage payments plus taxes and other debt payments). These borrowers provide full documentation and generally have reliable payment histories.

Private equity investments - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Regular way purchase or sale - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Regulatory capital - the amount of capital that the Group holds, determined in accordance with rules established by the FSA for the consolidated Group and by local regulators for individual Group companies.

Renegotiated loans - loans are generally renegotiated either as part of the ongoing banking relationship with a creditworthy customer or in response to a borrower's financial difficulties. In the latter case, renegotiation encompasses not only revisions to the terms of a loan such as a maturity extension, a payment moratorium, a concessionary rate of interest but also the restructuring of all or part of the exposure including debt forgiveness or a debt for equity swap. Loans renegotiated as part of the ongoing banking relationship with a creditworthy customer, are treated as new loans.

Repurchase agreement (Repo) - see Sale and repurchase agreements.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages.

Restructured loans - see Renegotiated loans.

Retail loans - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

Return on equity - profit attributable to ordinary and B shareholders divided by average shareholders' equity as a percentage.

Reverse repurchase agreement (Reverse repo) - see Sale and repurchase agreements.

Risk appetite - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

Risk asset ratio (RAR) - total regulatory capital as a percentage of risk-weighted assets.

Risk elements in lending (REIL) - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the Basel Capital Accord as implemented by the FSA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell, the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a special purpose entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans). Liability securitisations typically involve issuing bonds that assume the risk of a potential insurance liability (ranging from a catastrophic natural event to an unexpected claims level on a certain product type).

Settlement balances - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

Sovereign exposures - exposures to governments, ministries, departments of governments and central banks.

Special purpose entity (SPE) - an entity created by a sponsor, typically a major bank, finance company, investment bank or insurance company. An SPE can take the form of a corporation, trust, partnership or a limited liability company. Its operations are typically limited for example in a securitisation to the acquisition and financing of specific assets or liabilities.

Structured credit portfolio (SCP) - a portfolio of certain of the Group's illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures - held within Non-Core division.

Structured Investment Vehicle (SIV) - a limited-purpose operating company that undertakes arbitrage activities by purchasing highly rated medium and long-term, fixed-income assets and funding itself with short-term, highly rated commercial paper and medium-term notes.

Glossary of terms continued

Structured notes - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

Student loan related assets - assets that are referenced to underlying student loans.

Subordinated liabilities - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Sub-prime - mortgage loans to customers with one or more high risk characteristics, such as: unreliable or poor payment histories; loan-to-value ratio of greater than 80%; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

Super senior CDO - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

Tangible net asset value (TNAV) - owners' equity attributable to ordinary and B shareholders less intangible assets divided by the number of ordinary and B shares in issue.

Tier 1 capital - core Tier 1 capital plus other Tier 1 securities in issue, less material holdings in financial companies.

Tier 1 capital ratio - Tier 1 capital as a percentage of risk-weighted assets.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances, unrealised available-for-sale equity gains and revaluation reserves less certain regulatory deductions.

US Government National Mortgage Association - see Ginnie Mae.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditor to enable them to express an opinion on the Group's financial statements.

US Federal Agencies - see Federal Agencies.

Value-at-risk (VaR) - a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels.

Wholesale funding - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

Wrapped security - a debt security where the holder benefits from credit protection provided by a third party, typically a financial guarantor or monoline insurer.

Write down - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

Wrong-way risk - the risk of loss when the risk factors driving the exposure to a counterparty or customer are positively correlated with the creditworthiness of that counterparty i.e. the size of the exposure increases at the same time as the risk of the counterparty or customer being unable to meet that obligation, increases.

Principal offices

The Royal Bank of Scotland plc
PO Box 1000 Gogarburn Edinburgh EH12 1HQ
280 Bishopsgate London EC2M 4RB

National Westminster Bank Plc
135 Bishopsgate London EC2M 3UR

Citizens
Citizens Financial Group, Inc.
One Citizens Plaza Providence RI 02903 USA

Ulster Bank
11-16 Donegall Square East Belfast BT1 5UB
George's Quay Dublin 2

RBS Holdings USA Inc.
600 Washington Blvd Stamford CT 06901 USA

Coutts Group
440 Strand London WC2R 0QS

The Royal Bank of Scotland International Limited
Royal Bank House 71 Bath Street
St Helier Jersey Channel Islands JE4 8PJ

NatWest Offshore
23/25 Broad Street
St Helier Jersey Channel Islands JE4 0YX