Annual Report and Accounts 2012

Annual Report and Accounts

2	Board of directors and secretary		
4	Financial review		
25	Risk and balance sheet management		
197	Report of the directors		
202	Statement of directors' responsibilities		
203	Independent auditor's report to the members of The Royal Bank of Scotland plc		
204	Consolidated income statement		
205	Consolidated statement of comprehensive income		
206	Balance sheets		
207	Statements of changes in equity		
209	Cash flow statements		
210	Accounting policies		
222	Notes on the accounts		
	1	Net interest income	222
	2	Non-interest income	223
	3	Operating expenses	224
	4	Pensions	228
	5	Auditor's remuneration	232
	6	Tax	232
	7	Profit attributable to preference shareholders	233
	8	Ordinary dividends	233
	9	(Loss)/profit dealt with in the accounts of the Bank	233
	10	Financial instruments - classification	234
	11	Financial instruments - valuation	243
	12	Financial instruments - maturity analysis	259
	13	Financial assets - impairments	262
	14	Derivatives	265
	15	Debt securities	269
	16	Equity shares	271
	17	Investments in Group undertakings	272
	18	Intangible assets	272
	19	Property, plant and equipment	277
	20	Prepayments, accrued income and other assets	280
	21	Assets and liabilities of disposal groups	280
	22	Short positions	281
	23	Accruals, deferred income and other liabilities	281
	24	Deferred tax	283
	25	Subordinated liabilities	286
	26	Share capital and reserves	292
	27	Leases	293
	28	Securitisations, asset transfers and other collateral given	295
	29	Special purpose entities	297
	30	Capital resources	299
	31	Memorandum items	301
	32	Net cash (outflow)/inflow from operating activities	309
	33	Analysis of the net investment in business interests and intangible assets	310
	34	Interest received and paid	310
	35	Analysis of changes in financing during the year	310
	36	Analysis of cash and cash equivalents	311
	37	Segmental analysis	312
	38	Directors' and key management remuneration	317
	39	Transactions with directors and key management	317
	40	Related parties	318
	41	Ultimate holding company	319
	42	Post balance sheet events	319
320	Additional information		

Board of directors and secretary

Chairman
Philip Hampton
Nominations (Chair)

Executive directors
Stephen Hester
Bruce Van Saun

Independent non-executive directors
Sandy Crombie
Senior Independent Director
Sustainability (Chair), Nominations, Remuneration, Risk

Alison Davis
Nominations, Remuneration, Sustainability

Tony Di Iorio
Audit, Nominations, Risk

Penny Hughes
Remuneration (Chair), Nominations

Joe MacHale
Nominations, Risk

Brendan Nelson
Audit (Chair), Nominations, Risk

Baroness Noakes
Audit, Nominations, Risk

Arthur 'Art' Ryan
Nominations, Remuneration

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 Performance and Remuneration Committee
Risk	member of the Board Risk Committee
Sustainability	member of the Group Sustainability Committee

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The Royal Bank of Scotland plc
Registered in Scotland No. SC90312

Presentation of information

In the Report and Accounts, and unless specified otherwise, the terms 'the Royal Bank', 'RBS plc' or 'the Bank' mean The Royal Bank of Scotland plc, the 'Group' means the Bank and its subsidiaries, 'RBSG' or the 'holding company' mean The Royal Bank of Scotland Group plc, 'RBS Group' means the holding company and its subsidiaries, and 'NatWest' means National Westminster Bank Plc.

The Bank publishes its financial statements in pounds sterling ('£' or 'sterling'). The abbreviations '£m' and '£bn' represent millions and thousands of millions of pounds sterling, respectively, and references to 'pence' represent pence in the United Kingdom ('UK'). Reference to 'dollars' or '$' are to United States of America ('US') dollars. The abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars, respectively, and references to 'cents' represent cents in the US. The abbreviation '€' represents the 'euro', the European single currency, and the abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively.

International Financial Reporting Standards

As required by the Companies Act 2006 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared 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 (together 'IFRS'). They also comply with IFRS as issued by the IASB.

Divisional reorganisation and Group reporting changes

Comparative data have been restated to reflect the divisional reorganisation (see page 4) and certain Group reporting changes (see below) during 2012.

Fair value of own debt and derivative liabilities

The Group had previously excluded changes in the fair value of own debt (FVOD) in presenting its divisional results given it is a volatile non-cash item. To better align the divisional performance, movements in the fair value of own derivative liabilities, previously incorporated within Markets operating performance, are now combined with movements in FVOD in a single measure, 'Own Credit Adjustments'. As a result, Markets operating results have been adjusted to reflect this change which does not affect profit/(loss) before and after tax.

Disposal groups

Since 2011, the assets and liabilities relating to the RBS England and Wales and NatWest Scotland branch-based businesses, along with certain SME and corporate activities across the UK ('UK branch-based businesses'), were classified within Disposal groups. Santander's withdrawal from the sale in October 2012 has led the Group to conclude that a sale within 12 months is unlikely; accordingly the balance sheet at 31 December 2012 does not classify the assets and liabilities of the UK branch-based businesses within Disposal groups. IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' does not permit restatement on reclassification.

Glossary

A glossary of terms is provided on pages 336 to 343.

Description of business

Introduction

The Royal Bank of Scotland plc is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc, a large banking and financial services group. 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.

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 2012, HM Treasury's holding of ordinary shares in the holding company was 65.3% and its economic interest was 81.1%.

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 saw the reorganisation of the RBS Group's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities. The changes ensure the wholesale businesses continue to deliver against the RBS Group's strategy.

The changes 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.

Global Banking & Markets (GBM) and Global Transaction Services (GTS) divisions have been reorganised as follows:

- The 'Markets' business maintains 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 has been combined with the international businesses of the GTS arm into a new 'International Banking' unit and provides 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 is now managed within RBS's domestic corporate banking businesses in the UK, Ireland (Ulster Bank) and the US (US Retail & Commercial).

Our wholesale business retains 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.

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 the 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.

International Banking serves the world's largest companies with a leading client proposition focused on financing, transaction services and risk management. International Banking serves as the delivery channel for Markets products to corporate clients and serves international subsidiaries of both International Banking and clients from UK Corporate, Ulster Bank and US Retail & Commercial through its international network.

Ulster Bank is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

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.

Markets is a leading origination, sales and trading business across debt finance, fixed income, currencies and investor products. The division offers a unified service to the Group's corporate and institutional clients. The Markets' sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division's trading and structuring teams to meet the client's objectives across financing, risk management, investment, securitisation and liquidity.

Central Functions comprises Group and corporate functions, such as treasury, 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 legacy GBM businesses, 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.

Business developments

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2007, RFS Holdings B.V., which was jointly owned by the RBS Group, the Dutch State (successor to Fortis) and Santander (together, the "Consortium Members") completed the acquisition of ABN AMRO Holding N.V.

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V."). Certain assets of RBS N.V. continue to be shared by the Consortium Members.

In October 2011, the RBS Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank pursuant to Part VII of the UK Financial Services and Markets Act 2000. Substantially all of the Netherlands and EMEA businesses were transferred in September 2012. Further transfers are expected to take place during 2013 but are subject to certain authorisations including regulatory approval where necessary. The RBS Group now anticipates that the transfers in China will be completed at a later date.

Business divestments

To comply with the European Commission State aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These measures supplement the Strategic Plan previously announced by the Group. These include the divestment of Direct Line Insurance Group plc, the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of 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").

In 2010, the Group reached agreement with Santander UK plc ('Santander') on the sale of the UK branch-based businesses. However, in October 2012, the Group announced that it had received notification of Santander's decision to pull out of its agreed purchase of these businesses. Santander's decision followed extensive work by both parties to separate the businesses into a largely standalone form and to prepare the businesses, customers and staff for transfer. RBS is continuing to work to fulfil its obligations to divest these businesses.

Recent developments

Liability Management Exercise

In January 2013, The Royal Bank of Scotland plc completed a cash tender offer for approximately £2 billion principal amount of certain US Dollar, Euro, Sterling, Swiss Franc and Singapore Dollar denominated senior unsecured securities.

Markets & International Banking Executive changes

On 6 February 2013, the Group announced that John Hourican, Chief Executive, Markets & International Banking, will leave the Group once he has completed a handover of his responsibilities. With effect from 1 March 2013, Suneel Kamlani and Peter Nielsen will be co-heads of the Markets division and John Owen will continue to lead the International Banking division and will all report directly to the Group Chief Executive.

Competition

The Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand remains subdued as many customers continue to delever and the UK economy has remained weak. Competition for retail deposits remains strong 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, RBS 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 Business review (pages 25 to 196). 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 323 to 335.

- The RBS Group's businesses, earnings and financial condition have been and will continue to be negatively affected by global economic conditions, the instability in the global financial markets and increased competition and political risks including proposed referenda on Scottish independence and UK membership of the EU. 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 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 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 RBS Group is subject to a number of regulatory initiatives which may adversely affect its business, including the UK Government's implementation of the final recommendations of the Independent Commission on Banking's final report on competition and possible structural reforms in the UK banking industry, the US Federal Reserve's proposal for applying US capital, liquidity and enhanced prudential standards to certain of the RBS Group's US operations.

- 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.

- 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 including on dividend policy, modifying or cancelling contracts or limiting the RBS Group's operations. 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.

- RBSG or any of 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 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.

- 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 Group's business, results of operations and financial condition and give rise to increased operational risk.

- 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.

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

- 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.

- 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 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.

Financial summary

Summary consolidated income statement for the year ended 31 December 2012

	2012 £m	2011 £m
Net interest income	10,632	11,298
Fees and commissions receivable	5,558	5,898
Fees and commissions payable	(963)	(1,047)
Income from trading activities	1,511	2,014
Gain on redemption of own debt	454	255
Other operating income	1,296	3,388
Non-interest income	7,856	10,508
Total income	18,488	21,806
Operating expenses	(16,686)	(15,494)
Profit before impairment losses	1,802	6,312
Impairment losses	(5,214)	(7,176)
Operating loss before tax	(3,412)	(864)
Tax charge	(364)	(731)
Loss for the year	(3,776)	(1,595)
Non-controlling interests	(19)	8
Preference dividends	(58)	(58)
Loss attributable to ordinary shareholders	(3,853)	(1,645)

Operating loss

Operating loss before tax was £3,412 million compared with £864 million in 2011. There was a strong trading performance and lower costs in Markets, reflecting reduced headcount and lower levels of variable compensation, including reductions and clawbacks following the Group's LIBOR settlements, and a better operating performance in Non-Core, where losses fell by 61%. These improvements were more than offset by weaker performance in Retail & Commercial, as economic conditions remained difficult. Operating expenses were affected by charges in relation to Payment Protection Insurance (PPI) claims, Interest Rate Hedging Products redress and related costs, and regulatory fines.

Total income

Total income decreased 15% to £18,488 million in 2012, primarily due to own credit adjustments, partially offset by a lower fair value charge on the Asset Protection Scheme and a higher gain in redemption of own debt.

Net interest income

Net interest income decreased 6% to £10,632 million in 2012 largely reflecting lower interest-earning asset balances and strong deposit competition.

Non-interest income

Non-interest income was down 25% to £7,856 million compared with £10,508 million in 2011 primarily due to the continuing strengthening of RBS's credit profile which resulted in a £3,904 million accounting charge in relation to own credit adjustment versus a gain of £797 million in 2011. This was partially offset by a lower fair value charge of £44 million compared with £906 million in 2011 on the Asset Protection Scheme and a higher gain on redemption of own debt of £454 million (2011 - £255 million).

Operating expenses

Operating expenses increased by 8% to £16,686 million compared with £15,494 million in 2011 primarily due to higher PPI costs, higher integration and restructuring costs, penalties and fines relating to the setting of LIBOR and other rates, and amounts provided to meet the costs of redress to small and medium sized businesses, classified as retail clients under FSA rules, who were mis-sold interest rate hedging products.

To reflect current experience of Payment Protection Insurance complaints received, RBS increased its PPI provision by £1,110 million (2011 - £850 million) in 2012, bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion (59%) in redress had been paid by 31 December 2012.

Integration and restructuring costs were up £333 million to £1,226 million versus £893 million in 2011, primarily driven by costs incurred in relation to the strategic restructuring of Markets and International Banking that took place during 2012.

A provision of £700 million has been made in respect of the redress that RBS expects to offer some small and medium-sized businesses classified as retail clients under FSA rules who had purchased interest rate hedging products. On 31 January 2013 the FSA announced its findings following a pilot review of the sale of all interest rate hedging products, including vanilla hedging products, to clients classified as non-sophisticated, along with a framework for redress.

On 6 February 2013, RBS Group reached agreement with the FSA, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million.

Cost:income ratio

The Group's cost:income ratio was 90% compared with 71% in 2011. On a managed basis[1], the cost:income ratio was 60% compared with 61% in 2011 reflecting the ongoing focus on cost control in an environment where income growth remained challenging.

Impairment losses

Impairment losses were £5,214 million compared with £7,176 million in 2011. This was primarily driven by a £1,660 million decrease in Non-Core impairments, mostly in the Ulster Bank and commercial real estate portfolios, and improvements in UK Retail and US Retail & Commercial. These were partially offset by an increase in International Banking, principally reflecting the transfer of assets from RBS N.V.

Capital ratios

Capital ratios at 31 December 2012 were 9.5% (Core Tier 1), 11.0% (Tier 1) and 15.4% (Total).

Note:
(1) Managed basis excludes certain one-off and other items. Results on this basis exclude own credit adjustments, Asset Protection Scheme, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory fines, amortisation of purchased intangible assets, integration and restructuring costs, gain on redemption of own debt, strategic disposals, bank levy, bonus tax and write-down of goodwill and other intangible assets.

Divisional performance

The results of each division before one-off and other items ('managed basis') are set out below. The results are stated before own credit adjustments, Asset Protection Scheme, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory fines, amortisation of purchased intangible assets, integration and restructuring costs, gain on redemption of own debt, strategic disposals, bank levy, bonus tax 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	2012 £m	2011 £m
UK Retail	2,106	2,168
UK Corporate	1,877	1,956
Wealth	321	299
International Banking	645	1,010
Ulster Bank	(1,008)	(964)
US Retail & Commercial	860	654
Retail & Commercial	4,801	5,123
Markets	1,505	600
Central items	(1,538)	(1,339)
Core	4,768	4,384
Non-Core	(1,187)	(3,068)
Operating profit	3,581	1,316
Own credit adjustments	(3,904)	797
Asset Protection Scheme	(44)	(906)
Payment Protection Insurance costs	(1,110)	(850)
Interest Rate Hedging Products redress and related costs	(700)	—
Regulatory fines	(381)	—
Amortisation of purchased intangible assets	(41)	(68)
Integration and restructuring costs	(1,226)	(893)
Gain on redemption of own debt	454	255
Strategic disposals	185	(137)
Bank levy	(175)	(300)
Bonus tax	—	(78)
Write-down of goodwill and other intangible assets	(51)	—
Operating loss before tax	(3,412)	(864)

The performance of each division is reviewed on pages 11 to 21.

UK Retail

	2012 £m	2011 £m
Net interest income	4,084	4,320
Net fees and commissions	911	1,126
Other non-interest income	(7)	—
Non-interest income	904	1,126
Total income	4,988	5,446
Direct expenses		
- staff costs	(787)	(823)
- other	(352)	(409)
Indirect expenses	(1,214)	(1,258)
	(2,353)	(2,490)
Operating profit before impairment losses	2,635	2,956
Impairment losses	(529)	(788)
Operating profit	2,106	2,168

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross) (1)		
- mortgages	99.1	95.0
- personal	8.8	10.2
- cards	5.7	5.7
	113.6	110.9
Customer deposits (1)	107.6	102.2
Assets under management (excluding deposits)	6.0	5.5

Note:
(1) Includes businesses outlined for disposal: loans and advances to customers - £7.6 billion (2011 - £7.3 billion) and customer deposits - £8.5 billion (2011 - £8.8 billion).

Over the last four years UK Retail has undertaken stretching initiatives and undergone significant change in order to meet its goal to consistently improve the service it offers to its customers. Highlights in 2012 include:

- Continued progress on the RBS and NatWest Customer Charter commitments supporting our goal of becoming Britain's most helpful retail bank;

- Providing more than £500 million of cheaper mortgages through the Government's Funding for Lending Scheme (FLS), launched at the end of June 2012 and opened for drawings in August 2012, which represents 14% of all completions in the last quarter of 2012;

- Seeking and responding to customer feedback to enhance the retail mobile banking app which is used by more than two million customers to manage their money and complete over one million transactions every week;

- Increasing online banking webchat functionality to allow customers real-time access to an advisor, direct from their computer, who can answer queries and action basic account services 24 hours a day; and

- Continued to invest in simplifying processes to make it easier for customers to bank with us, including introducing more than 200 cash deposit machines and ATMs to further reduce queuing times in branches.

However, the business has also had setbacks in the year. Customers suffered from disruptions to payment systems in June. Throughout this time UK Retail staff worked tirelessly to deal quickly with the issues and provide full redress and compensation to customers affected. In addition, the provision relating to historic Payment Protection Insurance (PPI) mis-selling was increased by £1.1 billion in 2012, bringing total PPI expense to date to £2.2 billion. This expense is not included in operating profit. With the new UK conduct regulator examining many products and services along with associated disclosures and sales practices, there are likely to be further impacts to business practices and potential additional costs of redress. The business is actively working to ensure its products set and sales practices are appropriate.

Ross McEwan joined UK Retail as its new Chief Executive in September 2012 and spent considerable time engaging with customers and employees around the country and reviewing business processes and performance. With his management team, he has developed a range of initiatives, building upon existing efforts, which focus on simplifying processes and providing a better experience for all customers. Ultimately, with a lot of hard work, the goal is to be the best retail bank in the UK.

UK Retail continued

2012 compared with 2011

Operating profit fell by 3% to £2,106 million, as an 8% decline in income was only partly offset by lower costs, down 6%, and improved impairment losses, down 33%.

Mortgage balances grew by £4.1 billion with the share of new business at 10%, ahead of our stock level of 8%. Growth as a result of FLS was starting to appear by the end of the year as mortgage applications moved through the pipeline to completion. Deposit growth of 5% was in line with the market and drove an improvement in the loan:deposit ratio to 103%.

Net interest income was down 5% due to weaker deposit margins and reduction in unsecured balances, partly offset by mortgage growth. Unsecured balances now represent 13% of total loans and advances to customers compared with 23% in 2008, following realignment of risk appetite and strong mortgage growth. Net interest margin declined as a result of lower rates on current account hedges and increased competition on savings rates in the early part of the year, partly offset by widening asset margins.

Non-interest income was 20% lower mainly due to:

- lower unauthorised overdraft fees as we continue to help customers manage their finances by providing mobile text alerts and further improving mobile banking functionality;
- weak consumer confidence lowering spending and associated fees on cards; and
- lower investment income as a result of weak customer demand and less advisor availability due to restructuring and retraining in preparation for regulatory changes in 2013.

Costs were down £137 million, 6%, driven by the ongoing simplification of processes across the business, lower headcount and lower FSCS levy.

Impairment losses were £259 million or 33% lower, reflecting the continued benefit of risk appetite tightening in prior years and also a smaller unsecured loan book.

UK Corporate

	2012 £m	2011 £m
Net interest income	2,891	2,983
Net fees and commissions	1,365	1,375
Other non-interest income	383	395
Non-interest income	1,748	1,770
Total income	4,639	4,753
Direct expenses		
- staff costs	(928)	(921)
- other	(363)	(391)
Indirect expenses	(633)	(693)
	(1,924)	(2,005)
Operating profit before impairment losses	2,715	2,748
Impairment losses	(838)	(792)
Operating profit	1,877	1,956

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross) (1)	107.0	110.6
Customer deposits (1)	127.1	126.3

Note:
(1) Includes businesses outlined for disposal: loans and advances to customers - £11.3 billion (2011 - £12.2 billion) and customer deposits - £13.0 billion (2011 - £13.0 billion).

During 2012, UK Corporate continued to support its customers and the UK economy and further demonstrated a commitment to the communities it operates in.

RBS Group was the first bank to support the Government's Funding for Lending Scheme (FLS). The division is using the FLS to stimulate loan demand through reduced interest rates for its customers. Since the scheme's launch, UK Corporate has supported over 11,000 SMEs with over £1.7 billion of allocated funds through FLS initiatives. In addition, UK Corporate is providing targeted support to manufacturers through its Manufacturing Fund. This has made £1 billion available to customers, facilitating investment in technology and innovation and freeing up working capital. UK Corporate launched a Carbon Reduction Fund which provides £200 million of ring-fenced funding for businesses undertaking energy-efficiency projects. The division has also supported its clients in accessing the corporate bond markets. Corporate clients raised a total of £19 billion of bonds in 2012.

Throughout the year, UK Corporate has also continued to invest in the service it delivers to its customers through:

- The introduction of a new enhanced telephony and online offering, Business Connect. This already supports over 170,000 small business customers, offering telephony access to experienced relationship managers from 8am to 8pm, in addition to its traditional branch and relationship manager network;

- New mobile banking apps that allow customers to manage multiple accounts, make payments and transfers, and view detailed statements. In 2012 over 70,000 users were using the app twice a day, transacting more than £700 million since launch; and

- Regional 'Great place to do business' events which bring investors, local authorities and prominent members of the community together to identify opportunities for stimulating growth in the community.

UK Corporate has invested significantly to further enhance the skills of its people. As part of improvements to its specialist sector propositions, the business is tailoring its industry leading accreditation programme with industry specific modules. The bespoke modules are endorsed by key sector bodies such as the National Farmers' Union.

UK Corporate was the first high street bank to support the Evening Standard and City Gateway apprenticeship initiative, hiring an initial 16 young people onto its scheme.

2012 compared with 2011

Operating profit decreased by 4%, with income down 2% and impairments up 6%, partially offset by a 4% decrease in costs.

Net interest income was 3% lower, reflecting a 3% fall in lending volumes as loan repayments outstripped new lending, deposit margin compression due to strong competition and the continuation of low yields on current accounts. This was partially offset by improved asset margins and a 1% increase in deposit volumes.

Non-interest income was broadly in line with 2011, with stable income from transaction services, asset finance, Markets revenue share and other lending fees.

Total costs were down 4% due to tight control over direct discretionary expenditure combined with lower indirect costs as a result of operational savings, partially offset by increased investment expenditure.

Impairments increased by 6% with lower specific provisions, mainly in the SME business, more than offset by reduced levels of latent provision releases across the division (£44 million in 2012 versus £226 million in 2011).

Wealth

	2012 £m	2011 £m
Net interest income	740	645
Net fees and commissions	364	373
Other non-interest income	84	84
Non-interest income	448	457
Total income	1,188	1,102
Direct expenses		
- staff costs	(420)	(410)
- other	(222)	(193)
Indirect expenses	(179)	(175)
	(821)	(778)
Operating profit before impairment losses	367	324
Impairment losses	(46)	(25)
Operating profit	321	299
	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- mortgages	8.8	8.3
- personal	5.5	6.9
- other	2.8	1.7
	17.1	16.9
Customer deposits	38.9	38.1
Assets under management (excluding deposits)	28.9	30.9

2012 saw improved performance overall, with higher lending and deposit margins and volumes driving higher income.

In 2012 the Coutts businesses continued to focus on implementing and delivering the new divisional strategy outlined in 2011. The sale of Coutts' Latin American businesses and the completion of the rollout of Coutts global technology platform in the UK were tangible examples of this. By the end of the year the division had exited over 100 countries since the strategy was introduced and was serving clients in the remaining countries through one central operating platform, a clear demonstration of the division's commitment to its strategy.

In the UK, Q4 2012 saw the launch of Coutts' new Retail Distribution Review (RDR)-compliant advice proposition and products. Significant investment was made during 2012 to ensure clients would continue to receive the best service, advice and products based on their specific needs. One example of this was the introduction of seven new UK and global RDR-compliant multi-asset funds, allowing clients to continue to invest in a broad range of asset classes matched to their needs and risk appetites.

Clients in the UK also benefited from the launch of the Coutts Mobile service in October, offering clients greater choice and flexibility in the way they manage their banking needs electronically.

In the International business, the division further invested in Dubai, Singapore and Mumbai as it continued to embed its targeted growth strategy. Clients also benefited from enhancements to the collateralised lending programme, where higher lending limits and a greater number of currencies available has increased its relevance to clients.

2012 compared with 2011

Operating profit increased by £22 million, or 7% to £321 million driven by higher income partially offset by increased expenses and higher impairment losses.

Total income increased by £86 million, with net interest income up £95 million, largely driven by improvements in margins and strong divisional treasury income, particularly during H1 2012.

Non-interest income fell by 2% as the gain from the disposal of the Latin American, Caribbean and African businesses was more than offset by a decline in fee income in the UK and lower investment volumes, driven by continued economic uncertainty.

Expenses were £43 million or 6% higher at £821 million, with significant investment in change programmes, including the development of new products and services capability and the implementation of RDR in the UK.

Expenses also increased as a result of client redress following a past business review into the sale of the ALICO Enhanced Variable Rate Fund announced in November 2011 and a Financial Services Authority fine of £8.75 million relating to Anti Money Laundering control processes.

Client assets and liabilities fell by 1% with a £2 billion decrease in assets under management, primarily reflecting low margin client outflows of £1.4 billion and the impact of client transfers following the disposal of the Latin American, Caribbean and African businesses. This fall was partially offset by increases in lending and deposit volumes.

Impairment losses were £46 million, up £21 million, largely reflecting a small number of large specific impairments.

International Banking

	2012 £m	2011 £m
Net interest income	797	861
Non-interest income	920	1,023
Total income	1,717	1,884
Direct expenses		
- staff costs	(494)	(523)
- other	(140)	(171)
Indirect expenses	(307)	(196)
	(941)	(890)
Operating profit before impairment losses	776	994
Impairment (losses)/recoveries	(131)	16
Operating profit	645	1,010
	£bn	£bn
Balance sheet		
Total assets (1)	49.1	50.9
Loans and advances	39.0	39.7
Customer deposits	41.5	18.9

Note:
(1) Excludes disposal groups.

International Banking was formed in January 2012 to create an integrated, client-focused business which serves RBS's large global customers' financing, risk management, trade finance, payments and cash management needs internationally.

Since its formation, the division has made significant progress in strengthening its balance sheet and making efficient use of resources. The loan portfolio decreased due to strategic reduction initiatives and disciplined capital allocation. The division's liability composition also improved, with additional customer deposits raised in the final quarter and the strategic run-off of commercial paper and short-term bank deposits.

Performance in 2012 was restricted by macroeconomic pressures and additional regulatory requirements across the industry. Given these constraints, International Banking kept its focus on cost control throughout the year.

Despite these headwinds, the division was recognised externally for its efforts in serving its customers' needs, helping RBS Group gain awards such as:

- Top European investment grade corporate bond bookrunner (Dealogic).
- Number one cash management manager in the UK and number two in Europe (Euromoney Cash Management Survey).
- Quality Leader in Large Corporate Trade Finance in the UK, and number one for Large Corporate Trade Finance Penetration in the UK (Greenwich).

2012 compared with 2011

Operating profit decreased by £365 million, primarily due to a decline in income and an increase in impairment losses.

Income was 9% lower including the transfer of assets from N.V.:

- Loan portfolio decreased, mainly due to a strategic reduction in assets, in order to allocate capital more efficiently, and the effect of portfolio credit hedging and lower corporate appetite for risk management activities.
- Cash management was broadly in line with the previous year. Deposit margins declined following reductions in both three month LIBOR and five year fixed rates across Europe; however, this was offset by lower liquidity costs due to the strategic initiative to reduce short-term bank deposits.
- The restructuring in 2012 led to a reduction in activities undertaken in the division, which contributed to a decline in income.

Expenses increased by £51 million due to the migration of headcount and associated costs from RBS N.V. Excluding this migration, expenses declined reflecting planned restructuring initiatives following the formation of the International Banking division. Savings were achieved through headcount reduction, run-off of discontinued businesses and a resulting decrease in infrastructure support costs. Revenue-linked expenses also fell in line with the decrease in income.

Impairment losses increased by £147 million primarily as a result of the transfer of assets from RBS N.V.

Total assets and loans and advances declined by 4% and 2% respectively, with targeted reductions in the lending portfolio following a strategic reduction in assets.

Customer deposits increased by 120% mainly due to the transfer of assets from RBS N.V. Excluding this impact, customer deposits were marginally higher as successful efforts to rebuild customer confidence following the Moody's credit rating downgrade and the RBS Group technology incident in June 2012 outweighed economic pressures.

Ulster Bank

	2012 £m	2011 £m
Net interest income	634	713
Net fees and commissions	145	142
Other non-interest income	51	69
Non-interest income	196	211
Total income	830	924
Direct expenses		
- staff costs	(211)	(221)
- other	(49)	(67)
Indirect expenses	(214)	(216)
	(474)	(504)
Operating profit before impairment losses	356	420
Impairment losses	(1,364)	(1,384)
Operating loss	(1,008)	(964)

	£bn	£bn
Balance sheet		
Loans and advances to customers (gross)		
- mortgages	19.2	20.0
- corporate		
- property	4.3	4.8
- other corporate	7.8	7.7
- other lending	1.4	1.6
	32.7	34.1
Customer deposits	22.1	21.8

The challenging macroeconomic environment across the island of Ireland had a significant impact on Ulster Bank's financial performance for 2012. There were some emerging signs of improvement in the Republic of Ireland economy during Q4 2012, most notably in the availability of institutional funding, some stabilisation of residential property prices and continued economic growth, albeit modest.

While impairment levels remained elevated during 2012, net interest margin and expense management improved. Further progress was made on Ulster Bank's deposit gathering strategy with customer deposit balances increasing by 7% on a constant currency basis in Q4 2012, driving a significant reduction in the loan to deposit ratio.

Following the Group technology incident in June 2012, Ulster Bank made significant efforts to help customers who were affected, extending branch hours, tripling call centre staff and providing full redress.

2012 compared with 2011

Operating loss increased by £44 million primarily reflecting a reduction in income driven by lower interest earning asset volumes.

Total expenses fell by £30 million, reflecting the benefits of cost saving initiatives.

Impairment losses remained elevated, as weak underlying credit metrics prevailed. Falling asset values throughout most of 2012 and high levels of unemployment coupled with weak domestic demand continued to depress the property market. The impairment charge for 2012 was driven by a combination of new defaulting customers and deteriorating security values.

The loan to deposit ratio improved from 143% to 130%, driven by a combination of deposit growth and a decrease in the loan book. At constant currency, the loan book decreased by 2% as a result of natural amortisation and limited new lending due to low levels of market demand. Retail and SME deposits increased by 8%; however, this was partly offset by outflows of wholesale balances driven by market volatility and the impact of a rating downgrade in the second half of 2011.

US Retail & Commercial

	2012 US$m	2011 US$m	2012 £m	2011 £m
Net interest income	3,096	3,099	1,954	1,932
Net fees and commissions	1,233	1,350	778	841
Other non-interest income	579	473	365	296
Non-interest income	1,812	1,823	1,143	1,137
Total income	4,908	4,922	3,097	3,069
Direct expenses				
- staff costs	(1,313)	(1,344)	(828)	(838)
- other	(833)	(893)	(526)	(557)
- litigation settlement	(138)	—	(88)	—
Indirect expenses	(1,115)	(1,114)	(704)	(694)
	(3,399)	(3,351)	(2,146)	(2,089)
Operating profit before impairment losses	1,509	1,571	951	980
Impairment losses	(145)	(524)	(91)	(326)
Operating profit	1,364	1,047	860	654
Average exchange rate - US$/£			1.585	1.604
	US$bn	US$bn	£bn	£bn
Balance sheet				
Loans and advances to customers (gross)				
- residential mortgages	9.4	9.4	5.8	6.1
- home equity	21.5	23.1	13.3	14.9
- corporate and commercial	38.5	35.3	23.8	22.9
- other consumer	13.5	12.0	8.4	7.7
	82.9	79.8	51.3	51.6
Customer deposits (excluding repos)	95.6	92.8	59.2	60.0
Spot exchange rate - US$/£			1.616	1.548

In the first quarter of 2012, RBS Citizens implemented five strategic priorities to sharpen the division's back-to-basics strategy. The strategy is founded on the belief that building an engaged workforce which is focused on the customer experience and on being their primary banking partner, with an embedded culture of risk management, will position the franchise to deliver financial results consistent with a top performing regional bank.

Efforts in both the Consumer and Commercial businesses throughout 2012 were aligned with those priorities and our customers have acknowledged our efforts. According to a 2012 survey conducted by American Banker, RBS Citizens was ranked in the top ten of US banks for corporate reputation, an improvement of eight places from 2011.

Core Customer Commitments were implemented in Consumer Banking's branch network at the end of last year. Early indications show progress towards the Commitments' aim to enhance customer experience:

- At the end of 2012, 77% of customers surveyed externally were 'completely satisfied' or 'very satisfied', compared with the peer average of 71%.
- RBS Citizens' net promoter score, a measure of how likely customers are to recommend the bank, increased to 20% over the course of 2012 and was over ten percentage points above the peer average.

Consumer Banking further improved and expanded its distribution channels and product capabilities including the roll-out of intelligent deposit machines and the on-going build out of its mortgage capabilities, reaching the top 20 nationally for mortgage originations in 2012. The business made enhancements to its mobile banking services and subsequently its apps for both iPhone and Android were rated the 'best integrated apps' in the industry based on an analysis of consumer ratings conducted by Javelin Strategy & Research.

In 2012, Commercial Banking responded to client feedback, introducing its own core Client Commitments and developing a new Commercial Client on-boarding process to improve the way clients are welcomed to RBS Citizens.

Commercial Banking took further significant steps towards strengthening its customer proposition with a more streamlined, efficient and integrated service and product offering by integrating the Treasury Solutions, Foreign Exchange and Interest Rate Derivatives functions into Commercial Banking.

The business made good progress towards expanding its capital markets capabilities. At the end of 2012, RBS Citizens ranked #4 in the new capital markets business for middle market customers within the footprint, and ranked in the top ten nationally.

US Retail & Commercial continued

2012 compared with 2011

US Retail & Commercial posted an operating profit of $1,364 million, up $317 million, or 30%, from 2011. Excluding the $138 million litigation settlement in Q1 2012 and the $62 million net gain on the sale of Visa B shares in Q2 2012, operating profit was up $393 million, or 38%, largely reflecting lower impairment losses due to an improved credit environment.

Net interest income was down $3 million, driven by consumer loan run-off and lower asset yields reflecting prevailing economic conditions. This was partially offset by targeted commercial loan growth, deposit pricing discipline and lower funding costs.

Non-interest income was down $11 million, or 1%, reflecting a decline in debit card fees as a result of the Durbin Amendment legislation and lower securities gains and deposit fees. This was largely offset by strong mortgage banking fees of $109 million, up 71%, and the $75 million gross gain on the sale of Visa B shares.

Loans and advances to customers were up $3.1 billion, or 4%, due to strong growth in commercial loan volumes.

Customer deposits increased by 3% with strong growth achieved in checking balances. Consumer checking balances grew by 4% while small business checking balances grew by 8% over the year.

Excluding the $138 million litigation settlement, relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010, and the $13 million litigation reserve associated with the sale of Visa B shares, and a one-off $33 million pension gain in Q4 2012, total expenses were down 2%, reflecting lower loan collection costs and the elimination of the Everyday Points rewards programme for consumer debit card customers, partially offset by higher operational losses.

During the year, RBS Citizens offered former employees a one-time opportunity to receive the value of future pension benefits as a single lump sum payment. The transaction allowed RBS Citizens to partially de-risk its pension plan and future liability under the plan. A strong participant take-up rate of 60% enabled RBS Citizens to reduce its pension liability by 17% and recognise a $33 million accounting gain.

Impairment losses were down $379 million, or 72%, reflecting an improved credit environment and lower impairments on securities. Loan impairments improved by $266 million driven primarily by commercial loan impairments. Impairments as a percentage of loans and advances fell to 20 basis points.

Markets

	2012 £m	2011 £m
Net interest expense	(273)	(192)
Net fees and commissions	58	78
Income from trading activities	3,938	3,124
Other operating income	172	134
Non-interest income	4,168	3,336
Total income	3,895	3,144
Direct expenses		
- staff costs	(1,282)	(1,591)
- other	(672)	(572)
Indirect expenses	(440)	(373)
	(2,394)	(2,536)
Operating profit before impairment losses	1,501	608
Impairment recoveries/(losses)	4	(8)
Operating profit	1,505	600

	£bn	£bn
Balance sheet		
Loans and advances to customers	29.3	29.4
Loans and advances to banks	36.3	40.9
Reverse repos	103.4	98.7
Securities	86.4	98.4
Cash and eligible bills	26.8	19.2
Other	10.2	20.9
Total assets (excluding derivatives mark-to-market)	292.4	307.5
Customer deposits (excluding repos)	30.1	34.2

During 2012, the economic environment was dominated by weak prospects for global growth and the uncertain outlook for Eurozone sovereign debt. However, positive central bank activity and a more stable credit environment resulted in marginally improved trading opportunities.

2012 compared with 2011

Operating profit increased by 151%, reflecting 24% growth in income and 6% decrease in expenses.

Income growth was driven by Flow Credit and Counterparty Exposure Management. Both areas incurred losses following the sharp deterioration in credit markets in Q3 2011 but recorded gains in 2012 following improved risk management and more benign market conditions.

The decline in total expenses was driven by staff costs, reflecting lower headcount and lower levels of variable compensation, including reductions and clawbacks following the RBS Group's LIBOR settlements reached on 6 February 2013.

The reduction in total assets reflected management action to optimise and de-risk the balance sheet, consistent with previously disclosed medium-term objectives.

Central items

	2012 £m	2011 £m
Central items not allocated	(1,538)	(1,339)

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.

2012 compared with 2011

Central items not allocated represented a charge of £1,538 million in 2012, an increase of £199 million compared with 2011.

Non-Core

	2012 £m	2011 £m
Net interest income	865	1,228
Net fees and commissions	111	72
Loss from trading activities	(565)	(613)
Other operating income	1,324	1,073
Non-interest income	870	532
Total income	1,735	1,760
Direct expenses		
- staff costs	(246)	(303)
- other	(370)	(529)
Indirect expenses	(97)	(127)
	(713)	(959)
Operating profit before impairment losses	1,022	801
Impairment losses	(2,209)	(3,869)
Operating loss	(1,187)	(3,068)

	£bn	£bn
Balance sheet		
Total assets (excluding derivatives)	52.7	84.1
Total assets (including derivatives)	58.5	94.9
Loans and advances to customers (gross)	51.8	72.7
Customer deposits	1.6	1.8

2012 compared with 2011

Total assets (excluding derivatives) fell to £53 billion in 2012. Ongoing disposal activity and portfolio run-off delivered a reduction of £31 billion. The disposal of RBS Aviation Capital in Q2 2012 contributed c.£5 billion of this reduction.

Operating loss of £1,187 million was £1,881 million lower than 2011, principally due to lower impairments, partially offset by lower net interest income following run-off and disposals.

Impairment losses fell by £1,660 million to £2,209 million, with £1,366 million of this reduction from the Ulster Bank portfolio and £269 million from the real estate portfolio.

Income declined by £25 million, with continued divestment and run-off reducing net interest income and lower rental income following the disposal of RBS Aviation Capital in Q2 2012, materially offset by the result of a liquidation of CLO structures within Markets and sale of underlying collateral.

Expenses were £246 million lower, driven by reduced headcount and lower operating lease depreciation, principally following the disposal of RBS Aviation Capital.

Consolidated balance sheet at 31 December 2012

	2012 £m	2011 £m
Assets		
Cash and balances at central banks	74,524	68,487
Net loans and advances to banks	47,623	59,380
Reverse repurchase agreements and stock borrowing	34,444	37,760
Loans and advances to banks	82,067	97,140
Net loans and advances to customers	424,794	428,142
Reverse repurchase agreements and stock borrowing	70,043	61,257
Loans and advances to customers	494,837	489,399
Debt securities	136,585	169,141
Equity shares	13,872	11,762
Settlement balances	5,717	6,902
Derivatives	445,101	532,807
Intangible assets	12,403	12,365
Property, plant and equipment	9,694	11,478
Deferred tax	3,066	3,320
Prepayments, accrued income and other assets	6,104	5,892
Assets of disposal groups	304	24,088
Total assets	1,284,274	1,432,781
Liabilities		
Bank deposits	57,937	70,197
Repurchase agreements and stock lending	44,323	38,900
Deposits by banks	102,260	109,097
Customer deposits	431,200	384,211
Repurchase agreements and stock lending	87,997	88,177
Customer accounts	519,197	472,388
Debt securities in issue	83,278	140,837
Settlement balances	5,832	6,778
Short positions	27,541	40,446
Derivatives	436,085	527,836
Accruals, deferred income and other liabilities	12,027	14,809
Retirement benefit liabilities	3,854	2,188
Deferred tax	789	1,384
Subordinated liabilities	33,851	32,324
Liabilities of disposal groups	135	22,840
Total liabilities	1,224,849	1,370,927
Non-controlling interests	137	128
Owners' equity	59,288	61,726
Total equity	59,425	61,854
Total liabilities and equity	1,284,274	1,432,781

Commentary on consolidated balance sheet

2012 compared with 2011

Total assets of £1,284.3 billion at 31 December 2012 were down £148.5 billion, 10%, compared with 31 December 2011. This was principally driven by a decrease in loans and advances led by Non-Core disposals and run-off, decreases in debt securities and the continuing reduction in the mark-to-market value of derivatives.

Cash and balances at central banks were up £6.0 billion, 9%, to £74.5 billion principally due to cash balances held in the businesses transferred from RBS N.V. during 2012.

Loans and advances to banks decreased by £15.1 billion, 16%, to £82.1 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £3.3 billion, 9%, to £34.5 billion, bank placings declined £11.8 billion, 20%, to £47.6 billion.

Loans and advances to customers increased £5.4 billion, 1%, to £494.8 billion. Within this, reverse repurchase agreements were up £8.8 billion, 14%, to £70.0 billion. Customer lending decreased by £3.4 billion, 1%, to £424.8 billion, or £1.1 billion to £445.5 billion before impairments. This principally reflected further reductions in Non-Core along with decreases in UK Corporate and Ulster Bank, partially offset by the transfer from disposal groups of £18.9 billion of customer balances relating to the UK branch-based businesses, together with underlying growth in UK Retail and £11.8 billion of loans and advances to customers relating to businesses transferred from RBS N.V.

Debt securities were down £32.6 billion, 19%, to £136.6 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds.

Equity shares increased £2.1 billion, 18%, to £13.9 billion reflecting an increase in trading in the UK equities business.

Settlement balance assets and liabilities decreased £1.2 billion to £5.7 billion and £0.9 billion to £5.8 billion respectively reflecting the overall reduction in size of the balance sheet.

Movements in the value of derivative assets, down £87.7 billion, 16%, to £445.1 billion, and liabilities, down £91.8 billion, 17% to £436.1 billion, primarily reflect decreases in interest rate and credit derivative contracts, together with the effect of currency movements, with Sterling strengthening against both the US dollar and the Euro.

Property, plant and equipment decreased by £1.8 billion, 16%, to £9.7 billion driven largely by the disposal of investment property in Non-Core.

The decrease in assets and liabilities of disposal groups, down £23.8 billion to £0.3 billion, and £22.7 billion to £0.1 billion respectively, primarily reflects the transfer of the UK branch-based businesses out of disposal groups following Santander's withdrawal from the agreed sale, together with the disposal of RBS Aviation Capital.

Deposits by banks decreased £6.8 billion, 6%, to £102.3 billion, with a decrease in inter-bank deposits, down £12.2 billion, 17%, to £58.0 billion. This was partly offset by an increase in repurchase agreements and stock lending ('repos'), up £5.4 billion, 14%, to £44.3 billion, improving the Group's mix of secured and unsecured funding.

Customer accounts increased £46.8 billion, 10%, to £519.2 billion. Within this, repos decreased £0.2 billion to £88.0 billion. Excluding repos, customer deposits were up £47.0 billion at £431.2 billion, primarily reflecting the transfer from disposal groups of £21.5 billion of customer accounts relating to the UK branch-based businesses together with £19.3 billion of customer accounts relating to certain businesses transferred from RBS N.V. Customer deposits also increased in UK Retail, US Retail & Commercial, UK Corporate, Ulster Bank, and Wealth partly offset by decreases in Markets and Non-Core.

Debt securities in issue decreased £57.6 billion, 41%, to £83.3 billion reflecting the maturity of the remaining notes issued under the UK Government's Credit Guarantee Scheme, £21.3 billion, the repurchase of bonds and medium term notes as a result of the liability management exercise completed in September 2012, £4.4 billion, and the continuing reduction of commercial paper and medium term notes in issue in line with the Group's strategy. These reductions were partly offset by £6.7 billion of debt securities in issue relating to businesses transferred from RBS N.V.

Short positions were down £12.9 billion, 32%, to £27.5 billion mirroring decreases in debt securities.

Retirement benefit liabilities increased by £1.7 billion, 76%, to £3.9 billion with net actuarial losses of £2.3 billion on the Group's defined benefit pension schemes, primarily arising from significant reductions in the real discount rates in the Sterling, Euro and US dollar currency zones. These were partially offset by the £0.6 billion excess of employer contributions paid over the current year pension charge.

Subordinated liabilities increased by £1.5 billion, 5%, to £33.9 billion. This primarily related to issuances of £1.4 billion of undated loan capital and net increases in dated loan capital issuances of £1.6 billion and redemptions of £0.3 billion, partly offset by a net decrease of £0.7 billion arising from the liability management exercise completed in March 2012, which consisted of redemptions of £3.4 billion offset by the issuance of £2.7 billion new loan capital.

Owner's equity decreased by £2.4 billion, 4%, to £59.3 billion, reflecting the £3.9 billion attributable loss for the year together with movements in foreign exchange reserves, £0.8 billion, losses in available-for-sale reserves, £0.5 billion and the recognition of actuarial losses in respect of the Group's defined benefit pension schemes, net of tax, £1.8 billion. Partially offsetting these reductions were gains in cash flow hedging reserves, £0.8 billion, capital contributions from the holding company, £2.9 billion, an increase in share premium, £0.7 billion, as a result of the merger and demerger transaction to transfer certain businesses from RBS N.V., and other reserve movements, £0.2 billion.

Cash flow

	2012 £m	2011 £m
Net cash flows from operating activities	(30,436)	2,438
Net cash flows from investing activities	26,652	2,114
Net cash flows from financing activities	4,396	3,303
Effects of exchange rate changes on cash and cash equivalents	(3,347)	(1,196)
Net (decrease)/increase in cash and cash equivalents	(2,735)	6,659

2012

The major factors contributing to the net cash outflow from operating activities of £30,436 million were the increase of £36,173 million in operating assets and liabilities, loans and advances written-off net of recoveries of £3,555 million and operating loss before tax of £3,412 million, partially offset by depreciation and amortisation £1,614 million, the elimination of foreign exchange differences of £6,111 million and provisions for impairment losses of £5,214 million.

Net cash inflows from investing activities of £26,652 million related to net inflows from sales and maturities of securities of £17,664 million, net investment in business interests and intangible assets of £8,245 million and the sale of property, plant and equipment of £2,099 million, partially offset by the purchase of property, plant and equipment of £1,356 million. Net investments in business interests and intangible assets is primarily attributable to £8,933 million of cash in relation to businesses transferred from RBS N.V.

Net cash inflows from financing activities of £4,396 million primarily arose from the issue of subordinated liabilities of £2,968 million and a capital contribution of £2,870 million, offset in part by repayment of subordinated liabilities of £264 million and interest paid on subordinated liabilities of £1,114 million.

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 provisions for impairment losses of £7,176 million, partially offset by the operating loss before tax of £864 million, loans and advances written-off net of recoveries of £3,675 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.

Financial review *Risk and balance sheet management*

26	Risk appetite and risk governance
39	Capital management
45	Liquidity, funding and related risks
57	Credit risk
86	Balance sheet analysis
147	Market risk
156	Country risk
185	Other risks

Risk appetite and risk governance

27	Risk appetite
29	Risk governance
33	Stress testing
34	Risk coverage

Risk and balance sheet management

In this section (pages 25 to 196) 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.

Risk appetite and risk governance

Risk appetite*

Risk appetite is both a key business tool and an integral part of RBS's enterprise-wide approach to risk management. It is aligned with the Group's strategic objectives, helping to strike an optimal balance between building a sustainable risk profile and creating long-term value for the Group's customers, investors and wider stakeholders. The risk appetite framework is designed to ensure that each business can withstand significant deteriorations in economic and market conditions.

The Group's risk appetite is set and owned by the RBS Group Board. It identifies and establishes the level and type of risks that RBS is able and willing to take in order to:

- *meet its strategic objectives -* the Group's Strategic Plan is built on the core foundations of serving its customers well, building a sustainable risk profile and creating long-term value for its shareholders; and

- *meet its wider obligations to stakeholders -* a bank that is safe and sound and puts serving customers at the heart of its thinking should also perform well for its owners, employees, regulators and communities.

Risk appetite is cascaded and embedded across the Group. It provides a greater understanding of the acceptable levels of risk for each business, aligning commercial strategies with the use of scarce financial resources, such as capital and funding. It provides a solid platform from which RBS can focus on its key business strengths and competitive advantages over the long term.

Delivering a sustainable and conservative risk profile

Risk appetite starts with the tone from the top (i.e. the strategic goals and risk philosophy set by the Group Board) and is cascaded through key targets, limits and risk tolerances that influence decision making from enterprise-wide to transactional level.

A strong risk culture is a key part of ensuring risk appetite is effectively embedded across the Group. The link between risk appetite and strategic objectives encourages people at all levels of the business to think about risk, how they apply it and how they manage it. It incorporates the quantitative and qualitative aspects of risk, and uses both absolute and relative risk measures.

The risk appetite framework is based upon four main pillars:

- *Risk envelope metrics -* RBS Group has set sustainable business goals over a medium-term horizon including a target for the capital ratio, leverage ratio, loan:deposit ratio, liquidity portfolio and use of wholesale funding. These effectively set the broad boundaries within which the Group operates. The Non-Core division also acts as a primary driver for reducing risk and the size of the balance sheet.

- *Quantitative risk appetite targets -* Risk appetite is also aligned to potential risk exposures and vulnerabilities under severe but plausible stress conditions. Quantitative targets, under stress conditions, are set around the Group's strategic risk objectives.

- *Qualitative risk appetite targets -* The third strategic risk objective of maintaining stakeholder confidence covers qualitative aspects relating to the culture of risk management and controls and meeting stakeholder expectations. Risk appetite is based around identified expectations across a range of stakeholders (e.g. customers, employees, investors and the general public) and is closely aligned with key risk policies and controls (e.g. the Group Policy Framework, conduct risk, reputational risk).

- *Risk control frameworks and limits -* Risk control frameworks set granular tolerances and limits for material risk types (e.g. credit risk, market risk, conduct risk and operational risk) that are used to manage risk on a day-to-day basis. These limits support and are required to be consistent with the high-level risk appetite targets.

The framework is supported by a programme of communication, engagement and training rolled out across the Group to engender a wide understanding of the purpose and value of an effective risk appetite.

The Group Policy Framework (refer to the following section) directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in the Group's risk control and governance. This integrated approach ensures that an appropriate standard of control is set for each of the material risks the Group faces, with an effective assurance process put in place to monitor and report on performance.

Risk appetite has its own policy standard within the Group Policy Framework that sets out clear roles and responsibilities to measure, cascade and report performance against risk appetite, and to provide assurances that business is being conducted within approved risk limits and tolerances.

* unaudited

Risk appetite and risk governance: Risk appetite* continued

The Board Risk Committee reviews the framework and its targets on a regular basis to ensure they remain aligned to strategic objectives, business performance, emerging risks and changes in the external environment.

Creating sustainable value within risk appetite

Risk appetite supports value creation delivered in a safe and sustainable way. It is embedded within the annual planning and budgeting process. Business strategies are designed on the basis of key value drivers (e.g. regulatory framework, customer franchises, internal control framework, incentives) and whether they fit within agreed risk appetite boundaries.

A range of different but complementary tools have been developed to measure whether strategic plans are consistent with risk appetite, to test broader 'what if' questions and to assess the impact of changes in key assumptions:

- *Integrated stress testing -* (refer to page 33) assesses how earnings, capital and funding positions change under an unfavourable, yet plausible, scenario. Stress scenarios can differ by theme, geographical location or severity.
- *Economic capital -* provides complementary insights, with a breadth of understanding of risk profile changes and 'tail risks' across millions of different modelled scenarios.
- *Sensitivity analysis -* provides 'ready reckoners' around changes in key variables. It offers a high-level view on questions such as 'what if GDP worsened by a further 1%?', identifying certain tipping points where the Group's risk profile moves outside its risk appetite.

Effective processes for reporting the results have also been developed, presenting the Board and senior management with a holistic and dynamic view of key risk exposures.

Group Policy Framework*

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

The Group Policy Framework (GPF), introduced in 2009, supports this goal by providing a consistent and structured overarching framework for conduct, control and governance. It provides clear guidance and controls on how the 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 Group has ethical principals and clear control standards to identify the risks it faces to support effective risk management and meet regulatory and legal requirements;
- Policies are followed across the 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 ensure staff are aware of their own responsibilities. Policy standard owners and sponsors review their policies on a regular basis, documenting identified shortfalls and addressing them within an agreed time frame.

In 2011, a number of key enhancements were delivered including the following:

- The Group's policy standards were rewritten to ensure they clearly express the existing mandatory controls required to mitigate the key risks the Group faces;
- All of the Group's policy standards were externally benchmarked; and
- 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.

* unaudited

During 2012, the scope of the GPF was refined further. Key developments included:

- Following external benchmarking exercises, additional policy standards were introduced setting out new mandatory controls required to mitigate key risks to the Group.

- A conduct risk framework was agreed and is being progressively established. Grouped under four policy standards - employee conduct, corporate conduct, market conduct; and conduct towards our customers - each is designed to provide high level direction to the Group and is supported by the Group's Code of Conduct.

- The Group's key credit risk policies and mandatory controls were restructured and realigned to reflect the two distinct portfolios of credit risk: wholesale and retail. These changes are aimed at simplifying the policy structure and making it clearer to divisions which standards are applicable to their respective businesses.

- Certain procedural-related policy standards were removed from the framework to reduce bureaucracy and simplify the structure.

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

Risk governance*

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

To enable the 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 Group, as set out in the diagram below.

Group Board

Executive Committee
Board Risk Committee
Group Audit Committee
Group Performance and Remuneration Committee
Group Sustainability Committee

Executive Credit Group
Executive Risk Forum
Divisional Risk and Audit Committees

Group Asset and Liability Management Committee (1)
Group Risk Committee (2)
Conduct Risk Committee

Comprises independent non-executive directors

Notes:
(1) The following sub-committees report directly to the Group Asset and Liability Management Committee: Capital and Stress Testing Committee, Pension Risk Committee, Balance Sheet Management Committee.
(2) The following 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. The Capital and Stress Testing Committee also provides monthly updates to the Group Risk Committee, escalating issues as necessary.

** unaudited*

Risk appetite and risk governance: 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 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 2012, the Conduct Risk Committee was created as a sub-committee of the Executive Risk Forum. Effective conduct risk management is not only a commercial imperative for the Group; customers, clients and counterparties demand it as a precursor to building trust. For more information on conduct risk and the Group's management of this risk type, refer to page 193.

Board/Committee	Risk focus	Membership
Group Board	The Group Board ensures that the Group manages risk effectively by 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. It operates under delegated authority from the Group Board.	Group Chief Executive Group Finance Director Chief Administration 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 exposure of the Group and risk strategy. It reviews the Group's performance on risk appetite, oversees the operation of the Group Policy Framework and provides a risk review of remuneration arrangements. 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, financial reporting and regulatory compliance practices of the Group, as well as its systems and standards of internal controls and monitors the Group's processes for internal audit and external audit. 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.
Group Performance and Remuneration Committee	The Group Performance and Remuneration Committee has oversight of the Group's policy on remuneration and receives advice from RBS 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
Group Sustainability Committee	The Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues related to all stakeholder groups. This includes customer and related citizenship activities, oversight of the delivery of the Purpose, Vision and Values cultural and behavioural change, and oversight of the sustainability aspects of the people agenda. It operates under delegated authority from the Group Board.	Independent non-executive directors

** unaudited*

Board/Committee	Risk focus	Membership
Executive Risk Forum	The Executive Risk Forum has full authority to act on all material and/or enterprise-wide risk and control matters across the Group. It approves the most material limits and decisions above defined thresholds and delegates decisions below these thresholds to sub-committees and appropriate individuals. It operates under delegated authority from the Executive Committee.	Group Chief Executive Group Finance Director Chief Administration Officer Chief Executive Officers of divisions Head of Restructuring and Risk Deputy Group Chief Risk Officer
Group Asset and Liability Management Committee	The Group Asset and Liability Management Committee is responsible for identifying, managing and controlling Group balance sheet risks in executing its business strategy. It operates under delegated authority from the Executive Risk Forum.	Group Finance Director Group Treasurer Chief Executive Officers of divisions Head of Restructuring and Risk Key Group Finance function heads Chief Executive Officer, Markets, M&IB
Group Risk Committee	The Group Risk Committee acts on material and/or enterprise-wide risk and control matters across the Group. It is an oversight committee which reviews and challenges risks and limits across the functional areas and plays a key role exercising and demonstrating effective risk oversight across the Group. It reviews risks and issues on both a thematic and specific basis and focuses on forward-looking, emerging risks. It considers the overall risk profile across the Group and identifies any key issues for escalation to the Executive Risk Forum. It operates under delegated authority from the Executive Risk Forum.	Deputy Group Chief Risk Officer Divisional Chief Risk Officers Key Group Risk function heads
Conduct Risk Committee	The Conduct Risk Committee is responsible for the governance, leadership and strategic oversight of the Group's conduct risk agenda, as well as escalating and reporting any material or strategically significant issues or matters to the Executive Risk Forum. It operates under delegated authority from the Executive Risk Forum.	Head of Restructuring and Risk Group General Counsel Deputy Group Chief Risk Officer Global Head of Compliance Director, Group Regulatory Affairs Chief Executive Officer, Wealth Management Managing Director, Products and Marketing, UK Retail Chief Executive Officer, Corporate Banking Vice Chairman, RBS Citizens Financial Group Co-Head, M&IB Americas Director, Group Operations, Business Services Chief Operating Officer, Ulster Bank Group Chief Executive Officer, RBS England & Wales and NatWest Scotland Head of Group Internal Audit
Pension Risk Committee	The Pension Risk Committee considers the Group-wide view of pension risk appetite, mechanisms that could potentially be used for managing risk within the funds, and implications of the pension schemes' financial strategy. It also reviews actuarial funding assumptions from a Group perspective as appropriate. The Pension Risk Committee consults with the Trustee's Investment Executive where necessary. The Pension Risk Committee operates under delegated authority from the Group Asset and Liability Management Committee.	Group Finance Director Head of Restructuring and Risk Group Treasurer Global Head of Market and Insurance Risk Group Chief Accountant Chief Executive Officer, Markets, M&IB Global Head of Markets, M&IB Group Head of Pension Risk Deputy Group Chief Risk Officer Head of Group Pensions

Risk appetite and risk governance: **Risk governance*** continued

Board/Committee	Risk focus	Membership
Capital and Stress Testing Committee	The Capital and Stress Testing Committee leads the integrated development and maintenance of risk capital approaches, frameworks and standards. It reviews positions and plans, agrees approaches and standards and provides cross-functional challenge on the topics outlined in its terms of reference. It is responsible to the Group Finance Director and the Head of Restructuring and Risk for many of these activities. It provides updates to the Group Asset and Liability Management Committee and Group Risk Committee and seeks approvals where necessary. It operates under delegated authority from the Group Asset and Liability Management Committee.	Group Finance Director Key Group Finance function heads Key Group Risk function heads
Executive Credit Group	The Executive Credit Group decides on requests for the extension of existing or new credit limits on behalf of the Group Board where the proposed aggregate facility limits are in excess of the credit approval authorities granted to individuals in divisions or in RBS 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, Corporate Banking Group B members (1) Group Chief Executive Group Finance Director Deputy Chief Executive Officers, M&IB (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; and review accounting policies, internal control, financial reporting functions, internal audit, external audit and regulatory compliance.	Members: at least three non-executive members who are executives of the 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*

Stress testing*

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

Internal stress tests

The 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 divisional, legal entity and Group levels.

The Executive Risk Forum (refer to page 31) is the main body overseeing the Group's stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any Group-wide stress test and ensuring that, where necessary, appropriate management actions are undertaken. The Board Risk Committee receives reports detailing stress tests undertaken as part of the financial planning process. It reviews and challenges the stress scenarios and considers their impact on the Group's financial position. These reports outline relevant management actions as well as the extent to which such actions mitigate the effects of the stress scenario on the Group's capital adequacy. The Board Risk Committee may also request additional stress tests as it deems necessary.

Stress testing forms part of the Group's risk and capital management framework and is a major component of the Basel III requirements. It highlights to senior management potential unexpected adverse 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 tests, part of the financial planning process are conducted and presented to senior management semi-annually. Stress tests are also conducted to meet regulatory requirements as well as to assess the impact of business decisions on the Group's capital position. Examples of the former include the European Banking Authority's EU-wide stress tests, the International Monetary Fund's Financial Sector Assessment Program and the UK Financial Services Authority's anchor stress tests while examples of the latter include stress tests conducted in connection with the transfer of assets from The Royal Bank of Scotland N.V. to The Royal Bank of Scotland plc.

Scenario stress testing is conducted throughout the Group as detailed below:

- As part of the financial planning and strategy cycle, stress tests are conducted by divisions and aggregated to produce firm-wide results. These stress tests are also used for monitoring divisional and Group risk appetite.

- Stress testing is performed centrally by Group functions both to meet regulatory requirements and for ad-hoc business analysis and decision-making. These stress tests also include reverse stress tests, which identify scenarios and circumstances that could render RBS's business model unviable.

- Division-specific stress testing is undertaken to support risk identification and risk management decision-making.

- Risk-type specific stress testing is also conducted. For example, within the market risk management framework, a comprehensive programme of stress tests covers a variety of historical and hypothetical scenarios, including reverse stress tests.

Stress test scenarios specifically target both firm-wide vulnerabilities and negative global impacts. They consider a five-year horizon and include stress projections for macroeconomic variables such as GDP, unemployment rates, property prices, stock price indices, interest rates and inflation.

** unaudited*

Risk appetite and risk governance continued

Risk coverage*

The main risk types faced by the Group are presented below, together with a summary of the key areas of focus and how the Group managed these risks in 2012.

Risk type	Definition	Features	How the Group managed risk and the focus in 2012
Capital adequacy risk	The risk that the Group has insufficient capital.	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.	Core Tier 1 ratio was 9.5%, a 110 basis point improvement on 2011 (excluding the effect of APS). This largely reflected reduction in risk profile with risk-weighted assets (RWAs) down by 6%, principally in Non-Core due to disposals and run-off and in Markets. Refer to pages 39 to 44.
Liquidity and funding risk	The risk that the Group is unable to meet its financial liabilities as they fall due.		The Group's performance in 2012 represented a new benchmark in the management of liquidity risk as the Group began operating under normalised market practices for the management of liquidity and funding risk despite a backdrop of continued market uncertainty and certain Group-specific factors such as a downgrade of the Group's external credit rating. Refer to pages 45 to 56.
Credit risk	The risk that the Group will incur losses owing to the failure of a customer or counterparty 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.	The Group manages credit risk based on a suite of credit approval, risk concentration, early warning and problem management frameworks and associated risk management systems and tools. With a view to strengthening its credit risk management framework and ensuring consistent application across the Group, during 2012 the Group Credit Risk function launched a set of credit control standards with which divisions must comply, to supplement the existing policy suite. These standards comprise not only governance and policy but also behavioural, organisational and management norms that determine how the Group manages credit from origination to repayment. During 2012, loan impairment charges were 24% lower than in 2011 despite continuing challenges in Ulster Bank Group (Core and Non-Core) and commercial real estate portfolios. The Group also continued to make progress in reducing key credit concentration risks, with exposure to commercial real estate declining 16% during 2012. Refer to pages 57 to 146.

** unaudited*

Risk type	Definition	Features	How the Group managed risk and the focus in 2012
Market risk	The risk arising from fluctuations in interest rates, foreign currency, credit spreads, equity prices, commodity 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. The majority of the Group's market risk exposure is in the Markets, International Banking and Non-Core divisions and Group Treasury. The Group is also exposed to market risk through interest rate risk and foreign exchange risk on its non-trading activities in the retail and commercial businesses.	A comprehensive structure is in place aimed at ensuring the Group does not exceed its qualitative and quantitative tolerance for market risk. The Group's market risk policy statements set out its qualitative tolerance for market risk. They define the governance, responsibilities and requirements for the identification, measurement, analysis, management and communication of market risk arising from the Group's trading and non-trading investment activities. The Group market risk limit framework expresses the Group's quantitative tolerance for market risk. The Group limit metrics capture, in broad terms, the full range of market risk exposures, ensuring the risk is appropriately defined and communicated. During 2012, the Group continued to reduce its risk exposures; market risk limits were lowered accordingly. Average trading VaR was £98 million, 9% lower than 2011, largely reflecting asset sales in Non-Core and decreases in ABS trading inventory in Markets. Refer to pages 147 to 155.
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. Primarily present in credit portfolios of Markets, International Banking, Ulster Bank (Ireland), Group Centre (mainly Treasury) and Non-Core.	Under the Group's country risk framework, all countries except the UK and the US are currently under limit control. All countries with material exposures are monitored continually using the Group's country risk watchlist process to identify emerging issues and facilitate the development of mitigation strategies. Detailed portfolio reviews are undertaken on a regular basis to ensure that country portfolio compositions remain aligned to the Group's country risk appetite in light of evolving economic and political developments. In the context of several sovereign downgrades, the Group has made continued progress in managing down its sovereign exposures. Having recognised an impairment on its holding of Greek government bonds in 2011, the Group participated in the restructuring of Greek sovereign debt in the first quarter of 2012 and no longer holds Greek government bonds. During 2012, the Group brought nearly all advanced countries under country limit control and further restricted its country risk appetite. Balance sheet exposures to periphery eurozone countries decreased by 8% or £4 billion to £52 billion with £13 billion outside of Ireland. Funding mismatches in Ireland and Italy were approximately £9 billion and £0.5 billion respectively. Mismatches in other periphery eurozone countries were modest. Refer to pages 156 to 184.

Risk appetite and risk governance: Risk coverage* continued

Risk type	Definition	Features	How the Group managed risk and the focus in 2012
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent significant losses.	The Group aims to manage operational risk to an acceptable level by taking into account the cost of minimising the risk against the resultant reduction in exposure. During 2012, the Group continued to make good progress in enhancing its operational risk framework and risk management capabilities. Key areas of focus have included: embedding risk assessments, increasing the coverage of the scenario analysis portfolio, and improving statistical capital modelling capabilities. Operational risk data have been enriched by the outputs from these enhancements, resulting in a more complete view of the Group's operational risk profile and more informed risk appetite decisions. The level of operational risk remains high due to the scale of change occurring across the Group (both structural and regulatory), macroeconomic stresses (e.g. eurozone distress) and other external threats such as e-crime. In June 2012 the Group was affected by a technology incident as a result of which the processing of certain customers accounts and payments were subject to considerable delay. Refer to pages 186 to 188.
Regulatory risk	The risk arising from non-compliance with regulatory requirements, regulatory change or regulator expectations.	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. Financial cost and reputational damage in respect of penalties for non-compliance/breach of regulations.	Management of regulatory risk entails early identification and effective management of changes in legislative and regulatory requirements that may affect the Group. Within the Group Policy Framework, specific policies define the minimum standards for regulatory engagement, upstream risk management and registration and licensing of individuals. These set minimum standards within their respective areas, applicable across the Group. During 2012, the Group, along with the rest of the banking industry, continued to experience unprecedented levels of prospective changes to laws and regulations from national and supranational regulators. Particular areas of focus were: conduct regulation; prudential regulation (capital, liquidity, governance and risk management); treatment of systemically important entities (systemic capital surcharges and recovery and resolution planning); and structural reforms, with the UK's Independent Commission on Banking proposals, the European Union's Liikanen Group recommendations and the Dodd-Frank/Volcker Rule agenda in the US. Refer to pages 188 to 192.

* unaudited

Risk type	Definition	Features	How the Group managed risk and the focus in 2012
Conduct risk	The risk that the conduct of the Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss.	Arises from breaches of regulatory rules or laws by individual employees, or as a result of the Group's retail or wholesale market conduct. It may also arise from the failure to meet customers' or regulators' expectations of the Group. Non-compliance may result in regulator enforcement, adverse publicity and financial penalties.	A defined and measurable appetite for conduct risk has been established to ensure commercial decisions take account of conduct risk implications. A management framework has been developed to enable the consistent identification, assessment and mitigation of conduct risks. Embedding of this framework started during 2012 and is continuing in 2013. Grouped under four pillars (employee conduct, corporate conduct, market conduct and conduct towards the Group's customers), each conduct risk policy is designed to ensure the Group meets its obligations and expectations. Awareness initiatives and targeted conduct risk training for each policy, aligned to the phased policy roll-out, have been developed and are being delivered to help embed understanding and provide the necessary clarity. These actions are designed to facilitate effective conduct risk management, and address shortcomings identified through recent instances of inappropriate conduct. Refer to page 193.
Reputational risk	The risk of brand damage and/or financial loss due to the failure to meet stakeholders' expectations of the Group.	Can arise from a range of actions taken (or, in some cases, not taken) by the Group, as well as its wider policies and practices. Can be detrimental to the business in a number of ways, including an inability to build or sustain customer relationships, low staff morale, regulatory censure, or reduced access to funding sources.	The Group Board has ultimate responsibility for managing the Group's reputation, although all parts of the Group have responsibility for any reputational impact arising from their operations. The Board's oversight is supported by executive risk committees (including a new Conduct Risk Committee) and by the Group Sustainability Committee. In 2012, the Group strengthened the alignment of reputational risk management with its strategic objective of serving customers well and with the management of a range of risk types that have a reputational sensitivity. There are still legacy reputational issues to work through, but dealing with them in an open and direct manner is a necessary prerequisite to rebuilding a strong reputation for the Group. Refer to page 194.

Risk appetite and risk governance: Risk coverage* continued

Risk type	Definition	Features	How the Group managed risk and the focus in 2012
Business risk	The risk of losses as a result of adverse variance in the Group's revenues and/or costs relative to its business plan and strategy.	May be caused by internal factors such as volatility in pricing, sales volumes and input costs, and/or by external factors such as exposure to macroeconomic, regulatory and industry risks. Influenced by other risks the Group faces that may contribute to adverse changes in revenues and/or costs, were these risks to crystallise.	The Group seeks to minimise its exposure to business risk, subject to its wider strategic objectives. Business risk is identified, measured and managed through the Group's planning cycles and performance management processes. The Group operates a rolling forecast process which identifies projected changes in, or risks to, operating profit and ensures appropriate action is taken. The management of business risk lies primarily with divisions, with oversight at the Group level led by Finance. During 2012, the Group continued to de-risk its balance sheet and to shrink its more volatile Markets business. The Group has further enhanced its scenario modelling to better understand potential threats to earnings and, to develop appropriate contingency plans. Refer to page 194.
Pension risk	The risk arising from the Group's contractual liabilities to or with respect to its defined benefit pension schemes, as well as the risk that it will have to make additional contributions to such schemes.	Funding position can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities.	The Group manages the risk it faces as a sponsor of its defined pension schemes using a framework that encompasses risk reporting and monitoring, stress testing, modelling and an associated governance structure. This helps ensure the Group is able to fulfil its obligation to support the defined benefit pension schemes to which it has exposure. In 2012, the Group focused on enhancing its pension risk management and modelling systems and implementing a Group pension risk policy standard. Refer to pages 195 and 196.

Each risk type maps into the 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 of the following pages.

** unaudited*

Capital management

40	Introduction
40	2012 achievements
40	Governance and approach
41	Capital ratios
42	Capital resources
42	Flow statement (Basel 2.5)
43	Components of capital (Basel 2.5)
44	Looking forward
44	Basel III
44	Model changes
44	Other regulatory capital changes
44	European Banking Authority (EBA) recommendation

Capital management

Introduction*

RBS Group aims to maintain an appropriate level of capital in each legal entity to meet its business needs and regulatory requirements, and RBS Group operates within an agreed risk appetite.

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

2012 achievements

The Group's Core Tier 1 ratio of 9.5% is higher than at the end of 2011 and the total ratio is 15.4%, despite absorbing regulatory changes and in the face of challenging economic headwinds and continuing costs of de-risking. This reflects continued focus on reshaping the Group's use of capital.

Stress testing analysis shows that the de-risking in the RBS Group has been effective in reducing the impacts of stress scenarios and at the same time the capital ratios have been improving. Changes to the risk profiles as a result of de-risking include run-down of Non-Core, reduction in concentrations, and revising the strategic footprint of the Markets division.

Governance and approach*

The RBS Group Asset and Liability Management Committee (GALCO) is responsible for ensuring RBS Group maintains adequate capital at all times and reviews the plans and outcomes for all the major legal entities of the RBS Group. The Capital and Stress Testing Committee (CAST) is a cross-functional body driving and directing integrated risk capital activities including determination of the amount of capital that should be held, how and where capital is allocated and planning for actions that would ensure that an adequate capital position would be maintained in a stressed environment. 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 the RBS Group through the Internal Capital Adequacy Assessment Process and then agreed between the RBS Group Board and the appropriate supervisory authority. This process includes determination of the target ratios for the regulated entities of the RBS Group, including Group.

RBS Group's own determination of how much capital is sufficient is derived from the desired credit rating level, risk appetite and reflects the current and emerging regulatory requirements of RBS Group.

The RBS Group identifies the management and recovery actions that could be applied to manage the capital position in stress environments. These form an important part of the capital management approach and the contingency planning arrangements, complementing the established buffers.

Monitoring and maintenance*

Based on these determinations, which are continually reassessed, RBS Group aims to maintain capital adequacy, both at the RBS 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 the RBS Group. In the event that the projected position might deteriorate 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 expects to remain adequately capitalised at RBS Group and legal entity level.

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. Principal 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 target returns set by the RBS Group Board. The allocations also reflect strategic priorities, the intensity of regulatory capital use and the usage of other key resources such as balance sheet funding and liquidity.

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 to ensure customer activity is appropriately aligned with RBS Group and divisional targets and allocations.

The Financial Services Authority (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 than 8% with a Tier 1 component of not less than 4%.

** unaudited*

Capital ratios*

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

Capital	2012 £bn	2011 £bn	2010 £bn
Core Tier 1	41.6	36.5	34.5
Core Tier 1 (excluding Asset Protection Scheme (APS))	41.6	39.3	38.7
Tier 1	48.3	43.7	41.6
Total	67.6	58.2	55.8
Risk-weighted assets by risk			
Credit risk			
- non-counterparty	310.0	311.9	349.4
- counterparty	47.4	59.7	51.1
Market risk	39.3	59.4	78.9
Operational risk	41.4	37.0	35.9
	438.1	468.0	515.3
APS relief	—	(69.1)	(105.6)
	438.1	398.9	409.7
Risk asset ratios	%	%	%
Core Tier 1	9.5	9.2	8.4
Core Tier 1 (excluding APS)	9.5	8.4	7.5
Tier 1	11.0	11.0	10.1
Total	15.4	14.6	13.6

Key point

- The Core Tier 1 ratio has improved to 9.5% at 31 December 2012 driven by continued run-down and disposal of Non-Core assets and the reshaping of the balance sheet and capital usage in Markets.

* unaudited

Capital management continued

Capital resources*

Flow statement (Basel 2.5)

The table below analyses the movement in Core Tier 1, Other Tier 1 and Tier 2 capital during the year.

Core Tier 1 capital	2012 £m
At 1 January 2012	36,522
Capital contribution from parent undertaking	2,870
Attributable loss net of movements in fair value of own credit	(1,133)
Ordinary shares issued	706
Share capital and reserve movements in respect of employee share schemes	141
Foreign exchange reserve movements	(788)
Increase in non-controlling interests	9
Decrease in capital deductions including APS first loss	3,966
Increase in goodwill and intangibles	(38)
Defined pension fund movement (net of prudential filter adjustment)	(928)
Other movements	240
At 31 December 2012	41,567
Other Tier 1 capital	
At 1 January 2012	7,187
Foreign exchange movements	(192)
Decrease in Tier 1 deductions	(290)
At 31 December 2012	6,705
Tier 2 capital	
At 1 January 2012	14,813
Dated subordinated debt issued	5,527
Dated subordinated debt redeemed/matured	(3,582)
Foreign exchange movements	(317)
Decrease in capital deductions including APS first loss	4,248
Other movements	(1,163)
At 31 December 2012	19,526
Supervisory deductions	
At 1 January 2012	(295)
Decrease in deductions	65
At 31 December 2012	(230)
Total regulatory capital at 31 December 2012	67,568

* unaudited

Components of capital (Basel 2.5)*

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

	2012 £m	2011 £m	2010 £m
Shareholders' equity (excluding non-controlling interests)			
Shareholders' equity per balance sheet	59,288	61,726	57,010
Other equity instruments	(1,421)	(1,421)	(1,421)
	57,867	60,305	55,589
Non-controlling interests per balance sheet	137	128	597
Regulatory adjustments and deductions			
Own credit	1,563	(1,157)	(622)
Defined pension benefit adjustment	913	—	—
Unrealised gains on AFS debt securities	(1,710)	(2,114)	(843)
Unrealised gains on AFS equity shares	(40)	(106)	(74)
Cash flow hedging reserve	(1,815)	(1,018)	81
Other adjustments for regulatory purposes	10	(230)	(277)
Goodwill and other intangible assets	(12,403)	(12,365)	(11,832)
50% excess of expected losses over impairment provisions (net of tax)	(1,954)	(2,553)	(1,998)
50% of securitisation positions	(1,001)	(1,605)	(1,916)
50% of APS first loss	—	(2,763)	(4,225)
	(16,437)	(23,911)	(21,706)
Core Tier 1 capital	41,567	36,522	34,480
Other Tier 1 capital			
Preference shares - debt	2,759	2,857	2,890
Innovative/hybrid Tier 1 securities	3,551	3,645	3,638
	6,310	6,502	6,528
Tier 1 deductions			
50% of material holdings	(239)	(235)	(242)
Tax on excess of expected losses over impairment provisions	634	920	797
	395	685	555
Total Tier 1 capital	48,272	43,709	41,563
Qualifying Tier 2 capital			
Undated subordinated debt	4,814	4,916	4,925
Dated subordinated debt, net of amortisation	18,121	17,272	18,067
Unrealised gains on AFS equity shares	40	106	74
Collectively assessed impairment provisions	379	584	672
Non-controlling Tier 2 capital	—	11	11
	23,354	22,889	23,749
Tier 2 deductions			
50% of securitisation positions	(1,001)	(1,605)	(1,916)
50% excess of expected losses over impairment provisions	(2,588)	(3,473)	(2,795)
50% of material holdings	(239)	(235)	(242)
50% of APS first loss	—	(2,763)	(4,225)
	(3,828)	(8,076)	(9,178)
Total Tier 2 capital	19,526	14,813	14,571
Supervisory deductions			
Unconsolidated investments	(37)	(111)	(116)
Other deductions	(193)	(184)	(267)
	(230)	(295)	(383)
Total regulatory capital	67,568	58,227	55,751

* *unaudited*

Capital management continued

Looking forward

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 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.

The new capital requirements regulation and capital requirements directive that implement Basel III proposals within the European Union (EU) (collectively known as CRD IV) are in two parts, Capital Requirements Directive (CRD) and the Capital Requirements Regulation. Further technical detail will be provided by the European Banking Authority through its Implementing Technical Standards and Regulatory Technical Standards.

The CRD IV has not yet been finalised and consequently the Basel III implementation date of 1 January 2013 has been missed. While it is anticipated that agreement of the CRD IV will be achieved during 2013, the implementation date remains uncertain.

CRD IV and Basel III will impose a minimum common equity Tier 1 (CET1) ratio of 4.5% of RWAs. There are three buffers which will affect the Group: the capital conservation buffer[1]; the counter-cyclical capital buffer[2] (up to 2.5% of RWAs), to be applied when macro-economic conditions indicate areas of the economy are over-heating; and the Global-Systemically Important Bank (G-SIB) buffer[3], leading to an additional common equity Tier 1 requirement of 4% and a total common equity Tier 1 ratio of 8.5%. The regulatory target capital requirements will be phased in and are expected to apply in full from 1 January 2019.

The changes in the definition of regulatory capital under CRD IV and the capital ratios will be subject to transitional rules:

- The increase in the minimum capital ratios and the new buffer requirements will be phased in over the five years from implementation of the CRD IV;
- The application of the regulatory deductions and adjustments at the level of common equity, including the new deduction for deferred tax assets, will also be phased in over the five years from implementation; the current adjustment for unrealised gains and losses on available-for-sale securities will be phased out; and
- Subordinated debt instruments which do not meet the new eligibility criteria will be will be grandfathered on a reducing basis over ten years.

The RBS Group is well advanced in its preparations to comply with the new requirements based on the draft rules. Given the phasing of both capital requirements and target levels, in advance of needing to comply with the fully loaded end state requirements, the RBS Group will have the opportunity to continue to generate additional capital from earnings and take management actions to mitigate the impact of CRD IV. It is not yet clear how the rules will apply to legal entities within the RBS Group in terms of operation of buffers and target ratios.

The estimated impact on Group RWA at the end of 2012 is c.£31 billion on a fully loaded basis.[4]

The actual impact of CRD IV on capital may be materially different as the requirements and related technical standards have not yet been finalised and will ultimately be subject to application by local regulators. The actual impact will also be dependent on required regulatory approvals and the extent to which further management action is taken prior to implementation.

Model changes

RBS Group, in conjunction with the FSA, regularly evaluates its models for the assessment of RWAs ascribed to credit risk (including counterparty risk) across various classes. This includes implementing changes to the RWA requirements for commercial real estate portfolios consistent with revised industry guidance from the FSA. The changes to the Group's RWAs resulting from model changes during 2012 have increased RWA requirements by £41 billion of which £12 billion relates to property guidance. Further uplifts are expected in 2013 totalling c.£10 billion to £15 billion.

Other regulatory capital changes*

The RBS 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-off and disposal of Non-Core assets and deleveraging in Markets, as the business focuses on the most productive returns on capital.

European Banking Authority (EBA) recommendation

The EBA issued a recommendation in 2011 that the national regulators should ensure that credit institutions build up a temporary capital buffer to reach a 9% Core Tier 1 ratio by 30 June 2012 ('the recapitalisation of EU banks'). In its final report on the recapitalisation exercise in October 2012, the EBA stated that once the CRD IV is finally adopted, the 2011 recommendation would be replaced with a new recommendation. The new recommendation will include the requirement for banks to maintain a nominal amount of Core Tier 1 capital as defined by the EBA for the 2011 stress test and recapitalisation recommendation) corresponding to the amount of 9% of the RWAs at 30 June 2012. RBS Group does not expect the potential floor to become a limiting factor.

Notes:

(1) The capital conservation buffer is set at 2.5% of RWAs and is intended to be available in periods of stress. Drawing on the buffer would lead to a corresponding reduction in the ability to make discretionary payments such as dividends and variable compensation.

(2) The counter-cyclical buffer is institution specific and depends on the RBS Group's geographical footprint and the macroeconomic conditions pertaining in the individual countries in which the RBS Group operates. As there is a time lag involved in determining this ratio, it has been assumed that it will be zero for the time being.

(3) The G-SIB buffer is dependent on the regulatory assessment of the RBS Group. RBS Group has been provisionally assessed as requiring additional CET1 of 1.5% in the list published by the Financial Stability Board (FSB) on 1 November 2012. The FSB list is updated annually. The actual requirement will be phased in from 2016, initially for those banks identified (in the list) as G-SIBs in November 2014.

(4) Based on the following principal assumptions: (i) deductions for financial holdings of less than 10% of CET1 capital have been excluded pending the finalisation of CRD IV rules (ii) RWA uplifts assume approval of all regulatory models and completion of planned management actions (iii) RWA uplifts include the impact of credit valuation adjustments (CVA) and asset valuation correlation on banks and central clearing counterparties (iv) EU corporates, pension funds and sovereigns are assumed to be exempt from CVA volatility charge in calculating RWA impacts (v) includes securitisation positions after planned business reductions (vi) includes methodology changes that take effect immediately on CRD IV implementation.

* unaudited

Liquidity, funding and related risks

46	Introduction
46	Liquidity risk
46	Stress testing
47	Contingency planning
47	Liquidity reserves
48	Regulatory oversight
48	Funding risk
48	Funding sources
48	Central bank funding
48	Balance sheet composition
49	Liquidity and funding risk: Analyses
49	Funding sources
50	- Notes issued
50	- Deposit and repo funding
50	- Customer loan:deposit ratio and funding gap
51	Liquidity portfolio
53	Encumbrance
55	Non-traded interest rate risk
55	- Introduction and methodology
55	- Analyses
55	Value-at-risk
56	Currency risk
56	- Structural foreign currency exposures

Liquidity, funding and related risks

Introduction

Liquidity risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as and when they fall due. Liquidity risk is highly dependent on company specific characteristics such as the maturity profile and composition of the Group's assets and liabilities, the quality and marketable value of its liquidity buffer and broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

Safety and soundness of the balance sheet is one of the central pillars of the Group's restructuring strategy. Effective management of liquidity risk is central to the safety and soundness agenda. The Group's experiences in 2008 have heavily influenced both the Group's and other stakeholders' approach to this area.

Liquidity risk

The Group has in place a comprehensive set of policies to manage liquidity risk that reflects internal risk appetite, best market practice and complies with prevailing regulatory strictures. These policies have been comprehensively updated since 2008 reflecting:

- the Group's experiences in 2008 and 2009;
- the Group's restructuring plan and revised risk appetite and framework;
- regulatory developments and enhancements;
- ongoing instability in global financial markets; and
- more conservative expectations from the Group's various stakeholders.

These policies are designed to address three broad issues which ensure that:

- the Group's main legal entities maintain adequate liquidity resources at all times to meet liabilities as and when they fall due;
- the Group maintains an adequate liquidity buffer appropriate to the business activities of the Group and its risk profile; and
- the Group has in place robust strategies, policies, systems and procedures for identifying, measuring, monitoring and managing liquidity risk.

At its simplest, these policies and the governance and actions they mandate, determine the sources of liquidity risk and the steps the Group can take when these risks exceed certain tolerances which are actively monitored. These include not only when and how to use the Group's liquidity buffer but also what other adjustments to the Group's balance sheet could be undertaken to manage these risks within Group appetite.

These policies are reviewed at least annually or sooner if the Group's own liquidity position changes or if market conditions and/or regulatory rules warrant further amendment or refinement.

During 2012, the Group's liquidity risk management was tested by two different events, the lowering of the Group's credit rating and the technology incident. These two events highlight the variety of circumstances and events through which liquidity risk can materialise.

In the case of the credit rating downgrade by Moody's, the Group was given adequate notice to plan for such an outcome and challenge Moody's analytical approach. Potential or actual changes in the Group's or any of its subsidiaries ratings prompt an intensive internal review of the likelihood and magnitude of such an outcome on customer and counterparty behaviours. These include stress testing and scenario modelling. This analysis was reviewed internally and shared with the FSA. As a precautionary measure the Group increased the size of its liquidity buffer in the period leading up the conclusion of the rating review. Such actions proved unnecessary once Moody's concluded their rating review as there was very limited impact on customer or counterparty behaviour.

Conversely, the technology event could not be foreseen and whilst similar steps to understand the full impact needed to be taken, the process was performed under a vastly compacted timeframe. Both events have demonstrated the considerable progress the Group has made in addressing the sources of liquidity risk and mitigating any impacts, real or reputational.

Stress testing*

The strength of any bank's liquidity risk management can only be evaluated on the Group's ability to survive under stress.

Simulated liquidity stress testing is regularly performed for each business as well as the major operating subsidiaries. Stress tests are designed to look at the impact of a variety of firm-specific and market-related scenarios on the future adequacy of the Group's liquidity resources. Stress tests can be run at any time in response to the emergence of one of these risks.

Scenarios include assumptions about significant changes in key funding sources, external credit ratings, contingent uses of funding, and political and economic conditions or events in particular countries. For example, during 2012 the Group undertook a specific series of stress tests to assess the likely worst case impact associated with a one notch downgrade to the Group's credit rating by Moody's. Stress scenarios are applied to both on-balance sheet instruments and off-balance sheet activities, to provide a comprehensive view of potential cash flows.

In determining the adequacy of the Group's liquidity resources the Group focuses on the stressed outflows it could be anticipated to experience as a result of any stress scenario occurring. These outflows are measured as occurring over certain time periods which extend from any given day out to two weeks, to as long as three months. The Group is expected to be able to withstand these stressed outflows through its own resources (principally the use of the liquidity buffer) over these time horizons without having to revert to extraordinary central bank or governmental assistance.

** unaudited*

The Group's actual experiences from the 2008 and 2009 period have factored heavily into the liquidity analysis in the past, although more recent market conditions and events provide more up-to-date data for scenario modelling. Stress tests are augmented from time to time to reflect firm-specific or emerging market risks that could have a material impact on the Group's liquidity position.

The Group's liquidity risk appetite is measured by reference to the liquidity buffer as a percentage of stressed contractual and behavioural outflows under the worst of three severe stress scenarios as envisaged under the FSA regime. Liquidity risk is expressed as a surplus of liquid assets over three months' stressed outflows under the worst of a market-wide stress, an idiosyncratic stress and a combination of both.

The results of stress testing are an active part of management and strategy in balance sheet management and inform allocation, target and limit discussions. In short, limits in the business-as-usual environment are bounded by capacity to satisfy the Group's liquidity needs in the stress environments.

Key liquidity risk stress testing assumptions

- *Net wholesale funding* - Outflows at contractual maturity of wholesale funding and conduit commercial paper, with no rollover/new issuance. Prime Brokerage, 100% loss of excess client derivative margin and 100% loss of excess client cash.

- *Secured financing and increased haircuts* - Loss of secured funding capacity at contractual maturity date and incremental haircut widening, depending upon collateral type.

- *Retail and commercial bank deposits* - Substantial outflows as the Group could be seen as a greater credit risk than competitors.

- *Intra-day cash flows* - Liquid collateral held against intra-day requirement at clearing and payment systems is regarded as encumbered with no liquidity value assumed. Liquid collateral is held against withdrawal of unsecured intra-day lines provided by third parties.

- *Intra-group commitments and support* - Risk of cash within subsidiaries becoming unavailable to the wider Group and contingent calls for funding on Group Treasury from subsidiaries and affiliates.

- *Funding concentrations* - Additional outflows recognised against concentration of providers of wholesale secured financing.

- *Off-balance sheet activities* - Collateral outflows due to market movements, and all collateral owed by the Group to counterparties but not yet called; anticipated increase in firm's derivative initial margin requirement in stress scenarios; collateral outflows contingent upon a multi-notch credit rating downgrade of Group firms; drawdown on committed facilities provided to corporates, based on counterparty type, creditworthiness and facility type; and drawdown on retail commitments.

- *Franchise viability* - Group liquidity stress testing includes additional liquidity in order to meet outflows that are non-contractual in nature, but are necessary in order to support valuable franchise businesses.

- *Management action* - Unencumbered marketable assets that are held outside of the Core liquidity buffer and are of verifiable liquidity value to the firm, are assumed to be monetised (subject to haircut/valuation adjustment).

Contingency planning

The Group has a Contingency Funding Plan (CFP), which is updated as the balance sheet evolves and forms the basis of analysis and actions to remediate adverse circumstances as and if they arise. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. The CFP provides a detailed description of the availability, size and timing of all sources of contingent liquidity available to the 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 processes for actions that may be required to meet the outflows. Roles and responsibilities for the effective implementation of the CFP are also documented.

Liquidity reserves

Liquidity risks are mitigated by the Group's centrally managed liquidity buffer. The size of the reserve is an output from internal modelling and the FSA's ILG. The majority of the portfolio is held in the FSA regulated UK Defined Liquidity Group (UK DLG) comprising the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company.

Certain of the Group's significant operating subsidiaries - RBS Citizens Financial Group Inc. and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations but may differ with FSA rules. These portfolios are the responsibility of the local Treasurer who reports to the Group Treasurer.

The Group's liquidity buffer is managed by Group Treasury and is the responsibility of the Group Treasurer. The liquidity buffer is ring-fenced from the trading book within the Markets division. The liquidity buffer is actively managed so as to balance its liquidity value relative to the margin impact of maintaining a large and high quality investment portfolio. This is in line with internal liquidity risk policy and appetite and regulatory guidance. The portfolio is accounted for on an available-for-sale basis. The value of the portfolio can move up and down based on a variety of market movements. Gains can and will be taken through sales of portfolios. Such sales and gains are part of normal portfolio management and these gains can be used to offset costs in other parts of the Group.

The Group analyses its liquidity buffer including its locally managed liquidity pools into primary and secondary liquidity groups.
The primary liquidity group generally reflects eligible liquid assets, such as cash and balances at central banks, treasury bills and other high quality government and agency bonds, and other local primary qualifying liquid assets for each of the significant operating subsidiaries that maintain a local liquidity pool.

Liquidity risk: Liquidity reserves continued

Secondary liquidity assets represent other qualifying liquid assets that are eligible for local central bank liquidity facilities but do not meet the core local regulatory definition. For example, secondary liquid assets include self-issued securitisations or covered bonds that are retained on balance sheet and pre-positioned with a central bank so that they can be converted into additional sources of liquidity at very short notice.

The Group in consultation with the FSA and subject to the requirements of the FSA's Industrial Liquidity Guidance can change the composition of its liquidity buffer. The change in composition may relate to market specific factors, changes in internal liquidity risk mix or regulatory guidance. This occurred in 2012 when the FSA agreed to recognise an increase in the amount of secondary liquidity assets and a reduction in primary assets. Such a change was made possible in conjunction with the introduction of the Funding for Lending Scheme. The reduction in the balance of primary assets was also beneficial to the Group's margin.

Regulatory oversight

The 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 as documented in PS 09/16, on 1 June 2010. The new rules provide a standardised approach applied to all UK banks and all building societies as well as branches and subsidiaries of foreign financial firms. The rules focus on the UK DLG and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment.

In addition, 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.

Funding risk

As noted earlier, the Group actively participates in the broader international debate and process regarding further reform and refinement of liquidity risk oversight and policies, and will seek to adopt commonly agreed upon measures where there is consistent alignment between domestic and international regulators.

Funding sources

The Group has access to a variety of wholesale funding sources across the globe, including short-term money markets and term debt investors through its secured and unsecured funding programmes. These sources of funding are complementary to the Group's customer deposit gathering activities.

Diversity in funding is provided by its active role in the money markets, along with access to global capital flows through the Group's international client base. These funding programmes allow the Group (or its subsidiaries) to issue secured or unsecured, senior or subordinated securities. Over time the Group's wholesale funding franchise has been diversified by currency, geography, maturity and type.

The Group accesses the market directly or through one of its main operating subsidiaries through established funding programmes. The use of different entities to access the market from time to time allows the Group to further diversify its funding profile, take advantage of different benefits offered by using these entities, and in certain limited circumstances demonstrate to regulators that specific operating subsidiaries enjoy market access in their own right. This flexibility will become increasingly important in the future as the Group moves towards complying with the Independent Commission on Banking recommendations.

Central bank funding*

The Group may access various funding facilities offered by central banks from time to time. The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the Group's broader liquidity management and funding strategy. Overall usage and repayment of available central bank facilities will fit within the Group's overall liquidity risk appetite and concentration limits contained therein so as not to create outsized maturity exposures.

During 2012, the Group drew down €6.5 billion of funding under the European Central Bank's Long Term Refinancing Operation and £750 million of treasury bills under the Bank of England's Funding for Lending Scheme.

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 the liquidity profile 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 Group's lending.

The Group also accesses wholesale markets 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 Group's structural liquidity needs and, in some cases, achieves certain capital objectives.

** unaudited*

Liquidity and funding risk: Analyses

Funding sources

The table below shows the Group's principal funding sources excluding repurchase agreements.

	2012			2011			2010		
	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									
derivative cash collateral	27,631	—	27,631	30,884	—	30,884	26,639	—	26,639
other deposits	24,243	6,063	30,306	27,368	11,945	39,313	23,627	6,626	30,253
	51,874	6,063	57,937	58,252	11,945	70,197	50,266	6,626	56,892
Debt securities in issue									
conduit asset-backed commercial paper (ABCP)	—	—	—	11,164	—	11,164	15,075	—	15,075
other commercial paper (CP)	806	—	806	3,031	—	3,031	4,689	—	4,689
certificates of deposit (CDs)	2,907	—	2,907	14,422	—	14,422	35,370	—	35,370
medium-term notes (MTNs)	58,152	—	58,152	88,405	—	88,405	86,606	—	86,606
covered bonds	10,139	—	10,139	9,107	—	9,107	4,100	—	4,100
securitisations	11,274	—	11,274	14,708	—	14,708	18,822	—	18,822
	83,278	—	83,278	140,837	—	140,837	164,662	—	164,662
Subordinated liabilities	15,667	18,184	33,851	16,552	15,772	32,324	16,995	15,028	32,023
Notes issued	98,945	18,184	117,129	157,389	15,772	173,161	181,657	15,028	196,685
Wholesale funding	150,819	24,247	175,066	215,641	27,717	243,358	231,923	21,654	253,577
Customer deposits									
cash collateral	7,941	—	7,941	9,025	—	9,025	9,623	—	9,623
other deposits	417,499	5,778	423,277	393,827	3,179	397,006	376,902	8,934	385,836
Total customer deposits	425,440	5,778	431,218	402,852	3,179	406,031	386,525	8,934	395,459
Total funding	576,259	30,025	606,284	618,493	30,896	649,389	618,448	30,588	649,036

Disposal group deposits included above	2012	2011	2010
banks	—	—	266
customers	18	21,820	900
	18	21,820	1,166

The table below shows the Group's wholesale funding by source.

	Short-term wholesale funding (1)		Total wholesale funding		Net inter-bank funding (2)		
	Excluding derivative collateral £bn	Including derivative collateral £bn	Excluding derivative collateral £bn	Including derivative collateral £bn	Deposits £bn	Loans (3) £bn	Net inter-bank funding £bn
2012	33.7	61.3	147.4	175.1	24.2	(14.3)	9.9
2011	84.7	115.6	212.5	243.4	27.4	(14.1)	13.3
2010	101.6	128.2	227.0	253.6	23.6	(17.6)	6.0

Notes:
(1) Short-term wholesale balances denote those with a residual maturity of less than one year and include longer-term issuances.
(2) Excludes derivative collateral.
(3) Primarily short-term balances.

Key points

- Short-term wholesale funding excluding derivative collateral declined £51.0 billion from £84.7 billion to £33.7 billion, primarily due to a decrease of £46.1 billion in debt securities in issue with a maturity of less than one year.
- Customer deposits excluding derivative collateral but including disposal groups increased from £393.8 billion at 31 December 2011 to £417.5 billion.

Liquidity and funding risk: Analyses: Funding sources continued

Notes issued

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

	Debt securities in issue								
2012	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	—	3,323	9,425	1,038	761	14,547	2,385	16,932	15
1-3 years	—	384	17,684	2,948	500	21,516	4,624	26,140	22
3-5 years	—	1	12,300	2,380	—	14,681	1,055	15,736	13
More than 5 years	—	5	18,743	3,773	10,013	32,534	25,787	58,321	50
	—	3,713	58,152	10,139	11,274	83,278	33,851	117,129	100
2011									
Less than 1 year	11,164	17,173	32,278	—	27	60,642	684	61,326	35
1-3 years	—	278	19,702	2,760	479	23,219	3,389	26,608	15
3-5 years	—	1	13,236	3,673	—	16,910	4,971	21,881	13
More than 5 years	—	1	23,189	2,674	14,202	40,066	23,280	63,346	37
	11,164	17,453	88,405	9,107	14,708	140,837	32,324	173,161	100
2010									
Less than 1 year	15,075	39,344	25,726	—	88	80,233	1,076	81,309	41
1-3 years	—	700	32,850	1,078	12	34,640	269	34,909	18
3-5 years	—	10	11,493	1,294	34	12,831	6,748	19,579	10
More than 5 years	—	5	16,537	1,728	18,688	36,958	23,930	60,888	31
	15,075	40,059	86,606	4,100	18,822	164,662	32,023	196,685	100

Deposit and repo funding

The table below shows the composition of the Group's deposits excluding repos and repo funding.

	2012		2011		2010	
	Deposits £m	Repos £m	Deposits £m	Repos £m	Deposits £m	Repos £m
Financial institutions						
- central and other banks	57,937	44,323	70,197	38,900	56,892	28,594
- other financial institutions	64,435	86,940	63,370	86,032	70,512	75,782
Personal and corporate deposits	366,783	1,057	342,661	2,145	324,947	1,984
	489,155	132,320	476,228	127,077	452,351	106,360

Customer loan:deposit ratio and funding gap

The table below shows loans, deposits, customer loan:deposit ratio (LDR) and customer funding gap.

	Loans (1) £m	Deposits (2) £m	LDR (3) %	Funding surplus/(gap) (3) £m
2012	423,191	425,440	99	2,249
2011	446,073	402,852	111	(43,221)
2010	470,099	386,525	122	(83,574)

Notes:
(1) Loans and advances to customers excludes reverse repurchase agreements and stock borrowing and amounts due from holding company and fellow subsidiaries and includes disposal groups.
(2) Excludes repurchase agreements, stock lending and amounts due from holding company and fellow subsidiaries and includes disposal groups.
(3) Based on loans and advances to customers net of provisions and customer deposits as shown.

Liquidity portfolio

The table below analyses the Group's liquidity portfolio by product and between the UK Defined Liquidity Group (UK DLG), RBS Citizens Financial Group Inc. (CFG) and other subsidiaries, by liquidity value. Liquidity value is lower than carrying value principally as it is stated after the discounts applied by the Bank of England and other central banks to loans, within secondary liquidity portfolio, eligible for discounting.

	Liquidity value				
	Period end				
2012	UK DLG (1) £m	CFG £m	Other £m	Total £m	Average* £m
Cash and balances at central banks	64,822	891	38	65,751	71,290
Central and local government bonds					
AAA rated governments and US agencies	3,984	5,354	—	9,338	18,133
AA- to AA+ rated governments (2)	9,189	—	—	9,189	8,026
	13,173	5,354	—	18,527	26,159
Treasury bills	750	—	—	750	202
Primary liquidity	78,745	6,245	38	85,028	97,651
Other assets (3)					
AAA rated	3,396	7,373	—	10,769	16,050
below AAA rated and other high quality assets	44,090	—	557	44,647	23,951
Secondary liquidity	47,486	7,373	557	55,416	40,001
Total liquidity portfolio	126,231	13,618	595	140,444	137,652
Carrying value	157,574	20,524	2,109	180,207	
2011					
Cash and balances at central banks	55,100	1,406	1,426	57,932	65,881
Central and local government bonds					
AAA rated governments and US agencies	22,563	7,044	25	29,632	34,114
AA- to AA+ rated governments (2)	14,102	—	—	14,102	1,682
governments rated below AA	—	—	—	—	4
local government	—	—	—	—	15
	36,665	7,044	25	43,734	35,815
Treasury bills	—	—	—	—	5,937
Primary liquidity	91,765	8,450	1,451	101,666	107,633
Other assets (3)					
AAA rated	17,216	4,718	—	21,934	17,874
below AAA rated and other high quality assets	6,105	—	2,142	8,247	9,683
Secondary liquidity	23,321	4,718	2,142	30,181	27,557
Total liquidity portfolio	115,086	13,168	3,593	131,847	135,190
Carrying value	135,754	25,624	8,526	169,904	

For the notes to this table refer to the following page.

** unaudited*

Liquidity and funding risk: Analyses: Liquidity portfolio continued

2010	Liquidity value Period end UK DLG (1) £m	CFG £m	Other £m	Total £m
Cash and balances at central banks	43,804	2,314	367	46,485
Central and local government bonds				
AAA rated governments and US agencies	32,337	4,830	—	37,167
AA- to AA+ rated governments (2)	2,404	—	—	2,404
	34,741	4,830	—	39,571
Treasury bills	14,529	—	—	14,529
Primary liquidity	93,074	7,144	367	100,585
Other assets (3)				
AAA rated	7,787	—	3,358	11,145
below AAA rated and other high quality assets	8,313	4,601	604	13,518
Secondary liquidity	16,100	4,601	3,962	24,663
Total liquidity portfolio	109,174	11,745	4,329	125,248
Carrying value	120,178	18,055	4,329	142,562

Notes:
(1) The FSA regulated UK Defined Liquidity Group comprises the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company. In addition, certain of the Group's significant operating subsidiaries, RBS Citizens Financial Group Inc. and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations that may differ from FSA rules.
(2) Includes US government guaranteed and US government sponsored agencies.
(3) Includes assets eligible for discounting at the Bank of England and other central banks.

Encumbrance

The Group reviews all assets against the criteria of being able to finance them in a secured form (encumbrance) but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity, predictable and measurable cash flows, and a consistent and uniform underwriting and collection process. Retail assets including residential mortgages, credit card receivables and personal loans display many of these features.

From time to time the Group encumbers assets to serve as collateral to support certain wholesale funding initiatives. The three principal forms of encumbrance are own asset securitisations, covered bonds and securities repurchase agreements. The Group categorises its assets into three broad groups; assets that are:

- already encumbered and used to support funding currently in place via own asset securitisations, covered bonds and securities repurchase agreements.
- not currently encumbered but can for instance be used to access funding from market counterparties or central bank facilities as part of the Group's contingency funding.
- not currently encumbered. In this category, the Group has in place an enablement programme which seeks to identify assets which are capable of being encumbered and to identify the actions to facilitate such encumbrance whilst not impacting customer relationships or servicing.

The Group's encumbrance ratios are set out below.

Encumbrance ratios	2012 %	2011 %
Total	18	20
Excluding balances relating to derivative transactions	22	28
Excluding balances relating to derivative and securities financing transactions	12	21

Own-asset securitisations

The Group has a programme of own-asset securitisations where assets are transferred to bankruptcy remote special purpose entities (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. The following table shows the asset categories together with the carrying amounts of the assets and associated liabilities, for both own-asset securitisations where the debt securities issued are held by third parties and those where the debt securities issued are held by the Group.

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 associated with these loans, the partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds in issue included within debt securities in issue. The following table shows the asset categories and the carrying amounts of those assets and of the covered bonds issued.

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions (repos) 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 (which is equivalent to the 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.

Liquidity and funding risk: Analyses: Encumbrance continued

Assets encumbrance

2012	Encumbered assets relating to: Debt securities in issue: Securitisations and conduits £bn	Covered bonds £bn	Other secured liabilities: Derivatives £bn	Repos £bn	Secured borrowings £bn	Total encumbered assets £bn	Encumbered assets as a % of related total assets	Liquidity portfolio £bn	Other £bn	Total third party £bn	Balances with holding company and fellow subsidiaries £bn	Total £bn
Cash and balances at central banks	5.3	0.5	—	—	—	5.8	8	65.8	2.9	74.5	—	74.5
Loans and advances to banks (1)	—	—	11.6	—	—	11.6	45	—	14.1	25.7	21.9	47.6
Loans and advances to customers (1)												
- UK residential mortgages	16.4	16.0	—	—	—	32.4	30	58.7	18.0	109.1	—	109.1
- Irish residential mortgages	10.6	—	—	—	1.8	12.4	81	—	2.9	15.3	—	15.3
- US residential mortgages	—	—	—	—	—	—	—	7.6	14.1	21.7	—	21.7
- UK credit cards	3.0	—	—	—	—	3.0	44	—	3.8	6.8	—	6.8
- UK personal loans	4.7	—	—	—	—	4.7	62	—	2.9	7.6	—	7.6
- other	19.9	—	22.2	—	0.8	42.9	16	6.6	212.9	262.4	1.9	264.3
Debt securities	1.0	—	8.3	87.2	7.3	103.8	76	18.9	13.7	136.4	0.2	136.6
Equity shares	—	—	0.7	6.8	—	7.5	54	—	6.4	13.9	—	13.9
	60.9	16.5	42.8	94.0	9.9	224.1		157.6	291.7	673.4	24.0	697.4
Own asset securitisations								22.6				
Total liquidity portfolio								180.2				
Liabilities secured												
Inter Group - used for secondary liquidity	(22.6)	—	—	—	—	(22.6)						
Inter Group - other	(23.9)	—	—	—	—	(23.9)						
Third party (2)	(11.3)	(10.1)	(56.7)	(132.3)	(12.4)	(222.8)						
	(57.8)	(10.1)	(56.7)	(132.3)	(12.4)	(269.3)						
Total assets						1,253						
Total assets excluding derivatives						816						
Total assets excluding derivatives and reverse repos						711						

Notes:
(1) Excludes reverse repos.
(2) In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

Non-traded interest rate risk

Introduction and methodology

Non-traded interest rate risk impacts earnings arising from the Group's banking activities. This excludes positions in financial instruments which are classified as held-for-trading, or hedging items.

The Group provides a range of financial products to meet a variety of customer requirements. These products differ with regard to repricing frequency, tenor, indexation, prepayments, optionality and other features. When aggregated, they form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates.

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 net interest income 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 policy is to manage interest rate sensitivity in banking book portfolios within defined risk limits. With the exception of CFG and Markets, interest rate risk is transferred from the divisions to Group Treasury. Aggregate positions are then hedged externally using cash and derivative instruments, primarily interest rate swaps, to manage exposures within Group Asset and Liability Management Committee (GALCO) approved limits.

The Group assesses interest rate risk in the banking book (IRRBB) using a set of standards to define, measure and report the risk. These standards incorporate the expected divergence between contractual terms and the actual behaviour of fixed rate loan portfolios due to refinancing incentives and the risks associated with structural hedges of interest rate insensitive balances, which relates to the stability of the underlying portfolio.

Key measures used to evaluate IRRBB are subject to approval by divisional Asset and Liability Management Committees (ALCOs) and GALCO. Limits on IRRBB are proposed by the Group Treasurer for approval by the Executive Risk Forum annually. Residual risk positions are reported on a regular basis to divisional ALCOs and monthly to the RBS Group Balance Sheet Management Committee, GALCO, the Executive Risk Forum and the RBS Group Board.

The Group uses a variety of approaches to quantify its interest rate risk encompassing both earnings and value metrics. 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 earnings sensitivity over time against movements in interest rates.

Analyses

Value-at-risk

VaR metrics are based on interest rate repricing gap reports as at the reporting date. These incorporate customer products and associated funding and hedging transactions as well as non-financial assets and liabilities such as property, plant and equipment, capital and reserves. Behavioural assumptions are applied as appropriate.

The VaR does not provide a dynamic measurement of interest rate risk since static underlying repricing gap positions are assumed. Changes in customer behaviour under varying interest rate scenarios are captured by way of earnings risk measures. IRRBB VaR for the Group's Retail and Commercial banking activities at 99% confidence level and currency analysis of period end VaR were as follows:

	Average £m	Period end £m	Maximum £m	Minimum £m
2012	132	59	183	59
2011	156	153	177	109
2010	114	193	193	65

	2012 £m	2011 £m	2010 £m
Euro	24	31	37
Sterling	33	58	107
US dollar	67	162	232
Other	1	3	5

Key points

- Interest rate VaR at 31 December 2012 was 61% lower than at 31 December 2011 and the average exposure was 15% lower in 2012 than in 2011.
- The reduction in VaR reflects closer matching of the Group's structural interest rate hedges to the behavioural maturity profile of the hedged liabilities, as well as changes to the VaR methodology.
- It is estimated that the change in VaR methodology reduced VaR by £16 million (17%) on implementation.

Liquidity and funding risk: Analyses continued

Currency risk

Structural foreign currency exposures

The Group does not maintain material non-traded open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding.

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

2012	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
US dollar	16,194	(1,386)	14,808
Euro	7,271	(199)	7,072
Swiss franc	1,122	(1,045)	77
Other non-sterling	1,439	(1,011)	428
	26,026	(3,641)	22,385
2011			
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

Key points

- The Group's structural foreign currency exposure at 31 December 2012 was £22.4 billion, an increase of £1.2 billion from the end of 2011, due to a combination of increased net euro and minor currency investments, and increased dollar hedging.
- 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 £1.2 billion (2011 - £1.1 billion; 2010 - £1.0 billion) in equity, while a 5% weakening would result in a loss of £1.1 billion (2011 - £1.0 billion; 2010 - £0.9 billion) in equity.

Credit risk

58	Introduction
58	Top and emerging credit risks
59	Objectives, organisation and governance
60	Credit risk management framework
60	- Risk appetite and concentration risk management
60	- Product/asset class
60	- Sector concentration
61	- Single-name concentration
61	- Country
61	Controls and assurance
61	Credit risk measurement
62	Probability of default/customer credit grade
62	Exposure at default models
62	Loss given default models
62	Changes to wholesale credit risk models
63	Credit risk mitigation
63	Approaches and methodologies
63	Corporate exposures
64	- commercial real estate
64	- other corporate
65	Wholesale market exposures
65	Retail
66	Residential mortgages
67	Early problem identification and problem debt management
67	Wholesale customers
67	- Early problem recognition
67	- Watchlist
67	- Global Restructuring Group (GRG)
68	- Wholesale renegotiations
69	- Wholesale renegotiations during the year by sector
70	- Provisioning for wholesale renegotiated customers
70	- Recoveries and active insolvency management
70	Retail customers
70	- Collections and recoveries
70	- Retail forbearance
70	- Identification of forbearance
71	- Types of retail forbearance
71	- Arrears status and provisions
72	- Forbearance arrangements
73	- Provisioning for retail customers
74	Key credit portfolios
74	Commercial real estate
79	Residential mortgages
82	Personal lending
83	Ulster Bank Group (Core and Non-Core)

Credit risk

Introduction

Credit risk is the risk of financial loss due to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts. The credit risk that the Group faces arises mainly from wholesale and retail lending, provision of contingent obligations (such as letters of credit and guarantees) and counterparty credit risk arising from derivative contracts and securities financing transactions entered into with customers. Other material risks covered by the Group's credit risk management framework are:

- *Concentration risk* - the risk of an outsized loss due to the concentration of credit risk to a specific asset class or product, industry sector, customer or counterparty, or country.
- *Settlement risk* - the intra-day risk that arises when the Group releases funds prior to confirmed receipt of value from a third party.
- *Issuer risk* - the risk of loss on a tradable instrument (e.g. a bond) due to default by the issuer.
- *Wrong way risk* - the risk of loss that arises when the risk factors driving the exposure to a counterparty are positively correlated with the probability of default for that counterparty.
- *Credit mitigation risk* - the risk that credit risk mitigation (for example, taking a legal charge over property to secure a customer loan) is not enforceable or that the value of such mitigation decreases, thus leading to unanticipated losses.

Top and emerging credit risks*

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. The Group therefore remains sensitive to the economic conditions within the geographies in which it operates, in particular the UK, Ireland, the US and the eurozone.

The following credit risks continue to be the focus of management attention.

Irish property market

The continuing challenging economic climate within Ireland has resulted in impairment levels for Irish portfolios remaining at elevated levels. In particular, high unemployment, austerity measures and general economic uncertainty have reduced real estate lease rentals. This, together with limited liquidity, has depressed asset values and reduced consumer spending with a consequent downward impact on the commercial real estate portfolio as well as broader impacts on Ulster Bank Group's mortgage and small and medium enterprise (SME) lending portfolios. Further details on Ulster Bank Group's credit risk profile can be found on pages 83 to 85.

Commercial real estate

While progress has been made in reducing the overall exposure and rebalancing the portfolio, commercial real estate remains a key credit concentration risk for the Group. The Group has continued to strengthen its approach to managing sector concentration risk, with a particular focus on additional controls for the commercial real estate portfolio.

However, the credit performance remains sensitive to the economic environment in the UK and Ireland. Although some improvements have been seen in commercial real estate values across prime locations, secondary and tertiary values remain subdued.

Refinancing risk remains a focus of management attention and is assessed throughout the credit risk management life cycle. In particular, it is considered as part of the early problem recognition and impairment assessment processes.

Further details on the Group's exposure to commercial real estate can be found on pages 74 to 78.

Eurozone troubles

The ongoing impact of the troubles in the eurozone continued to be felt most significantly in the banking sector, where widening credit spreads and regulatory demand for increases in Tier 1 capital and liquidity exacerbated the risk management challenges already posed by the sector's continued weakness, as provisions and write-downs remain elevated.

A material percentage of global banking activity in risk mitigation now passes through the balance sheets of the top global players, increasing the systemic risks to the banking sector. The Group's exposures to these banks continue to be closely managed. In particular, the Group has intensified its management of settlement risk through ongoing review of the level of risk and the operational controls in place to manage it, together with proactive actions to reduce limits. The weaker banks in the eurozone also remained subject to heightened scrutiny and the Group's risk appetite for these banks was adjusted throughout 2012.

The Group has continued to focus on operational preparations for possible sovereign defaults and/or eurozone exits. The Group has also considered initiatives to determine and reduce redenomination risk. Further actions to mitigate risks and strengthen control in the eurozone typically included taking guarantees or insurance, updating collateral agreements, and tightening certain credit pre-approval processes.

Further details on the Group's approach to managing country risk and the risks faced within the eurozone can be found on pages 156 to 184.

* unaudited

Shipping
The downturn observed in the shipping sector since 2008 has continued, with an oversupply of vessels leading to lower asset prices and charter rates. The Group has continued to manage exposures within this portfolio intensively, with an increasing number of customers managed under the Group's Watchlist process (see page 67 for a description of this process). The financed fleet comprises modern vessels with experienced operators and despite the difficult market conditions impairments to date have remained low. However, impairment levels remain vulnerable to a continuing underperforming market.

Retailers
Given the cyclical nature of the retail corporate sector and its sensitivity to stressed economic conditions, the Group has continued to apply heightened scrutiny to this portfolio. Despite some high-profile failures of UK high street retailers, loss experience on the RBS retail portfolio remained low during 2012 as a result of active management. The portfolio is generally well diversified by geography and by counterparty.

Renegotiations and forbearance
Loan modifications take place in a variety of circumstances including but not limited to a customer's current or potential credit deterioration. Where the contractual payment terms of a loan have been changed because of the customer's financial difficulties, it is classified as 'renegotiated' in the wholesale portfolio and as 'forbearance' in the retail portfolio.

RBS uses renegotiations and forbearance as management tools to support viable customers through difficult financial periods in their lives or during business cycles. Used wisely, they can reduce the incidence of personal insolvency, as well as bankruptcies for otherwise successful enterprises. On a broader scale they can also help reduce the impact of "fire sale" pricing on real economic assets. However, they must be used selectively and require additional management vigilance throughout the loan life cycle. The Group has continued to take steps to improve its management and reporting of such loans within both corporate and retail businesses. More details of the Group's approach can be found on pages 68 to 74.

Objectives, organisation and governance
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 RBS 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 approved risk appetite.

Responsibility for development of, and compliance with, Group-wide policies and credit risk frameworks and Group-wide assessment of provision adequacy resides with 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 Group's business divisions.

The divisional credit risk management functions work together with GCR to ensure that the risk appetite set by the Group Board 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, ongoing credit risk stewardship, and early problem recognition and management.

Material aspects of the Group's credit risk management framework, such as credit risk appetite and limits for portfolios of strategic significance, are considered and approved by the Executive Risk Forum (ERF). The ERF has delegated approval authority to the Group Credit Risk Committee, a functional sub-committee of the Group Risk Committee, to act on credit risk matters. These include, but are not limited to, credit risk appetite and limits (within the overall risk appetite set by the Board and the ERF), credit risk strategy and frameworks, credit risk policy and the oversight of the credit profile across the Group.

The Group Credit Risk Committee is chaired by the RBS Group Chief Credit Officer and has representation from each of the Group's divisional credit risk functions. Monthly updates are provided to the Group Risk Committee on key matters approved under delegated authority by the RBS Group Credit Risk Committee, performance against limits, and emerging issues, to enable it to fulfil its role as an oversight committee.

Oversight of the Group's provision adequacy is provided by the RBS Group Audit Committee.

Key trends in the credit risk profile of the Group, performance against limits and emerging risks are set out in the RBS Risk Management Monthly Report provided to the Group Board, the Executive Committee and the Board Risk Committee.

The Group has established an appropriate and comprehensive framework for the management of credit risk that includes governance structures, risk appetite and concentration frameworks, policies, measurement and reporting tools and independent assurance.

In order to strengthen this framework and ensure consistent application across the Group, during 2012 the GCR function launched a set of credit control standards, to supplement the existing policy suite. These standards address divisional governance and policy requirements and reflect a set of behavioural, organisational and management norms that drive a sound divisional control environment and embed a strong risk culture.

Credit risk management framework

Risk appetite and concentration risk management

Risk appetite has been expressed by the Group Board through the setting of specific quantitative risk appetite targets under stress (refer to page 33). Of particular relevance in the management of credit risk are the targets for earnings volatility and capital adequacy. The Group's credit risk framework has therefore been designed around the factors that influence the Group's ability to meet these targets. These include the limiting of excess credit risk concentrations by product/asset class, industry sector, customer or counterparty (i.e. single name) and country any of which could generate higher volatility under stress and, if not adequately controlled, can undermine capital adequacy.

The frameworks are supported by a suite of Group-wide and divisional policies that set out the risk parameters within which business units must operate.

The management of concentration risk and associated limits are firmly embedded in the risk management processes of the Group and form a pivotal part of the Risk function's engagement with the businesses on the appropriateness of risk appetite choices. The ERF, or delegated committee, 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 Group's risk appetite in areas where it faces significant balance sheet concentrations or franchise challenges. The need to control concentrations must at all times be balanced against the need to ensure sufficient capacity within credit limits to support customers of sound credit quality, in particular within retail and small business customer segments.

During 2012, the credit risk function expanded the scope of its credit risk appetite controls through the active management of non-financial risks in the Group's lending decisions. The development of Environmental, Social and Ethical (ESE) risk policies for sectors considered to present a higher reputational risk (such as the defence, oil and gas sectors) provide a framework within which the Group can better manage its reputational risks. This ESE framework forms part of a wider initiative by the Group to improve reputational risk management and build trust with its stakeholders.

Product/asset class

- *Retail* - A formal framework establishes RBS Group-level statements and thresholds that are cascaded through all retail franchises in the 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 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 scores and strategies are data driven and utilise a wide range of credit information relating to the customer including, where appropriate, information on the customer's credit performance across their existing account holdings both with the bank and with other lenders. 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 Group, where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. Those portfolios identified as potentially representing a concentration or heightened risk are subject to formal governance, including periodic review, at either Group or divisional level, depending on materiality.

Sector concentration

Across wholesale portfolios, exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Through this sector framework, risk 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 Group or divisional level depending on materiality. These may include an assessment of the Group's franchise in a particular sector, an analysis of the outlook (including downside outcomes), identification of key vulnerabilities and stress/scenario tests.

The focus during 2012 was on embedding sector and sub-sector specific appetite within divisional policies and processes and on setting appropriate controls. This includes strengthening portfolio controls on key metrics and lending parameters, and the ongoing development of sector-specific lending policies.

As a result of the reviews carried out in 2012, the Group has reduced its risk appetite in the most material corporate sectors of commercial real estate and retail. For further details on sector-specific strategies, exposure reduction and key credit risks, refer to pages 78 to 85.

Single-name concentration*

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 sometimes 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. While 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.

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.

A number of credit risk mitigation techniques are available to reduce single name concentrations. To be considered suitable, credit risk mitigants must be effective in terms of legal certainty and enforceability and maturity/expiry dates must be the same or later than the underlying obligations. Typical mitigant types include, cash, bank/government guarantees, and credit default swaps (CDS).

Since 2009, the Group has been managing its corporate exposures to reduce concentrations and align its appetite for future business to the Group’s broader strategies for its large corporate franchises. The 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 Group’s risk measurement models.

In 2012, the Group implemented further refinements to the single name exposure management controls already in place which allows the Group to differentiate more consistently between the different product types.

Country

For information on how the Group manages credit risk by country, refer to the Country risk section on pages 156 to 184.

Controls and assurance*

The Group’s credit control and assurance framework comprises three key components: credit policy, policy compliance assurance and independent assurance.

The foundation is the Group Credit Policy Standard, which, as part of the Group Policy Framework (GPF) (refer to page 28), sets out the rules the Group’s businesses must follow to ensure that credit risks are identified and effectively managed through the credit lifecycle. During 2012, a major revision of the Group’s key credit policies was completed ensuring that the Group’s control environment is appropriately aligned to the risk appetite that the Group Board has approved, and provides a sound basis for the Group’s independent audit and assurance activities across the credit risk function.

The second component is a policy assurance activity that GCR undertakes to provide the RBS Group Chief Credit Officer with evidence of the effectiveness of the controls in place across the Group to manage credit risk. The results of these reviews are presented to the Group Credit Risk Committee on a regular basis in support of the self-certification that GCR is obliged to complete under the GPF.

Finally, a strong independent assurance function is an important element of a sound control environment. During 2011, the Group took the decision to strengthen its credit quality assurance (CQA) activities and moved all divisional CQA resources under the centralised management of GCR. The benefits of this action are already apparent in greater consistency of standards and cross-utilisation of resources, ensuring that subject matter experts bring their expertise to bear where relevant.

Reviews undertaken consistently address the four underlying risk pillars of: risk management, risk appetite, ratings and data integrity, and asset quality. Appropriate identification, escalation, remediation and related tracking of control breaches and improvements in operational processes are firmly embedded in the assurance process to ensure that divisions act upon review findings.

Credit risk measurement*

The Group uses credit risk models to support quantitative risk assessments in the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. Credit risk models used by the Group may be divided into three categories, as follows.

** unaudited*

Credit risk management framework continued

Probability of default/customer credit grade

These models assess whether a customer will be able to repay its obligations over a one year period.

Wholesale models - As part of the credit assessment process, the Group assigns each counterparty an internal credit grade based on its probability of default (PD). The Group uses a number of credit grading models which consider risk characteristics relevant to the customer. Credit grading models utilise a combination of quantitative inputs, such as recent financial performance and qualitative inputs such as management performance or sector outlook. The Group uses a credit grade in many of its risk management and measurement frameworks, including credit sanctioning and managing single-name concentration risk.

Retail models - Each customer account is scored using models based on the likelihood of default. Scorecards are statistically derived using customer data; customers are given a score that reflects their probability of default, and this score is used to support automated credit decision making.

Exposure at default models

Exposure at default (EAD) models estimate the level of use of a credit facility at the time of a borrower's default, recognising that customers may make more use of their existing credit facilities as they approach default. For revolving and variable draw-down type products that are not fully drawn, the EAD is higher than the current utilisation. This estimate of exposure can be reduced with financial collateral provided by the obligor or a netting agreement.

Models that measure counterparty credit risk exposure are used for derivatives and other traded instruments, where the amount of credit risk exposure may depend on one or more underlying market variables, such as interest or foreign exchange rates. These models drive the Group's internal credit risk management activities.

Loss given default models

Loss given default (LGD) models estimate the amount that cannot be recovered by the Group in the event of default. When estimating LGD, the Group takes into account both borrower and facility characteristics, as well as any security held or credit risk mitigation, such as credit protection or insurance. The cost of collections and a time discount factor for the delay in cash recovery are also incorporated.

Changes to wholesale credit risk models

The Group is updating its wholesale credit risk models, incorporating more recent data and reflecting new regulatory requirements applicable to wholesale internal ratings based (IRB) modelling. In 2012, the Group implemented updates to certain models, such as those used in the sovereign and financial institution asset classes; these updates affected the risk measures in the Group's disclosures. Further updates, primarily of models used for the corporate asset class, are planned for 2013.

Updates to models have generally affected relatively low-risk segments of the Group's portfolio. For example, the changes stemming from the introduction of updated probability of default models largely affected assets bearing the equivalent of investment-grade ratings.
In anticipation of these changes, the Group modified various risk frameworks, including its risk appetite framework and latent loss assessment. In addition, with the agreement of its regulators, the Group adjusted upwards the risk-weighted assets (RWAs) of some portfolios prior to the introduction of the new models.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, the Group in its commentary has differentiated between instances where movements in risk measures reflect the impact of model changes, and those that reflect movements in the size of underlying credit portfolios or their credit quality. However, it is not practicable to quantify the impact of model updates on individual asset quality bands.

Separately, as agreed with the Financial Services Authority (FSA), the Group has started to apply a slotting approach to calculate RWAs related to commercial real estate assets; this approach does not use modelled measures to determine RWAs and capital requirements.

Credit risk mitigation

Approaches and methodologies*

The 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 OTC derivative and secured financing transactions is further mitigated by the exchange of financial collateral and the use of market standard documentation. Further mitigation may occur 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 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, supportive independent legal opinions 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.

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 Group takes collateral in the form of real estate, which includes residential and commercial properties. The market value of the collateral will typically exceed the loan amount at the origination date. The market value is defined as the estimated amount for which the asset could be sold in an arms length transaction by a willing seller to a willing buyer.
- *Receivables -* When taking a charge over receivables, the 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 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 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 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 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.

** unaudited*

Credit risk mitigation continued

Commercial real estate

The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value (LTV) which represents loan value before provisions. 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 to assess property values, including internal expert judgement and indexation.

	Ulster Bank			Rest of the Group			Group		
Loan-to-value	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012									
<= 50%	183	24	207	7,210	281	7,491	7,393	305	7,698
> 50% and <= 70%	326	102	428	12,161	996	13,157	12,487	1,098	13,585
> 70% and <= 90%	462	250	712	6,438	1,042	7,480	6,900	1,292	8,192
> 90% and <= 100%	466	141	607	1,542	2,145	3,687	2,008	2,286	4,294
> 100% and <= 110%	103	596	699	1,019	1,449	2,468	1,122	2,045	3,167
> 110% and <= 130%	326	630	956	901	1,069	1,970	1,227	1,699	2,926
> 130% and <= 150%	274	878	1,152	322	913	1,235	596	1,791	2,387
> 150%	963	7,290	8,253	595	1,962	2,557	1,558	9,252	10,810
Total with LTVs	3,103	9,911	13,014	30,188	9,857	40,045	33,291	19,768	53,059
Minimal security (1)	7	1,461	1,468	3	13	16	10	1,474	1,484
Other (2)	97	715	812	6,494	1,191	7,685	6,591	1,906	8,497
Total	3,207	12,087	15,294	36,685	11,061	47,746	39,892	23,148	63,040
Total portfolio average LTV (3)	131%	286%	249%	65%	125%	80%	71%	206%	122%
2011									
<= 50%	272	32	304	7,091	332	7,423	7,363	364	7,727
> 50% and <= 70%	479	127	606	14,105	984	15,089	14,584	1,111	15,695
> 70% and <= 90%	808	332	1,140	10,042	1,191	11,233	10,850	1,523	12,373
> 90% and <= 100%	438	201	639	2,616	1,679	4,295	3,054	1,880	4,934
> 100% and <= 110%	474	390	864	1,524	1,928	3,452	1,998	2,318	4,316
> 110% and <= 130%	527	1,101	1,628	698	1,039	1,737	1,225	2,140	3,365
> 130% and <= 150%	506	1,066	1,572	239	912	1,151	745	1,978	2,723
> 150%	912	7,472	8,384	433	2,082	2,515	1,345	9,554	10,899
Total with LTVs	4,416	10,721	15,137	36,748	10,147	46,895	41,164	20,868	62,032
Minimal security (1)	72	1,086	1,158	—	—	—	72	1,086	1,158
Other (2)	193	625	818	8,994	1,844	10,838	9,187	2,469	11,656
Total	4,681	12,432	17,113	45,742	11,991	57,733	50,423	24,423	74,846
Total portfolio average LTV (3)	120%	264%	222%	69%	129%	82%	75%	203%	116%

Notes:
(1) In 2012, the Group reclassified loans with limited or non-physical security (defined as LTV>1,000%) as minimal security, for which a majority are commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect asset quality and recovery profile. 2011 presentation has been revised.
(2) Other performing loans of £6.6 billion (2011 - £9.2 billion) include general corporate lending, typically unsecured, to commercial real estate companies, and 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 (2011 - £2.5 billion) are subject to the Group's standard provisioning policies.
(3) Weighted average by exposure.

Other corporate

Corporate risk elements in lending and potential problem loans (excluding commercial real estate)	2012		2011		2010	
	Loans £m	Provisions £m	Loans £m	Provisions £m	Loans £m	Provisions £m
Secured	9,787	4,614	7,206	2,925	6,121	2,329
Unsecured	1,429	874	1,582	1,179	1,462	926

Wholesale market 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.

	2012 £bn	2011 £bn	2010 £bn
Reverse repurchase agreements	104.5	99.0	89.7
Securities received as collateral (1)	(104.4)	(97.9)	(88.9)
Derivative assets gross exposure			
- balances with holding company and fellow subsidiaries	7.2	10.4	17.5
- balances with third parties	437.9	522.4	411.5
Counterparty netting	(373.8)	(440.9)	(327.7)
Cash collateral held	(33.4)	(36.4)	(29.6)
Securities received as collateral	(5.6)	(5.3)	(2.9)

Note:
(1) In accordance with normal market practice, at 31 December 2012, £100.9 billion (2011 - £95.9 billion; 2010 - £88.8 billion) had been resold or re-pledged as collateral for the Group's own transactions.

Retail

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 assessment. 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 in ROI (monthly) and the Nationwide House Price Index in Northern Ireland).

For automobile lending in the US, new vehicles are valued at cost and used vehicles at the average trade-in value. At 31 December 2012, this portfolio amounted to £5.4 billion (2011 - £4.8 billion; 2010 - £5.1 billion).

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.

Credit risk mitigation continued

Residential mortgages

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average calculated on a weighted value basis. Loan balances are as at the end of the year whereas property values are calculated using the appropriate index.

	UK Retail			Ulster Bank			RBS Citizens (1)		
Loan-to-value	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012									
<= 50%	22,306	327	22,633	2,182	274	2,456	4,167	51	4,218
> 50% and <= 70%	27,408	457	27,865	1,635	197	1,832	4,806	76	4,882
> 70% and <= 90%	34,002	767	34,769	2,019	294	2,313	6,461	114	6,575
> 90% and <= 100%	7,073	366	7,439	1,119	156	1,275	2,011	57	2,068
> 100% and <= 110%	3,301	290	3,591	1,239	174	1,413	1,280	43	1,323
> 110% and <= 130%	1,919	239	2,158	2,412	397	2,809	1,263	42	1,305
> 130% and <= 150%	83	26	109	2,144	474	2,618	463	14	477
> 150%	—	—	—	3,156	1,290	4,446	365	14	379
Total with LTVs	96,092	2,472	98,564	15,906	3,256	19,162	20,816	411	21,227
Other (2)	486	12	498	—	—	—	292	19	311
Total	96,578	2,484	99,062	15,906	3,256	19,162	21,108	430	21,538
Total portfolio average LTV (3)	66%	80%	67%	108%	132%	112%	75%	86%	75%
Average LTV on new originations during the year			65%			74%			64%
2011									
<= 50%	21,537	285	21,822	2,568	222	2,790	4,745	49	4,794
> 50% and <= 70%	25,598	390	25,988	1,877	157	2,034	4,713	78	4,791
> 70% and <= 90%	33,738	671	34,409	2,280	223	2,503	6,893	125	7,018
> 90% and <= 100%	7,365	343	7,708	1,377	128	1,505	2,352	66	2,418
> 100% and <= 110%	3,817	276	4,093	1,462	130	1,592	1,517	53	1,570
> 110% and <= 130%	1,514	199	1,713	2,752	322	3,074	1,536	53	1,589
> 130% and <= 150%	60	15	75	2,607	369	2,976	626	28	654
> 150%	—	—	—	2,798	748	3,546	588	27	615
Total with LTVs	93,629	2,179	95,808	17,721	2,299	20,020	22,970	479	23,449
Other (2)	567	13	580	—	—	—	681	23	704
Total	94,196	2,192	96,388	17,721	2,299	20,020	23,651	502	24,153
Total portfolio average LTV (3)	67%	80%	67%	104%	125%	106%	76%	91%	77%
Average LTV on new originations during the year			63%			74%			63%
2010									
<= 50%	19,568	246	19,814	3,385	186	3,571	5,193	45	5,238
> 50% and <= 70%	24,363	345	24,708	2,534	152	2,686	4,902	79	4,981
> 70% and <= 90%	31,711	588	32,299	3,113	179	3,292	7,029	137	7,166
> 90% and <= 100%	7,998	319	8,317	1,958	121	2,079	2,459	67	2,526
> 100% and <= 110%	4,083	260	4,343	2,049	137	2,186	1,534	53	1,587
> 110% and <= 130%	1,722	202	1,924	4,033	358	4,391	1,425	61	1,486
> 130% and <= 150%	57	16	73	2,174	297	2,471	599	28	627
> 150%	—	—	—	355	131	486	589	36	625
Total with LTVs	89,502	1,976	91,478	19,601	1,561	21,162	23,730	506	24,236
Other (2)	1,090	24	1,114	—	—	—	762	30	792
Total	90,592	2,000	92,592	19,601	1,561	21,162	24,492	536	25,028
Total portfolio average LTV (3)	68%	81%	68%	91%	106%	92%	75%	94%	76%
Average LTV on new originations during the year			68%			79%			66%

Notes:
(1) Includes residential mortgages and home equity loans and lines (refer to page 81 for a breakdown of balances).
(2) Where no indexed LTV is held.
(3) Average LTV weighted by value is arrived at by calculating the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.
(4) Excludes mortgage lending in Wealth. This portfolio totalled £8.8 billion (2011 - £8.3 billion; 2010 - £7.8 billion) and continues to perform in line with expectations with minimal provision of £248 million.

Early problem identification and problem debt management

While the principles of identifying, managing and providing for problem debts are broadly similar for wholesale and retail customers, the procedures differ based on the nature of the assets, 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 (such as account level information) and external parameters (such as the share price of publicly listed customers).

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

Watchlist*

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 Group-wide policies, a number of mandatory actions are 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.

For all Watchlist Red cases, the division is required to consult with GRG on whether the relationship should be transferred to GRG (see more on 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 GRG.

At 31 December 2012, exposures to customers reported as Watchlist Red and managed within the divisions totalled £3.9 billion.

Strategies that are available within divisions include granting a 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. Refer to the section below on Wholesale renegotiations.

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

The following table shows a sector breakdown of credit risk assets of Watchlist Red counterparties under GRG management:

Watchlist Red credit risk assets under GRG management	2012			2011		
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
Property	5,605	4,373	9,978	6,213	5,994	12,207
Transport	2,212	331	2,543	1,041	2,195	3,236
Retail and leisure	1,481	412	1,893	1,501	620	2,121
Services	869	82	951	711	117	828
Other	3,066	1,099	4,165	1,703	811	2,514
Total	13,233	6,297	19,530	11,169	9,737	20,906

Global Restructuring Group

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

At 31 December 2012, 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 £19.5 billion.

* unaudited

Early problem identification and problem debt management continued

Wholesale renegotiations

Loan modifications take place in a variety of circumstances including but not limited to a customer's current or potential credit deterioration. Where the contractual payment terms of a loan have been changed because of the customer's financial difficulties, it is classified as 'renegotiated' in the wholesale portfolio.

Loans modified in the normal course of business where there is no evidence of financial difficulties and any changes to terms and conditions are within acceptable credit parameters, within credit risk appetite and/or reflective of improving conditions for the customer in the credit markets, are not considered to have been renegotiated.

A number of options are available to the Group when a wholesale customer is facing financial difficulties and corrective action is deemed necessary. Such actions are tailored to the individual circumstances of the customer. The aim of such actions is to assist the customer in restoring its financial health and to minimise risk to the Group. To ensure that the renegotiations are appropriate for the needs and financial profile of the customer, the Group requires minimum standards to be applied when assessing, recording, monitoring and reporting this type of activity.

Wholesale renegotiations involve 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 Group receiving an exit payment, a payment in kind or a deferred fee.

- *Payment concessions and loan rescheduling* - payment concessions or changes to the contracted amortisation profile including extensions in contracted maturity 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, such as an issue of equity capital. These types of concessions are 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 renegotiations 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.

In addition, the Group may offer a temporary covenant waiver, a recalibration of covenants and/or a covenant amendment to cure 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. These financial covenant concessions are monitored internally, but are not included in the renegotiated loans data (when this is the sole concession granted to a customer) as we believe that such concessions are qualitatively different from other renegotiations: The loan's payment terms are unchanged. Covenant concessions provide an early warning indicator rather than firm evidence of a significant deterioration in credit quality.

The impact on the credit quality of any change in terms and conditions of a loan is assessed at the time of granting such changes, and the appropriateness of the credit metrics reviewed at such time. For performing counterparties, credit metrics are an integral part of the latent provision methodology and therefore the impact of covenant concessions will be reflected in the latent provision. For non-performing counterparties, covenant concessions will be considered in the overall provision adequacy for these loans.

Covenant waivers and amendments are predominantly undertaken prior to transfer to GRG. The vast majority of the other types of renegotiations undertaken by the Group take place within GRG. Forgiveness of debt and exchange for equity is only available to customers in GRG.

Loans may be renegotiated more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms. Where renegotiation is no longer viable, the Group will consider other options such as the enforcement of security and or insolvency proceedings.

The data presented in the tables below include loans renegotiated during 2011 and 2012 which individually exceed thresholds set at divisional level, ranging from nil to £10 million. This population captures approximately 66% of that proportion of the wholesale portfolio which is either on Watchlist or under GRG stewardship. We continue to refine our reporting processes relating to renegotiated loans and as part of the 2012 review, the amounts in-progress and completed renegotiations relating to 2011 have been revised.

The table below shows the value of loans (excluding loans where the Group has initiated recovery procedures) where renegotiations were completed during the year by sector and renegotiation types.

	2012			2011 - Revised		
Wholesale renegotiations during the year by sector	Performing £m	Non-performing £m	Non-performing provision coverage %	Performing £m	Non-performing £m	Non-performing provision coverage %
Property	1,943	3,288	18	2,105	3,215	25
Transport	828	99	23	771	607	3
Telecommunications, media and technology	237	341	46	37	33	30
Retail and leisure	481	111	34	304	433	10
Other (1)	791	244	28	811	698	48
Total	4,280	4,083	22	4,028	4,986	24

Note:
(1) SME business within Wealth is now reported within Wholesale forbearance.

Renegotiation agreements

The table below analyses the incidence of the main types of renegotiation by loan value:

	Loans by value	
Arrangement type	2012 %	2011 %
Variation in margin	7	12
Payment concessions and loan rescheduling	67	91
Forgiveness of all or part of the outstanding debt	28	33
Other (2)	20	9

Notes:
(1) The total above exceeds 100% as an individual case can involve more than one type of arrangement.
(2) Main types of ‘other’ concessions include formal ‘standstill’ agreements, release of security and amendments to negative pledge. 2012 saw the completion of a small number of material standstill agreements, accounting for the higher proportion of the ‘other’ modification type.

Key points

- Renegotiations completed during 2012, subject to thresholds as explained above, were £8.4 billion (2011 - £9.0 billion). The volume of renegotiations continues at a high level as difficult economic conditions persist in the UK and Ireland, particularly in real estate markets and the Group continues its active problem debt management. Renegotiations are likely to remain significant: at 31 December 2012 loans totalling £13.5 billion (2011 - £11.1 billion) were in the process of being renegotiated but had not yet reached legal completion (these loans are not included in the tables above). Of these 69% were non-performing loans, with associated provision coverage of 32%, and 31% were performing loans. The principal types of arrangements being offered include variation in margin, payment concessions and loan rescheduling and forgiveness of all or part of the outstanding debt.

- Loans renegotiated during 2011 and 2012 outstanding at 31 December 2012 were £17.4 billion, of which £9.0 billion relates to arrangements completed during 2011.

- Additional provisions charged in 2012 relating to loans renegotiated during 2011 totalled £0.2 billion and provision coverage of those loans at 31 December 2012 was 24%.

- Of the loans renegotiated by GRG during 2011 and 2012 (£14.2 billion), 6.1% had been returned to performing portfolios managed by the business by 31 December 2012.

- Renegotiated loans disclosed in the table above may have been the subject of one or more covenant waivers or modifications. In addition loans totalling £3.5 billion granted financial covenant concessions only during the year are not included in the table above as these concessions do not affect a loan’s contractual cash flows.

Early problem identification and problem debt management continued

Provisioning for wholesale renegotiated customers

Wholesale renegotiations are predominantly individually assessed and are not therefore segregated into a separate risk pool.

Provisions for renegotiated wholesale loans are assessed in accordance with the Group's normal provisioning policies. For the non-performing population, provisions on exposures greater than £1 million are individually assessed by GRG. The provision required is calculated based on the difference between the debt outstanding and the present value of the estimated future cash flows. Exposures smaller than £1 million are deemed not to be individually significant and are assessed collectively by the originating division. Within the performing book, latent loss provisions are held for those losses that are incurred, but not yet identified.

Any one of the above types of renegotiation may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows from the renegotiated loan resulting in the recognition of an impairment loss. Renegotiations 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 renegotiation, including any concessions granted, are considered in order to establish whether an impairment provision is required.

In the case of non-performing loans that are renegotiated, the loan impairment provision assessment almost invariably takes place prior to the renegotiation. The quantum of the loan impairment provision may change once the terms of the renegotiation are known, resulting in an additional provision charge or a release of the provision in the period the renegotiation takes place.

The transfer of renegotiated wholesale loans from impaired to performing status follows assessment by relationship managers in GRG. When no further losses are anticipated and the customer is expected to meet the loan's revised terms, any provision is written off and the balance of the loan returned to performing status.

Performing loans that are renegotiated will be included in the calculation of the latent loss provisions. To the extent that the renegotiation event has affected the customer's estimated probably of default or loss given default, this will be reflected in the underlying calculation.

Recoveries and active insolvency management

The ultimate outcome of a renegotiation 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 renegotiation 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

Collections and recoveries

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, aim to support them where possible including the use of a range of forbearance options. If these strategies are unsuccessful, the customer is transferred to the recoveries team.

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 while treating customers fairly. A range of treatment options are available within recoveries, including litigation. In UK Retail and Ulster Bank, no repossession procedures are initiated until at least six months following the emergence of arrears. In Ulster Bank, new regulations further prohibit taking legal action for an extended period. Additionally, certain forbearance options are made available to customers within recoveries.

Retail 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

Customers are identified for forbearance treatment following initial contact from the customer, in the event of payment arrears or when the customer is transferred to collections 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, payment concessions, capitalisations of arrears over the remaining term of the mortgage, extension to the mortgage term and temporary conversions to interest only.

In payment concession arrangements a temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period.

For UK Retail, interest only conversions have not been used as a tool to support customers in financial stress since 2009. Following a change to policy in 2012, switching to interest only is no longer permitted for residential mortgage customers who are up to date on payments. For Ulster Bank, interest only conversions are only offered to customers in financial stress on a temporary basis.

As a result of the economic difficulties in the Republic of Ireland market and responding to regulatory intervention in the Irish mortgage market, Ulster Bank has developed additional treatment options to support customers in overcoming financial difficulties, over an extended period of time.

The principal types of forbearance granted in RBS Citizens' mortgage portfolio are the US government mandated HAMP (Home Affordable Modification Program) and RBS Citizens' proprietary modification programme. Both programmes typically feature a combination of 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 RBS Citizens' modification programme. Both are designed to evidence that the borrower is in financial difficulty as well as demonstrating willingness to pay.

For forbearance loans that are performing, the aim is to enable the customer to continue to service the loan. For forbearance loans classified as non-performing only those for which capitalisation of arrears has been agreed can qualify for return to the performing book. Transfer of such loans takes place currently once the customer has met the revised payment terms for at least six months and is expected to continue to do so.

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.

Arrears status and provisions

Mortgage arrears information for retail accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		
Arrears status and provisions	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Forborne balances %
2012									
UK Retail (1,2)	4,006	20	388	16	450	64	4,844	100	4.9
Ulster Bank (1,2)	915	100	546	60	527	194	1,988	354	10.4
RBS Citizens (3)	—	—	179	25	160	10	339	35	1.6
Wealth	38	—	—	—	7	—	45	—	0.5
	4,959	120	1,113	101	1,144	268	7,216	489	4.9
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
RBS Citizens (3)	—	—	91	10	89	10	180	20	0.8
Wealth	121	—	—	—	2	—	123	—	1.3
	4,691	94	958	68	919	193	6,568	355	4.4

Notes:
(1) Includes all forbearance arrangements whether relating to the customer's lifestyle changes or financial difficulty.
(2) Includes the current stock position of forbearance deals agreed since early 2008 for UK Retail and early 2009 for Ulster Bank.
(3) Forbearance stock reported at 31 December 2012 now includes home equity loans and lines as well as the residential mortgage portfolio.
(4) SME businesses within Wealth is now reported within Wholesale forbearance.

Early problem identification and problem debt management: Retail customers continued

Forbearance arrangements

The incidence of the main types of retail forbearance as at 31 December 2012 and 31 December 2011 are analysed below. For a small proportion of mortgages, more than one forbearance type applies.

	UK Retail £m	Ulster Bank £m	RBS Citizens £m	Wealth £m	Total (1) £m
2012					
Interest only conversions - temporary and permanent	1,220	924	—	6	2,150
Term extensions - capital repayment and interest only	2,271	183	—	27	2,481
Payment concessions/holidays	215	762	339	9	1,325
Capitalisation of arrears	932	119	—	—	1,051
Other	452	—	—	3	455
	5,090	1,988	339	45	7,462
2011					
Interest only conversions - temporary and permanent	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
	4,653	1,830	180	123	6,786

The table below shows forbearance agreed during 2012 analysed between performing and non-performing.

2012	UK Retail £m	Ulster Bank £m	RBS Citizens (1) £m	Wealth (2) £m	Total (3) £m
Performing forbearance in the year	1,809	2,111	88	18	4,026
Non-performing forbearance in the year	184	1,009	71	2	1,266
Total forbearance in the year (4)	1,993	3,120	159	20	5,292

Notes:
(1) Forbearance stock reported at 31 December 2012 now includes home equity loans and lines as well as the residential mortgage portfolio.
(2) SME business within Wealth is now reported within Wholesale forbearance.
(3) As an individual case can include more than one type of arrangement, the analysis in the table on forbearance arrangements exceeds the total value of cases subject to forbearance.
(4) Includes all deals agreed during the year (new customers and renewals) regardless of whether they remain active at the year end.

Key points

UK Retail

- The reported numbers for forbearance in UK Retail capture all instances where a change has been made to the contractual payment terms including those where the customer is up-to-date on payments and there is no obvious evidence of financial stress. The reported figures include stock dating back to 1 January 2008.

- At 31 December 2012, stock levels of £4.8 billion represent 4.9% of the total mortgage assets; this represents a 9.2% increase in forbearance stock since 31 December 2011. Of these, approximately 83% were up-to-date with payments (compared with approximately 97% of the mortgage population not subject to forbearance activity). The flow of forbearance arrangements has remained stable year on year.

- The most frequently occurring forbearance types were term extensions (47% of assets subject to forbearance at 31 December 2012), interest only conversions (25%) and capitalisations of arrears (19%). The stock of cases subject to interest only conversions reflects legacy policy. In 2009, UK Retail ceased providing this type of forbearance treatment for customers in financial difficulty and no longer permits interest only conversions on residential mortgages where the customer is current on payments.

- The provision cover on performing assets subject to forbearance was about five times that on assets not subject to forbearance.

Ulster Bank

- The reported numbers for forbearance in Ulster Bank Group capture all instances where a change has been made to the contractual payment terms including those where the customer is up-to-date on payments and there is no obvious evidence of financial stress. The reported figures include stock dating back to early 2009.

- Ulster Bank Group continues to assist customers in the difficult economic environment. Mortgage forbearance treatments have been in place since 2009 and are aimed at assisting customers in financial difficulty. At 31 December 2012, 10.4% of total mortgage assets (£1.9 billion) were subject to a forbearance arrangement, an increase from 9.1% (£1.8 billion) at 31 December 2011. The majority of these forbearance arrangements were in the performing book (73%).

- The majority of forbearance arrangements offered by Ulster Bank currently are temporary concessions, accounting for 85% of assets subject to forbearance at 31 December 2012. These are offered for periods of one to three years and incorporate different levels of repayment based on the customer's ability to pay. The additional treatment options developed by Ulster Retail will lead to a shift to more long term arrangements over time.

- Of these temporary forbearance types, the largest category at 31 December 2012 was interest only conversions, which accounted for 46% of total assets subject to forbearance. The other categories of temporary forbearance were payment concessions: reduced repayments (36%); and payment holidays (3%).

- The flow by forbearance type remained stable when compared with 2011 and there was a modest reduction, 3%, in customers seeking assistance for the first time year on year.

- The provision cover on performing assets subject to forbearance is approximately eight times higher than that on performing assets not subject to forbearance.

Provisioning for retail customers

Provisions are assessed in accordance with the Group's provisioning policies.

The majority of retail forbearance takes place in the performing book and, for the purposes of the latent loss provisions, these constitute a separate risk pool. They are subject to higher provisioning rates than the remainder of the performing book. These rates are reviewed regularly in both divisions. 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. In the non-performing portfolio, assets are grouped into homogeneous portfolios sharing similar credit characteristics according to the asset type. Further characteristics such as LTVs, arrears status and default vintage are also considered when assessing recoverable amount and calculating the related provision requirement. Whilst non-performing forbearance retail loans do not form a separate risk pool, the LGD models used to calculate the collective impairment provision will be affected by agreements made under forbearance arrangements.

In RBS Citizens, consumer loans subject to forbearance are segmented from the rest of the non-forborne population and assessed individually for impairment loan throughout their lives until the accounts are repaid or fully written-off. The amount of recorded impairment depends upon whether the loan is collateral dependent. If the loans are 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 loans' carrying amount over the present value of expected future cash flows is the impairment amount. Any confirmed losses are charged off immediately.

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 has 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 Group recognises an impairment at 90 days past due.

For corporate portfolios, given their complexity and nature, the 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 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 are assessed on a case-by-case basis. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. Future cash flows are estimated through a case-by-case analysis of individually assessed assets.

  This assessment takes into account the benefit of any guarantees 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.

Early problem identification and problem debt management: Retail customers continued

- *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 (refer to Problem debt management on page 70 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, to take into account 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.

Refer to pages 131 to 146 for analysis of impaired loans, related provisions and impairments.

Key credit portfolios*

Commercial real estate

The commercial real estate lending portfolio totalled £63.0 billion at 31 December 2012, an £11.8 billion or 16% decrease over the year and £24.1 billion or 28% decrease in the last two years. The commercial real estate sector comprises exposures to entities involved in the development of, or investment in, commercial and residential properties (including housebuilders). The analysis of lending utilisations below excludes rate risk management and contingent obligations.

	2012			2011			2010		
By division (1)	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m
Core									
UK Corporate	22,504	4,091	26,595	25,101	5,023	30,124	24,879	5,819	30,698
Ulster Bank	3,575	729	4,304	3,882	881	4,763	4,284	1,090	5,374
US Retail & Commercial	3,857	3	3,860	4,235	70	4,305	4,322	93	4,415
International Banking	849	315	1,164	872	299	1,171	723	302	1,025
Markets	630	57	687	141	61	202	181	275	456
	31,415	5,195	36,610	34,231	6,334	40,565	34,389	7,579	41,968
Non-Core									
UK Corporate	2,651	983	3,634	3,957	2,020	5,977	7,591	3,263	10,854
Ulster Bank	3,383	7,607	10,990	3,860	8,490	12,350	3,854	8,760	12,614
US Retail & Commercial	392	—	392	901	28	929	1,325	70	1,395
International Banking	11,260	154	11,414	14,689	336	15,025	19,906	379	20,285
	17,686	8,744	26,430	23,407	10,874	34,281	32,676	12,472	45,148
Total	49,101	13,939	63,040	57,638	17,208	74,846	67,065	20,051	87,116

For the notes to this table refer to the following page.

* unaudited

By geography (1)	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
2012										
UK (excluding NI) (2)	25,864	5,567	839	4,777	37,047	23,312	8,119	4,184	1,432	37,047
Ireland (ROI and NI) (2)	4,651	989	2,234	5,712	13,586	2,877	2,763	665	7,281	13,586
Western Europe (other)	5,995	370	22	33	6,420	403	5,962	24	31	6,420
US	4,230	981	—	15	5,226	4,629	582	15	—	5,226
RoW	454	—	65	242	761	194	260	307	—	761
	41,194	7,907	3,160	10,779	63,040	31,415	17,686	5,195	8,744	63,040
2011										
UK (excluding NI) (2)	28,653	6,359	1,198	6,511	42,721	25,904	9,108	5,118	2,591	42,721
Ireland (ROI and NI) (2)	5,146	1,132	2,591	6,317	15,186	3,157	3,121	793	8,115	15,186
Western Europe (other)	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) (2)	32,333	7,255	1,520	8,288	49,396	26,167	13,421	5,997	3,811	49,396
Ireland (ROI and NI) (2)	5,051	1,148	2,785	6,578	15,562	3,155	3,044	962	8,401	15,562
Western Europe (other)	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	189	1,404	430	147	2,170
	56,698	10,367	4,537	15,514	87,116	34,389	32,676	7,579	12,472	87,116

By sub-sector (1)	UK (excl NI) (2) £m	Ireland (ROI & NI) (2) £m	Western Europe (other) £m	US £m	RoW (2) £m	Total £m
2012						
Residential	10,344	6,701	403	996	242	18,686
Office	6,112	1,132	1,851	99	176	9,370
Retail	7,529	1,492	1,450	117	129	10,717
Industrial	3,550	476	143	4	39	4,212
Mixed/other	9,512	3,785	2,573	4,010	175	20,055
	37,047	13,586	6,420	5,226	761	63,040
2011						
Residential	12,870	7,449	1,100	1,325	319	23,063
Office	7,155	1,354	2,246	404	352	11,511
Retail	8,709	1,641	1,891	285	275	12,801
Industrial	4,317	507	520	24	105	5,473
Mixed/other	9,670	4,235	3,001	4,898	194	21,998
	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

Notes:
(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 £1.4 billion at 31 December 2012 (2011 - £1.3 billion), continues to perform in line with expectations and requires minimal provisions.
(2) ROI: Republic of Ireland; NI: Northern Ireland; RoW: rest of world.

Key credit portfolios*: Commercial real estate continued

Key points

- In line with the Group's strategy, the overall exposure to commercial real estate fell during 2012, across all geographies. The overall mix in terms of geography, sub-sector and investment versus development remained broadly unchanged.
- Most of the decrease was in Non-Core and was due to repayments, asset sales, and write-offs. The Non-Core portfolio totalled £26.4 billion (42% of the portfolio) at 31 December 2012 (2011 - £34.3 billion or 46% of the portfolio).
- The growth in Markets was caused by an increase in the inventory of US commercial real estate loans earmarked for securitisation as commercial mortgage-backed securities (CMBS). CMBS warehouse activity is tightly controlled with limits on maximum portfolio size and holding period, and marked-to-market on a daily basis.
- With the exception of exposure in Spain and Ireland, the Group had minimal commercial real estate exposure in the peripheral eurozone countries. Exposure in Spain was predominantly in the Non-Core portfolio and totalled £1.6 billion (2011 - £2.3 billion), of which 31% (2011 - 55%) was in default. The majority of the portfolio is managed by GRG. The Spanish portfolio has already been subject to material provisions, which are regularly assessed by reference to re-appraised asset values. Asset values vary significantly by type and geographic location. Refer to the Ulster Bank Group (Core and Non-Core) section on page 85 for details on the exposure in Ireland.
- The UK portfolio is focused on London and the South East at approximately 43% in 2012 (2011 - 44%) with the remainder spread across other UK Regions.
- Speculative lending, defined by the Group as short-term lending to property developers without sufficient pre-let revenue at origination to support investment financing after practical completion, represented less than 1% of the portfolio at 31 December 2012. The 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 sector is expected to remain challenging in key markets and new business will be accommodated from run-off of existing Core exposure. Over £5.5 billion of loans in UK Corporate (Core and Non-Core) have been repaid over the last 12 months whilst the risk profile of the remaining performing book has remained relatively unchanged.

Maturity profile of portfolio	UK Corporate £m	Ulster Bank £m	International Banking £m	US Retail & Commercial £m	Markets £m	Total £m
2012						
Core						
< 1 year (1)	8,639	3,000	216	797	59	12,711
1-2 years	3,999	284	283	801	130	5,497
2-3 years	3,817	215	505	667	—	5,204
> 3 years	9,597	805	160	1,595	498	12,655
Not classified (2)	543	—	—	—	—	543
Total	26,595	4,304	1,164	3,860	687	36,610
Non-Core						
< 1 year (1)	2,071	9,498	4,628	138	—	16,335
1-2 years	192	1,240	3,714	79	—	5,225
2-3 years	99	38	1,137	43	—	1,317
> 3 years	1,058	214	1,935	132	—	3,339
Not classified (2)	214	—	—	—	—	214
Total	3,634	10,990	11,414	392	—	26,430

* unaudited

2011	UK Corporate £m	Ulster Bank £m	International Banking £m	US Retail & Commercial £m	Markets £m	Total £m
Core						
< 1 year (1)	8,268	3,030	142	1,056	—	12,496
1-2 years	5,187	391	218	638	60	6,494
2-3 years	3,587	117	230	765	133	4,832
> 3 years	10,871	1,225	581	1,846	9	14,532
Not classified (2)	2,211	—	—	—	—	2,211
Total	30,124	4,763	1,171	4,305	202	40,565
Non-Core						
< 1 year (1)	3,224	11,089	7,093	293	—	21,699
1-2 years	508	692	3,064	163	—	4,427
2-3 years	312	177	1,738	152	—	2,379
> 3 years	1,636	392	3,126	321	—	5,475
Not classified (2)	297	—	4	—	—	301
Total	5,977	12,350	15,025	929	—	34,281

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

Key points

- The overall maturity profile has remained relatively unchanged over the last 12 months.
- Non-Core exposure maturing in under 1 year has reduced from £21.7 billion in 2011 to £16.3 billion in 2012.
- The majority of Ulster Bank's commercial real estate portfolio was categorised as under 1 year, owing to the high level of non-performing assets in the portfolio as Ulster Bank includes most renegotiated facilities as on demand.
- Refinancing risk remains a focus of management attention and is assessed throughout the credit risk management lifecycle.

Portfolio by asset quality (AQ) band	AQ1-AQ2 £m	AQ3-AQ4 £m	AQ5-AQ6 £m	AQ7-AQ8 £m	AQ9 £m	AQ10 £m	Total £m
2012							
Core	767	6,011	16,592	6,575	1,283	5,382	36,610
Non-Core	177	578	3,680	3,200	1,029	17,766	26,430
	944	6,589	20,272	9,775	2,312	23,148	63,040
2011							
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
	1,774	8,001	25,005	10,147	5,496	24,423	74,846

Key points

- There has been an overall decrease in AQ10 during the year with reductions in Non-Core partially offset by increases in Ulster Bank and UK Corporate. The increase in defaulted exposure in UK Corporate is a result of a small number of significant individual cases. The high proportion of the portfolio in the AQ10 band was driven by exposures in Non-Core (Ulster Bank and International Banking) and Core (Ulster Bank).
- Of the total portfolio of £63.0 billion at 31 December 2012, £28.1 billion (2011 - £34.7 billion) was managed within the Group's standard credit processes and £5.1 billion (2011 - £5.9 billion) was receiving varying degrees of heightened credit management under the Group's Watchlist process. A further £29.8 billion (2011 - £34.3 billion) was managed within GRG and included Watchlist and non-performing exposures. The decrease in the portfolio managed by GRG was driven by Non-Core reductions.

Key credit portfolios*: Commercial real estate continued

The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value (LTV) which represents loan value before provisions. 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 to assess property values, including internal expert judgement and indexation.

	Ulster Bank			Rest of the Group			Group		
Loan-to-value	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012									
<= 50%	183	24	207	7,210	281	7,491	7,393	305	7,698
> 50% and <= 70%	326	102	428	12,161	996	13,157	12,487	1,098	13,585
> 70% and <= 90%	462	250	712	6,438	1,042	7,480	6,900	1,292	8,192
> 90% and <= 100%	466	141	607	1,542	2,145	3,687	2,008	2,286	4,294
> 100% and <= 110%	103	596	699	1,019	1,449	2,468	1,122	2,045	3,167
> 110% and <= 130%	326	630	956	901	1,069	1,970	1,227	1,699	2,926
> 130% and <= 150%	274	878	1,152	322	913	1,235	596	1,791	2,387
> 150%	963	7,290	8,253	595	1,962	2,557	1,558	9,252	10,810
Total with LTVs	3,103	9,911	13,014	30,188	9,857	40,045	33,291	19,768	53,059
Minimal security (1)	7	1,461	1,468	3	13	16	10	1,474	1,484
Other (2)	97	715	812	6,494	1,191	7,685	6,591	1,906	8,497
Total	3,207	12,087	15,294	36,685	11,061	47,746	39,892	23,148	63,040
Total portfolio average LTV (3)	131%	286%	249%	65%	125%	80%	71%	206%	122%
2011									
<= 50%	272	32	304	7,091	332	7,423	7,363	364	7,727
> 50% and <= 70%	479	127	606	14,105	984	15,089	14,584	1,111	15,695
> 70% and <= 90%	808	332	1,140	10,042	1,191	11,233	10,850	1,523	12,373
> 90% and <= 100%	438	201	639	2,616	1,679	4,295	3,054	1,880	4,934
> 100% and <= 110%	474	390	864	1,524	1,928	3,452	1,998	2,318	4,316
> 110% and <= 130%	527	1,101	1,628	698	1,039	1,737	1,225	2,140	3,365
> 130% and <= 150%	506	1,066	1,572	239	912	1,151	745	1,978	2,723
> 150%	912	7,472	8,384	433	2,082	2,515	1,345	9,554	10,899
Total with LTVs	4,416	10,721	15,137	36,748	10,147	46,895	41,164	20,868	62,032
Minimal security (1)	72	1,086	1,158	—	—	—	72	1,086	1,158
Other (2)	193	625	818	8,994	1,844	10,838	9,187	2,469	11,656
Total	4,681	12,432	17,113	45,742	11,991	57,733	50,423	24,423	74,846
Total portfolio average LTV (3)	120%	264%	222%	69%	129%	82%	75%	203%	116%

Notes:
(1) In 2012, the Group reclassified loans with limited or non-physical security (defined as LTV>1,000%) as minimal security, for which a majority are commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect asset quality and recovery profile. 2011 presentation has been revised.
(2) Other performing loans of £6.6 billion (2011 - £9.2 billion) include general corporate lending, typically unsecured, to commercial real estate companies, and major UK housebuilders. The credit quality of these exposures is consistent with that of the performing portfolio overall. Other non-performing loans of £1.9 billion (2011 - £2.5 billion) are subject to the Group's standard provisioning policies.
(3) Weighted average by exposure.

Key points

- 81% of the commercial real estate portfolio categorised as LTV > 100% was in Ulster Bank Group (Core - 15%; Non-Core - 43%) and International Banking (Non-Core - 23%). A majority of the portfolios are managed within GRG and are subject to review at least quarterly. Significant levels of provisions have been taken against these portfolios. Provisions as a percentage of REIL for the Ulster Bank Group commercial real estate portfolio were 58% at 31 December 2012 (2011 - 53%).
- The average interest coverage ratios for UK Corporate (Core and Non-Core) and International Banking (Non-Core) were 2.96x and 1.30x respectively, at 31 December 2012 (2011 - 2.71x 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 coverage for this portfolio was 1.34x at 31 December 2012 (2011 - 1.24x). As a number of different approaches are used within the Group and across geographies to calculate interest coverage ratios, they may not be comparable for different portfolio types and organisations.

** unaudited*

Residential mortgages

The majority of the Group's secured lending exposures were in the UK, Ireland and the US. The analysis below includes both Core and Non-Core.

	2012 £m	2011 £m	2010 £m
UK Retail	99,062	96,388	92,592
Ulster Bank	19,162	20,020	21,162
RBS Citizens (1)	21,538	24,153	25,028
	139,762	140,561	138,782

Note:
(1) 2011 and 2010 have been revised to include the legacy serviced by others portfolio.

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average calculated on a weighted value basis. Loan balances are as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

	UK Retail			Ulster Bank			RBS Citizens (1)		
Loan-to-value	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012									
<= 50%	22,306	327	22,633	2,182	274	2,456	4,167	51	4,218
> 50% and <= 70%	27,408	457	27,865	1,635	197	1,832	4,806	76	4,882
> 70% and <= 90%	34,002	767	34,769	2,019	294	2,313	6,461	114	6,575
> 90% and <= 100%	7,073	366	7,439	1,119	156	1,275	2,011	57	2,068
> 100% and <= 110%	3,301	290	3,591	1,239	174	1,413	1,280	43	1,323
> 110% and <= 130%	1,919	239	2,158	2,412	397	2,809	1,263	42	1,305
> 130% and <= 150%	83	26	109	2,144	474	2,618	463	14	477
> 150%	—	—	—	3,156	1,290	4,446	365	14	379
Total with LTVs	96,092	2,472	98,564	15,906	3,256	19,162	20,816	411	21,227
Other (2)	486	12	498	—	—	—	292	19	311
Total	96,578	2,484	99,062	15,906	3,256	19,162	21,108	430	21,538
Total portfolio average LTV (3)	66%	80%	67%	108%	132%	112%	75%	86%	75%
Average LTV on new originations during the year			65%			74%			64%
2011									
<= 50%	21,537	285	21,822	2,568	222	2,790	4,745	49	4,794
> 50% and <= 70%	25,598	390	25,988	1,877	157	2,034	4,713	78	4,791
> 70% and <= 90%	33,738	671	34,409	2,280	223	2,503	6,893	125	7,018
> 90% and <= 100%	7,365	343	7,708	1,377	128	1,505	2,352	66	2,418
> 100% and <= 110%	3,817	276	4,093	1,462	130	1,592	1,517	53	1,570
> 110% and <= 130%	1,514	199	1,713	2,752	322	3,074	1,536	53	1,589
> 130% and <= 150%	60	15	75	2,607	369	2,976	626	28	654
> 150%	—	—	—	2,798	748	3,546	588	27	615
Total with LTVs	93,629	2,179	95,808	17,721	2,299	20,020	22,970	479	23,449
Other (2)	567	13	580	—	—	—	681	23	704
Total	94,196	2,192	96,388	17,721	2,299	20,020	23,651	502	24,153
Total portfolio average LTV (3)	67%	80%	67%	104%	125%	106%	76%	91%	77%
Average LTV on new originations during the year			63%			74%			63%

For the notes to this table refer to the following page.

Key credit portfolios*: Residential mortgages continued

Loan-to-value	UK Retail			Ulster Bank			RBS Citizens (1)		
	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2010									
<= 50%	19,568	246	19,814	3,385	186	3,571	5,193	45	5,238
> 50% and <= 70%	24,363	345	24,708	2,534	152	2,686	4,902	79	4,981
> 70% and <= 90%	31,711	588	32,299	3,113	179	3,292	7,029	137	7,166
> 90% and <= 100%	7,998	319	8,317	1,958	121	2,079	2,459	67	2,526
> 100% and <= 110%	4,083	260	4,343	2,049	137	2,186	1,534	53	1,587
> 110% and <= 130%	1,722	202	1,924	4,033	358	4,391	1,425	61	1,486
> 130% and <= 150%	57	16	73	2,174	297	2,471	599	28	627
> 150%	—	—	—	355	131	486	589	36	625
Total with LTVs	89,502	1,976	91,478	19,601	1,561	21,162	23,730	506	24,236
Other (2)	1,090	24	1,114	—	—	—	762	30	792
Total	90,592	2,000	92,592	19,601	1,561	21,162	24,492	536	25,028
Total portfolio average LTV (3)	68%	81%	68%	91%	106%	92%	75%	94%	76%
Average LTV on new originations during the year			68%			79%			66%

Notes:
(1) Includes residential mortgages and home equity loans and lines (refer to page 81 for a breakdown of balances).
(2) Where no indexed LTV is held.
(3) Average LTV weighted by value is arrived at by calculating the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.
(4) Excludes mortgage lending in Wealth. This portfolio totalled £8.8 billion (2011 - £8.3 billion; 2010 - £7.8 billion) and continues to perform in line with expectations with minimal provision of £248 million.

Key points

UK Retail

- The UK Retail mortgage portfolio totalled approximately £99.1 billion at 31 December 2012, an increase of 2.8% from 31 December 2011.
- The assets are prime mortgages and include £7.9 billion, 8% (2011 - £6.9 billion) of residential buy-to-let lending. There is a small legacy portfolio of self-certified mortgages (0.2% of the total mortgage portfolio). Self-certified mortgages were withdrawn in 2004. The interest rate product mix is approximately one third fixed rate with the remainder on variable rate products including those on managed rates.
- UK Retail's mortgage business is subject to prudent underwriting standards. These include an affordability test using a stressed interest rate, credit scoring with different pass marks depending on LTV as well as a range of specific criteria, for example, LTV thresholds. Changes over the last few years include: a reduction in maximum LTV for prime residential mortgage lending from 100% to 95% in the first quarter of 2008 and from 95% to 90% in the third quarter of 2008 and a tightening of credit scoring pass marks: credit score thresholds were increased in the third quarter of 2009 and again in the third quarter of 2010. In the first quarter of 2011, new scorecards were introduced alongside a further tightening of thresholds, these were tightened still further in the second quarter of 2012.
- Gross new mortgage lending remained strong at £14 billion. The average of individual LTV on new originations was 65.2% weighted by value of lending (2011 - 63.0%) and 61.3% by volume (2011 - 58.4%). The ratio of total lending to total property valuations was 56.3% (2011 - 52.9%). Average LTV by volume is arrived at by calculating the LTV on each individual mortgage with no weighting applied in the calculation of the average. The ratio approach is the sum of all lending divided by the value of all properties held as security against the lending.
- The maximum LTV available to new customers remains at 90%, except for those buying properties under the government-sponsored, and indemnity backed, new build schemes that were launched during the year, where the maximum LTV is 95%. These schemes aim to support the mortgage market, particularly first time buyers, and completions under the scheme totalled £35 million during the year.
- Based on the Halifax Price Index at September 2012, the portfolio average indexed LTV by weighted value of debt outstanding was 66.8% (2011 - 67.2%) and 58.1% by volume (2011 - 57.8%). The ratio of total outstanding balances to total indexed property valuations is 48.5% (2011 - 48.4%).

* unaudited

- The arrears rate (more than three payments in arrears, excluding repossessions and shortfalls post property sale) improved marginally to 1.5% at 31 December 2012 from 1.6% at 31 December 2011. The number of properties repossessed in 2012 was 1,426 compared with 1,671 in 2011. Arrears rates remain sensitive to economic developments and are currently benefiting from the low interest rate environment.

- The mortgage impairment charge was £92 million for 2012 compared with £182 million in 2011 primarily due to lower loss rate adjustments on the non-performing back book, and a stable underlying rate of defaults.

- 25.6% of the residential owner occupied UK Retail mortgage book is on interest only terms down from 27.3% in 2011. A further 9.1% are on mixed repayments split between a combination of interest only and capital repayments (2011 - 9.6%). UK Retail withdrew interest only repayment products from sale to residential owner occupied customers with effect from 1 December 2012. Interest only repayment remains an option on buy-to-let mortgages. At 1.6%, the percentage of accounts more than 3 payments in arrears was similar to the 1.4% observed on capital repayment mortgages.

Ulster Bank

- Ulster Bank's residential mortgage portfolio totalled £19.2 billion at 31 December 2012, with 88% in the Republic of Ireland and 12% in Northern Ireland. At constant exchange rates, the portfolio decreased 2% from 31 December 2011 as a result of natural amortisation and limited growth due to low market demand.

- The assets include £2.3 billion of exposure (12%) of residential buy-to-let loans. The interest rate product mix is approximately 91% on a variable rate product (including tracker products) and 9% on a fixed rate.

- 16% of the total portfolio is on interest only which reflects legacy policy and is no longer available to residential mortgage customers on a permanent basis. Interest only is permitted on a temporary basis under the suite of forbearance treatments available within Ulster Bank (refer to page 73 for further information). Interest only repayment remains an option for private customers within Northern Ireland on an exception basis.

- Average LTVs increased from 31 December 2011 to 31 December 2012, on a value basis, as a result of decreases in the Central Statistics Office house price index (4%) impacting the Ulster Bank portfolio. The average of individual LTV on new originations was stable in 2012 at 74% (weighted by value of lending) and 69.4% by volume (2011 - 67.3%). The volume of business remains very low. The maximum LTV available to Ulster Bank customers is 90% with the exception of a specific Northern Ireland scheme which permits LTVs of up to 95%, in which Ulster Bank's exposure is capped at 85% LTV.

- Refer to the Ulster Bank Group (Core and Non-Core) section on page 85 for commentary on mortgage REIL and repossessions.

RBS Citizens

- RBS Citizens' mortgage portfolio totalled £21.5 billion at 31 December 2012, a reduction of 11% from 2011 (£24.2 billion). The Core business comprises 89% of the portfolio.

- The portfolio comprises £6.2 billion (Core - £5.8 billion; Non-Core - £0.4 billion) of residential mortgages, of which 1% are in second lien position. There is also £15.3 billion (Core - £13.3 billion; Non-Core - £2.0 billion) of home equity loans and lines. Home equity Core consists of 47% in first lien position while Non-Core consists of 95% in second lien position.

- RBS Citizens' lending originates predominantly in the 'footprint states' of New England, Mid Atlantic and Mid West regions. At 31 December 2012, £17.9 billion (83% of the total portfolio) was within footprint.

- The Non-Core portfolio comprises 11% of the mortgage portfolio with the serviced by others (SBO) portfolio being the largest component (75%). The SBO portfolio consists of purchased pools of home equity loans and lines. The full year charge-off rate was 7.4% for 2012 (excluding one-time events, the charge-off rate was 6.8%), which represents a year-on-year improvement (2011 - 8.6%). It is characterised by out-of-footprint geographies, high (95%) second lien concentration, and high LTV exposure (111% weighted average LTV at 31 December 2012). The SBO book has been closed to new purchases since the third quarter of 2007 and is in run-off, with exposure down from £2.3 billion at 31 December 2011 to £1.8 billion at 31 December 2012. The arrears rate of the SBO portfolio has decreased from 2.3% at 31 December 2011 to 1.9% at 31 December 2012 due primarily to portfolio liquidation (highest risk borrowers have been charged-off), as well as more effective account servicing and collections.

- The current weighted average LTV of the mortgage portfolio decreased from 77% at 31 December 2011 to 75% at 31 December 2012, driven by increases in the Case-Shiller home price index from the third quarter of 2011 to the third quarter of 2012. The current weighted average LTV of the mortgage portfolio, excluding SBO, is 71%.

Key credit portfolios* continued

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.

	2012		2011		2010	
	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)	5,624	2.3	5,675	3.0	6,025	5.0
UK Retail loans (1)	6,513	2.5	7,755	2.8	9,863	4.8
RBS Citizens cards (2)	916	3.8	936	5.1	1,005	9.9
RBS Citizens auto loans (2)	5,289	0.1	4,856	0.2	5,256	0.6

Notes:
(1) The ratio for UK Retail assets refers to the impairment charges for the year.
(2) The ratio for RBS 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, comprises credit cards, unsecured loans and overdrafts, and totalled £14.7 billion at 31 December 2012 (2011 - £16.0 billion).
- The decrease in portfolio size of 8.1% was driven by continued subdued loan recruitment activity and a continuing general market trend of customers repaying unsecured debt.
- The impairment charge on unsecured lending was £440 million for the year, down 24% on 2011, reflecting the continued benefit of risk appetite tightening in prior years, lower unsecured balances and also the investment in collections and recoveries capability. UK Retail continues to support customers experiencing financial difficulties including the provision of 'breathing space'. 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.

RBS Citizens

- RBS Citizens' credit card portfolio totalled £948 million at 31 December 2012 (2011 - £968 million). RBS Citizens' credit card business lends predominantly within the Bank's 12 state footprint and has traditionally adopted conservative risk strategies. Given the external climate, tighter lending criteria has been introduced leading to an improvement in credit quality. The portfolio's quarterly annualised loss performance in the third quarter of 2012 was 3.4% and ranked seventh out of 20 large and regional banks tracked.
- RBS Citizens' auto loan portfolio totalled £5.4 billion at 31 December 2012 (2011 - £4.8 billion). The auto loan business originates secured loans through a closely managed network of dealerships mainly located in the bank's footprint. The portfolio continues to possess strong credit risk fundamentals. The business purchased a £608 million auto loan portfolio from a large financial institution in the first quarter of 2012 that possessed a comparable credit and collateral profile. The acquired portfolio continues to outperform its delinquency and loss forecast. The portfolio's quarterly annualised loss performance in the third quarter of 2012 was 0.18% and continues to perform favourable against industry.

* unaudited

Ulster Bank Group (Core and Non-Core)

Overview

At 31 December 2012, Ulster Bank Group accounted for 10% of the RBS Group's total gross loans to customers (2011 and 2010 - 10%) and 8% of the RBS Group's Core gross loans to customers (2011 - 8%; 2010 - 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 £2,340 million for 2012 (2011 - £3,717 million; 2010 - £3,843 million) was driven by a combination of new defaulting customers and higher provisions on existing defaulted cases due primarily to deteriorating security values. Provisions as a percentage of risk elements in lending increased from 53% in 2011, to 57% in 2012, predominantly as a result of the deterioration in the value of the Non-Core commercial real estate development portfolio. Ulster Bank impairment provisions take into account recovery strategies for its commercial real estate portfolio, as currently there is very limited liquidity in Irish commercial and development property.

Core

The impairment charge for the year of £1,364 million (2011 - £1,384 million; 2010 - £1,161 million) reflects the difficult economic climate in Ireland, with elevated default levels across both mortgage and other corporate portfolios. The mortgage sector accounted for £646 million (47%) of the total 2012 impairment charge.

Non-Core

The impairment charge for the year was £976 million, a decrease of £1,357 million (2011 - £2,333 million; 2010 - £2,682 million), with the commercial real estate sector accounting for £899 million (92%) of the total 2012 impairment charge.

				Credit metrics				
Sector analysis	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
2012								
Core								
Mortgages	19,162	3,147	1,525	16.4	48	8.0	646	22
Commercial real estate								
- investment	3,575	1,551	593	43.4	38	16.6	221	—
- development	729	369	197	50.6	53	27.0	55	2
Other corporate	7,772	2,259	1,394	29.1	62	17.9	389	15
Other lending	1,414	207	201	14.6	97	14.2	53	33
	32,652	7,533	3,910	23.1	52	12.0	1,364	72
Non-Core								
Commercial real estate								
- investment	3,383	2,800	1,433	82.8	51	42.4	288	15
- development	7,607	7,286	4,720	95.8	65	62.0	611	103
Other corporate	1,570	1,230	711	78.3	58	45.3	77	23
	12,560	11,316	6,864	90.1	61	54.6	976	141
Ulster Bank Group								
Mortgages	19,162	3,147	1,525	16.4	48	8.0	646	22
Commercial real estate								
- investment	6,958	4,351	2,026	62.5	47	29.1	509	15
- development	8,336	7,655	4,917	91.8	64	59.0	666	105
Other corporate	9,342	3,489	2,105	37.3	60	22.5	466	38
Other lending	1,414	207	201	14.6	97	14.2	53	33
	45,212	18,849	10,774	41.7	57	23.8	2,340	213

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

2011	Gross loans £m	REIL £m	Provisions £m	Credit metrics: 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
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
Other lending	1,533	201	184	13.1	92	12.0	56	25
	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
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
Other lending	1,533	201	184	13.1	92	12.0	56	25
	48,032	17,134	9,050	35.7	53	18.8	3,717	173
2010								
Core								
Mortgages	21,162	1,566	439	7.4	28	2.1	294	7
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
Other lending	1,282	185	158	14.4	85	12.3	48	30
	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
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
Other lending	1,282	185	158	14.4	85	12.3	48	30
	51,441	13,661	5,977	26.6	44	11.6	3,843	48

** unaudited*

Key points

- Core REIL increased by £2.0 billion during the year, which reflects continued difficult conditions in both the commercial and residential property sectors in Ireland.
- Core mortgage REIL accounted for £1.0 billion of the overall increase, the trend reflecting continued deterioration of macroeconomic factors. However, the number of properties repossessed in 2012 was 127 (81 on a voluntary basis) compared with 161 (123 on a voluntary basis) in 2011.
- Core corporate REIL accounted for £1.0 billion of the overall increase, the movement driven by a small number of renegotiated arrangements for higher value real estate customers.
- Core coverage increased from 50% to 52% as a result of additional impairment charges on the non-performing book due to further deterioration in collateral values. Core coverage is diluted due to the increased REIL relating to corporate renegotiations with lower provision requirements. Adjusting for these cases Core coverage would be 56%.
- Non-Core REIL decreased by £0.3 billion reflecting lower defaults as well as recoveries, and write-offs of £0.2 billion.
- At 31 December 2012, 60% of REIL was in Non-Core (2011 - 68%). The majority of the Non-Core commercial real estate development portfolio is non-performing with provision coverage of 65%.

Geographical analysis

Commercial real estate

The commercial real estate lending portfolio for Ulster Bank Group (Core and Non-Core) totalled £15.3 billion at 31 December 2012, of which £11.0 billion or 72% was in Non-Core. The geographic split of the total Ulster Bank Group commercial real estate portfolio, based on the location of the underlying security, remained similar to 2011, with 63% in the Republic of Ireland, 26% in Northern Ireland and 11% in the UK (excluding Northern Ireland).

	Investment		Development		
Exposure by geography	Commercial £m	Residential £m	Commercial £m	Residential £m	Total £m
2012					
ROI	3,546	779	1,603	3,653	9,581
NI	1,083	210	631	2,059	3,983
UK (excluding NI)	1,239	86	82	290	1,697
RoW	14	1	8	10	33
	5,882	1,076	2,324	6,012	15,294
2011					
ROI	3,775	853	1,911	4,095	10,634
NI	1,322	279	680	2,222	4,503
UK (excluding NI)	1,371	111	95	336	1,913
RoW	27	4	—	32	63
	6,495	1,247	2,686	6,685	17,113
2010					
Ireland (ROI and NI)	5,032	1,098	2,785	6,578	15,493
UK (excluding NI)	1,869	115	110	359	2,453
RoW	23	1	—	18	42
	6,924	1,214	2,895	6,955	17,988

Key points

- Commercial real estate continues to be the primary sector driving the Ulster Bank Group non-performing loan book. A reduction over the year of £1.8 billion primarily reflects Ulster Bank's continuing strategy to reduce concentration risk to this sector.
- The outlook for the property sector remains challenging. While there may be some signs of stabilisation in main urban centres, the outlook continues to be negative for secondary property locations on the island of Ireland.
- During the year, Ulster Bank experienced further migration of commercial real estate exposures to its problem management framework, where various measures may be agreed to assist customers whose loans are performing but who are experiencing temporary financial difficulties. For further details on Wholesale renegotiations refer to page 68.

Residential mortgages

The mortgage lending portfolio analysis by country of location of the underlying security is set out below.

	2012 £m	2011 £m
ROI	16,873	17,767
NI	2,289	2,253
	19,162	20,020

Balance sheet analysis

87	Financial assets
87	- Exposure summary
88	Sector and geographic concentration
106	Asset quality
116	Debt securities
116	IFRS measurement classification and issuer
117	Ratings
121	Asset-backed securities
121	Introduction
122	Product, geography and IFRS measurement classification
125	Ratings
126	Equity shares
128	Derivatives
128	Credit derivatives
129	Monoline insurers
130	Credit derivative product companies (CDPCs)
131	REIL, provisions and AFS reserves
131	- Divisional analysis
133	- Sector and geographical regional analyses
142	- Provisions and AFS reserves methodology
142	- REIL flow statement
143	- REIL summary
143	- Past due analysis
144	- Impairment provision flow statement
145	- Impairment charge analysis
146	- Potential problem loans
146	- AFS reserves

Balance sheet analysis

Financial assets

Exposure summary

The table below analyses the Group's financial asset exposures, both gross and net of offset arrangements.

	Group				
2012	Gross exposure £m	IFRS offset (1) £m	Balance sheet value £m	Non-IFRS offset (2) £m	Exposure post offset £m
Cash balances at central banks	74,524	—	74,524	—	74,524
Reverse repos	142,864	(38,377)	104,487	(17,439)	87,048
Lending	448,676	—	448,676	(34,853)	413,823
Debt securities	136,406	—	136,406	—	136,406
Equity shares	13,872	—	13,872	—	13,872
Derivatives	811,349	(373,448)	437,901	(407,208)	30,693
Settlement balances	8,173	(2,456)	5,717	(1,760)	3,957
Total excluding disposal groups	1,635,864	(414,281)	1,221,583	(461,260)	760,323
Total including disposal groups	1,636,168	(414,281)	1,221,887	(461,260)	760,627
Amounts due from holding company and fellow subsidiaries	31,120	—	31,120	—	31,120
Gross of short positions	1,667,288	(414,281)	1,253,007	(461,260)	791,747
Short positions	(27,541)	—	(27,541)	—	(27,541)
Net of short positions	1,639,747	(414,281)	1,225,466	(461,260)	764,206
2011					
Cash balances at central banks	68,487	—	68,487	—	68,487
Reverse repos	136,601	(37,584)	99,017	(15,246)	83,771
Lending	459,498	—	459,498	(40,106)	419,392
Debt securities	168,339	—	168,339	—	168,339
Equity shares	11,762	—	11,762	—	11,762
Derivatives	1,066,634	(544,207)	522,427	(477,305)	45,122
Settlement balances	8,261	(1,359)	6,902	(2,188)	4,714
Other financial assets	32	—	32	—	32
Total excluding disposal groups	1,919,614	(583,150)	1,336,464	(534,845)	801,619
Total including disposal groups	1,938,938	(583,150)	1,355,788	(534,845)	820,943
Amounts due from holding company and fellow subsidiaries	39,206	—	39,206	—	39,206
Gross of short positions	1,978,144	(583,150)	1,394,994	(534,845)	860,149
Short positions	(40,446)	—	(40,446)	—	(40,446)
Net of short positions	1,937,698	(583,150)	1,354,548	(534,845)	819,703

For the notes to this table refer to the following page.

Balance sheet analysis: Financial assets: Exposure summary continued

2010	Group Gross exposure £m	IFRS offset (1) £m	Balance sheet value £m	Non-IFRS offset (2) £m	Exposure post offset £m
Cash balances at central banks	49,838	—	49,838	—	49,838
Reverse repos	129,676	(39,986)	89,690	(10,712)	78,978
Lending	509,342	—	509,342	(42,032)	467,310
Debt securities	166,018	—	166,018	—	166,018
Equity shares	2,340	—	2,340	—	2,340
Derivatives	862,114	(450,578)	411,536	(357,281)	54,255
Settlement balances	10,770	(2,022)	8,748	(1,535)	7,213
Other financial assets	30	—	30	—	30
Total excluding disposal groups	1,730,128	(492,586)	1,237,542	(411,560)	825,982
Total including disposal groups	1,739,652	(492,586)	1,247,066	(411,560)	835,506
Amounts due from holding company and fellow subsidiaries	24,274	—	24,274	—	24,274
Gross of short positions	1,763,926	(492,586)	1,271,340	(411,560)	859,780
Short positions	(41,130)	—	(41,130)	—	(41,130)
Net of short positions	1,722,796	(492,586)	1,230,210	(411,560)	818,650

Notes:
(1) Relates to offset arrangements that comply with IFRS criteria and to transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation.
(2) This reflects 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.

Sector and geographic concentration

The following tables provide an analysis of credit concentration of financial assets by sector and geography. Geographical regions are based on the location of the lending or issuing office.

	Group										
	Reverse	Lending			Securities						
2012	repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
Government (2)	441	8,457	669	9,126	86,891	—	5,746	589	102,793	(5,142)	97,651
Financial institutions - banks (3)	34,444	25,698	164	25,862	5,203	1,469	334,323	74,524	475,825	(340,372)	135,453
- other (4)	69,254	38,886	2,151	41,037	40,846	2,249	79,076	4,712	237,174	(97,438)	139,736
Personal - mortgages	—	146,758	2,452	149,210	—	—	—	—	149,210	(1)	149,209
- unsecured	—	30,438	781	31,219	—	—	—	4	31,223	(7)	31,216
Property	—	43,599	28,510	72,109	661	313	4,056	—	77,139	(1,333)	75,806
Construction	—	6,001	2,009	8,010	17	257	799	—	9,083	(1,687)	7,396
Manufacturing	325	20,794	1,134	21,928	173	1,545	1,606	144	25,721	(3,775)	21,946
Finance leases (5)	—	9,123	4,397	13,520	49	1	4	—	13,574	—	13,574
Retail, wholesale and repairs	—	20,532	893	21,425	258	1,676	896	41	24,296	(1,785)	22,511
Transport and storage	—	14,450	3,372	17,822	375	373	3,055	2	21,627	(3,240)	18,387
Health, education and leisure	—	15,767	918	16,685	224	552	891	59	18,411	(964)	17,447
Hotels and restaurants	—	6,887	933	7,820	96	51	493	11	8,471	(348)	8,123
Utilities	—	4,949	1,339	6,288	398	572	2,929	46	10,233	(2,766)	7,467
Other	23	25,184	2,238	27,422	1,623	4,926	4,027	109	38,130	(2,402)	35,728
Total third-party	104,487	417,523	51,960	469,483	136,814	13,984	437,901	80,241	1,242,910	(461,260)	781,650
Amounts due from holding company and fellow subsidiaries	—	23,693	48	23,741	179	—	7,200	—	31,120	—	31,120
Total gross of provisions	104,487	441,216	52,008	493,224	136,993	13,984	445,101	80,241	1,274,030	(461,260)	812,770
Provisions	—	(10,002)	(10,805)	(20,807)	(408)	(112)	—	—	(21,327)	n/a	(21,327)
Total excluding disposal groups	104,487	431,214	41,203	472,417	136,585	13,872	445,101	80,241	1,252,703	(461,260)	791,443
Disposal groups	—	—	283	283	—	5	3	13	304	—	304
Total including disposal groups	104,487	431,214	41,486	472,700	136,585	13,877	445,104	80,254	1,253,007	(461,260)	791,747

For the notes to this table refer to page 96.

2011	Reverse repos £m	Lending Core £m	Lending Non-Core £m	Lending Total £m	Securities Debt £m	Securities Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
	Group										
Government (2)	2,247	8,337	517	8,854	106,341	—	5,455	549	123,446	(1,098)	122,348
Financial institutions - banks (3)	37,760	32,189	44	32,233	—	1,448	400,322	68,487	540,250	(407,009)	133,241
- other (4)	58,233	42,155	2,915	45,070	58,271	1,490	92,634	5,616	261,314	(117,602)	143,712
Personal - mortgages	—	138,321	4,355	142,676	—	—	—	—	142,676	—	142,676
- unsecured	—	30,151	1,330	31,481	—	—	—	7	31,488	(7)	31,481
Property		38,310	37,693	76,003	462	174	4,446	1	81,086	(1,274)	79,812
Construction		6,169	2,512	8,681	50	29	905	—	9,665	(1,139)	8,526
Manufacturing	254	18,030	4,035	22,065	446	1,921	3,317	306	28,309	(2,214)	26,095
Finance leases (5)	—	8,355	6,059	14,414	127	2	73	—	14,616	(16)	14,600
Retail, wholesale and repairs	—	18,175	2,000	20,175	366	2,406	1,045	—	23,992	(1,671)	22,321
Transport and storage	436	15,675	4,576	20,251	207	68	3,382	—	24,344	(206)	24,138
Health, education and leisure	—	13,171	1,371	14,542	119	13	871	—	15,545	(973)	14,572
Hotels and restaurants	—	7,118	1,111	8,229	107	3	669	—	9,008	(184)	8,824
Utilities	—	4,959	1,627	6,586	608	285	3,266	—	10,745	(450)	10,295
Other	87	24,327	2,465	26,792	1,821	4,064	6,042	455	39,261	(1,002)	38,259
Total third-party	99,017	405,442	72,610	478,052	168,925	11,903	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	—	10,380	—	39,206	—	39,206
Total gross of provisions	99,017	433,402	72,674	506,076	169,727	11,903	532,807	75,421	1,394,951	(534,845)	860,106
Provisions	—	(7,751)	(10,803)	(18,554)	(586)	(141)	—	—	(19,281)	n/a	(19,281)
Total excluding disposal groups	99,017	425,651	61,871	487,522	169,141	11,762	532,807	75,421	1,375,670	(534,845)	840,825
Disposal groups	—	18,676	72	18,748	—	5	439	132	19,324	—	19,324
Total including disposal groups	99,017	444,327	61,943	506,270	169,141	11,767	533,246	75,553	1,394,994	(534,845)	860,149
2010											
Government (2)	626	6,473	667	7,140	104,735	—	7,228	285	120,014	(3,916)	116,098
Financial institutions - banks (3)	40,530	41,899	141	42,040	—	408	315,290	49,838	448,106	(329,266)	118,840
- other (4)	47,966	39,742	7,121	46,863	52,783	718	70,604	8,067	227,001	(67,138)	159,863
Personal - mortgages	—	140,351	5,326	145,677	—	—	—	—	145,677	(19)	145,658
- unsecured	—	32,552	3,452	36,004	—	—	—	7	36,011	(11)	36,000
Property	—	41,934	47,081	89,015	2,620	190	3,730	28	95,583	(1,046)	94,537
Construction	—	8,163	3,092	11,255	48	—	740	—	12,043	(1,406)	10,637
Manufacturing	389	19,271	5,469	24,740	696	23	2,880	—	28,728	(2,156)	26,572
Finance leases (5)	—	8,273	8,530	16,803	10	2	14	—	16,829	(134)	16,695
Retail, wholesale and repairs	—	18,635	2,551	21,186	404	13	1,057	—	22,660	(2,467)	20,193
Transport and storage	—	14,972	6,773	21,745	353	6	2,576	—	24,680	(224)	24,456
Health, education and leisure	—	17,267	1,737	19,004	1,464	26	1,151	—	21,645	(1,047)	20,598
Hotels and restaurants	—	8,149	1,472	9,621	276	—	515	—	10,412	(253)	10,159
Utilities	—	6,038	1,807	7,845	1,084	11	2,043	2	10,985	(985)	10,000
Other	179	23,954	3,220	27,174	2,030	1,063	3,708	389	34,543	(1,492)	33,051
Total third-party	89,690	427,673	98,439	526,112	166,503	2,460	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	—	17,469	—	24,274	—	24,274
Total gross of provisions	89,690	434,297	98,609	532,906	166,514	2,460	429,005	58,616	1,279,191	(411,560)	867,631
Provisions	—	(7,349)	(9,421)	(16,770)	(485)	(120)	—	—	(17,375)	n/a	(17,375)
Total excluding disposal groups	89,690	426,948	89,188	516,136	166,029	2,340	429,005	58,616	1,261,816	(411,560)	850,256
Disposal groups	—	251	3,262	3,513	—	17	5,148	846	9,524	—	9,524
Total including disposal groups	89,690	427,199	92,450	519,649	166,029	2,357	434,153	59,462	1,271,340	(411,560)	859,780

For the notes to this table refer to page 96.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

Key points

- Financial asset exposures after offset including disposal groups decreased by £60 billion or 7% to £761 billion, reflecting the Group's focus on reducing its funded balance sheet, primarily in Non-Core, Markets and International Banking.

- Reductions were across all major balance sheet categories: debt securities (£32 billion) and derivatives (£14 billion). Conditions in the financial markets and the Group's focus on risk appetite and sector concentration had a direct impact on the composition of its portfolio during the year.

- Exposures to central and local governments decreased by £25 billion principally in debt securities. This was driven by Markets de-risking its balance sheet, management of the Group Treasury liquidity portfolio as well as overall risk reduction in respect of eurozone exposures. The Group's portfolio comprises exposures to central governments and sub-sovereigns such as local authorities, primarily in the Group's key markets in the UK, Western Europe and the US.

- The banking sector is one of the largest in the Group's portfolio. The sector is well diversified geographically and by exposure with derivative exposures being largely collateralised. The sector is tightly controlled through the combination of the single name concentration framework, a suite of credit policies specifically tailored to the sector and country limits. Exposures to the banking sector marginally increased during the period. This reflected reduced interbank lending and derivative activity, and a reduction in limits to banks in countries under stress, such as the peripheral eurozone countries, offset by transfer of balances from RBS N.V.

- Exposure to other financial institutions comprising traded and non traded products is spread across a wide range of financial companies including insurance, securitisation vehicles, financial intermediaries including broker dealers and central counterparties (CCPs), financial guarantors - monolines and credit derivative product companies (CDPCs) - and funds comprising unleveraged, hedge and leveraged funds. The size of the Core portfolio has decreased marginally since 2011. Entities in this sector remain vulnerable to market shocks or contagion from the banking sector. Credit risk in these sectors is managed through the single name concentration, sector concentration and asset and product class frameworks, with specific sector and product caps in place where there is a perception of heightened credit risk, such as committed lending to banks, leveraged funds and insurance holding companies. The Group continues to develop its risk appetite framework for CCPs to reflect increased activity with these entities driven by regulatory requirements. The Group is also managing down its exposures to monolines and CDPCs with the aim of exiting these portfolios.

- The Group's exposure to property and construction sector decreased by £11 billion (including disposal groups), principally in commercial real estate lending. The majority of the Group's Core property exposure is within UK Corporate (73%). In relation to property exposure, the UK Corporate and Ulster Bank divisions saw further deterioration in asset quality during the year.

- Transport and storage includes the Group's shipping exposures of £11 billion which comprises asset-backed exposures to ocean-going vessels. Conditions remained poor across the major shipping market segments in 2012, with low charter rates and vessel values. A key protection for the Group is the minimum security covenant. This covenant is tested each quarter on an individual vessel basis to ensure prompt remedial action is taken if values fall significantly below agreed loan coverage ratios. There was an increase in the number of clients suffering liquidity issues or failing to meet their minimum security covenant and a commensurate rise in referrals to the Watchlist and the GRG. At 31 December 2012, 20% of the Group's exposure to this sector was in Watchlist Red. The Group's exposure to the shipping sector (including shipping related infrastructure) declined by 3.5% in 2012 as a result of amortisation and foreign exchange movements. At 31 December 2012, £0.7 billion of loans were included in risk elements in lending with an associated provision of £0.2 billion and impairment charge of £0.1 billion for 2012.

Within lending:

- UK Retail increased its lending to homeowners by £4.1 billion (including disposal groups), including first-time buyers, reflecting the impact of the UK Government's Funding for Lending Scheme (FLS); unsecured lending balances fell.

- UK Corporate lending decreased by £3.6 billion, reflecting a combination of customer deleveraging with low business confidence and portfolio de-risking, particularly in commercial real estate, which fell by £3.5 billion.

- Non-Core continued to make significant progress on its balance sheet strategy by reducing lending by £21 billion across all sectors, principally property and construction, where commercial real estate lending decreased by £7.9 billion, reflecting repayments and asset sales.

The tables on pages 91 to 96 analyse financial assets by geographical region (location of office) and sector.

	Group										
	Reverse	Lending			Securities				Balance	Non-IFRS	Exposure
	repos	Core	Non-Core	Total	Debt	Equity	Derivatives	Other	sheet value	offset (1)	post offset
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK											
Government (2)	441	8,052	8	8,060	60,827	—	5,537	47	74,912	(5,019)	69,893
Financial institutions - banks (3)	24,851	19,593	44	19,637	4,029	1,038	193,886	41,008	284,449	(201,458)	82,991
- other (4)	42,200	31,531	1,633	33,164	14,906	1,844	61,248	2,022	155,384	(78,825)	76,559
Personal - mortgages	—	109,511	19	109,530	—	—	—	—	109,530	—	109,530
- unsecured	—	19,636	55	19,691	—	—	—	4	19,695	(7)	19,688
Property	—	35,531	18,173	53,704	434	282	3,903	—	58,323	(1,328)	56,995
Construction	—	5,101	1,406	6,507	14	248	786	—	7,555	(1,666)	5,889
Manufacturing	325	9,405	631	10,036	12	1,498	1,274	111	13,256	(3,542)	9,714
Finance leases (5)	—	6,349	4,183	10,532	49	1	—	—	10,582	—	10,582
Retail, wholesale and repairs	—	11,081	428	11,509	194	1,551	701	41	13,996	(1,590)	12,406
Transport and storage	—	7,923	2,435	10,358	244	361	2,019	2	12,984	(2,279)	10,705
Health, education and leisure	—	11,530	371	11,901	56	548	806	59	13,370	(888)	12,482
Hotels and restaurants	—	5,505	484	5,989	73	51	493	11	6,617	(344)	6,273
Utilities	—	2,780	776	3,556	282	441	2,553	26	6,858	(2,515)	4,343
Other	19	13,949	1,754	15,703	912	4,369	2,602	109	23,714	(1,885)	21,829
Total third-party	67,836	297,477	32,400	329,877	82,032	12,232	275,808	43,440	811,225	(301,346)	509,879
Amounts due from holding company and fellow subsidiaries	—	20,923	48	20,971	179	—	2,837	—	23,987	—	23,987
Total gross of provisions	67,836	318,400	32,448	350,848	82,211	12,232	278,645	43,440	835,212	(301,346)	533,866
Provisions	—	(5,634)	(4,112)	(9,746)	(261)	(112)	—	—	(10,119)	n/a	(10,119)
Total net of provisions	67,836	312,766	28,336	341,102	81,950	12,120	278,645	43,440	825,093	(301,346)	523,747
US											
Government (2)	—	151	—	151	19,995	—	23	500	20,669	(17)	20,652
Financial institutions - banks (3)	5,024	1,203	27	1,230	421	349	116,711	11,315	135,050	(115,459)	19,591
- other (4)	22,808	40,006	203	4,209	25,457	202	13,366	2,238	68,280	(14,720)	53,560
Personal - mortgages	—	19,483	2,428	21,911	—	—	—	—	21,911	—	21,911
- unsecured	—	8,209	539	8,748	—	—	—	—	8,748	—	8,748
Property	—	2,847	496	3,343	8	26	34	—	3,411	—	3,411
Construction	—	384	4	388	3	2	9	—	402	—	402
Manufacturing	—	5,994	17	6,011	154	15	217	—	6,397	(215)	6,182
Finance leases (5)	—	2,471	—	2,471	—	—	—	—	2,471	—	2,471
Retail, wholesale and repairs	—	4,838	53	4,891	58	1	66	—	5,016	(52)	4,964
Transport and storage	—	1,521	395	1,916	37	—	855	—	2,808	(800)	2,008
Health, education and leisure	—	2,822	26	2,848	168	—	73	—	3,089	(70)	3,019
Hotels and restaurants	—	474	16	490	23	—	—	—	513	—	513
Utilities	—	929	27	956	96	15	258	—	1,325	(251)	1,074
Other	4	4,971	45	5,016	665	324	1,045	—	7,054	(277)	6,777
Total third-party	27,836	60,303	4,276	64,579	47,085	934	132,657	14,053	287,144	(131,861)	155,283
Amounts due from holding company and fellow subsidiaries	—	130	—	130	—	—	1,938	—	2,068	—	2,068
Total gross of provisions	27,836	60,433	4,276	64,709	47,085	934	134,595	14,053	289,212	(131,861)	157,351
Provisions	—	(578)	(287)	(865)	(45)	—	—	—	(910)	n/a	(910)
Total excluding disposal groups	27,836	59,855	3,989	63,844	47,040	934	134,595	14,053	288,302	(131,861)	156,441
Disposal groups	—	—	283	283	—	5	3	13	304	—	304
Total including disposal groups	27,836	59,855	4,272	64,127	47,040	939	134,598	14,066	288,606	(131,861)	156,745

For the notes to this table refer to page 96.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

		Group									
	Reverse	Lending			Securities				Balance	Non-IFRS	Exposure
	repos	Core	Non-Core	Total	Debt	Equity	Derivatives	Other	sheet value	offset (1)	post offset
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Europe											
Government (2)	—	224	619	843	795	—	54	—	1,692	(15)	1,677
Financial institutions - banks (3)	375	1,640	93	1,733	100	—	21	21,323	23,552	(2)	23,550
- other (4)	20	1,284	252	1,536	—	145	93	26	1,820	—	1,820
Personal - mortgages	—	17,446	5	17,451	—	—	—	—	17,451	(1)	17,450
- unsecured	—	1,540	187	1,727	—	—	—	—	1,727	—	1,727
Property	—	4,896	9,675	14,571	—	2	77	—	14,650	(5)	14,645
Construction	—	510	599	1,109	—	6	—	—	1,115	(21)	1,094
Manufacturing	—	4,227	459	4,686	—	26	24	1	4,737	(9)	4,728
Finance leases (5)	—	292	161	453	—	—	—	—	453	—	453
Retail, wholesale and repairs	—	3,036	406	3,442	—	109	7	—	3,558	(22)	3,536
Transport and storage	—	4,789	420	5,209	—	10	12	—	5,231	(5)	5,226
Health, education and leisure	—	1,169	382	1,551	—	—	—	—	1,551	(6)	1,545
Hotels and restaurants	—	893	433	1,326	—	—	—	—	1,326	(4)	1,322
Utilities	—	938	404	1,342	6	112	47	20	1,527	—	1,527
Other	—	4,299	412	4,711	1	165	38	—	4,915	(52)	4,863
Total third-party	395	47,183	14,507	61,690	902	575	373	21,370	85,305	(142)	85,163
Amounts due from holding company and fellow subsidiaries	—	534	—	534	—	—	380	—	914	—	914
Total gross of provisions	395	47,717	14,507	62,224	902	575	753	21,370	86,219	(142)	86,077
Provisions	—	(3,662)	(6,348)	(10,010)	—	—	—	—	(10,010)	n/a	(10,010)
Total net of provisions	395	44,055	8,159	52,214	902	575	753	21,370	76,209	(142)	76,067
RoW											
Government (2)	—	30	42	72	5,274	—	132	42	5,520	(91)	5,429
Financial institutions - banks (3)	4,194	3,262	—	3,262	653	82	23,705	878	32,774	(23,453)	9,321
- other (4)	4,226	2,065	63	2,128	483	58	4,369	426	11,690	(3,893)	7,797
Personal - mortgages	—	318	—	318	—	—	—	—	318	—	318
- unsecured	—	1,053	—	1,053	—	—	—	—	1,053	—	1,053
Property	—	325	166	491	219	3	42	—	755	—	755
Construction	—	6	—	6	—	1	4	—	11	—	11
Manufacturing	—	1,168	27	1,195	7	6	91	32	1,331	(9)	1,322
Finance leases (5)	—	11	53	64	—	—	4	—	68	—	68
Retail, wholesale and repairs	—	1,577	6	1,583	6	15	122	—	1,726	(121)	1,605
Transport and storage	—	217	122	339	94	2	169	—	604	(156)	448
Health, education and leisure	—	246	139	385	—	4	12	—	401	—	401
Hotels and restaurants	—	15	—	15	—	—	—	—	15	—	15
Utilities	—	302	132	434	14	4	71	—	523	—	523
Other	—	1,965	27	1,992	45	68	342	—	2,447	(188)	2,259
Total third-party	8,420	12,560	777	13,337	6,795	243	29,063	1,378	59,236	(27,911)	31,325
Amounts due from holding company and fellow subsidiaries	—	2,106	—	2,106	—	—	2,045	—	4,151	—	4,151
Total gross of provisions	8,420	14,666	777	15,443	6,795	243	31,108	1,378	63,387	(27,911)	35,476
Provisions	—	(128)	(58)	(186)	(102)	—	—	—	(288)	n/a	(288)
Total net of provisions	8,420	14,538	719	15,257	6,693	243	31,108	1,378	63,099	(27,911)	35,188

For the notes to this table refer to page 96.

2011	Reverse repos £m	Lending Core £m	Lending Non-Core £m	Lending Total £m	Securities Debt £m	Securities Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
Group											
UK											
Government (2)	2,130	8,012	25	8,037	75,754	—	5,198	548	91,667	(1,098)	90,569
Financial institutions - banks (3)	24,543	25,917	3	25,920	—	977	261,382	40,364	353,186	(274,012)	79,174
- other (4)	38,909	29,607	2,284	31,891	24,820	922	37,688	2,472	136,702	(54,243)	82,459
Personal - mortgages	—	99,302	1,423	100,725	—	—	—	—	100,725	—	100,725
- unsecured	—	19,218	127	19,345	—	—	—	—	19,345	(7)	19,338
Property	—	31,142	24,585	55,727	167	137	4,181	—	60,212	(1,265)	58,947
Construction	—	5,291	1,882	7,173	20	26	874	—	8,093	(1,115)	6,978
Manufacturing	254	9,611	789	10,400	336	1,908	2,077	—	14,975	(2,205)	12,770
Finance leases (5)	—	5,618	5,598	11,216	—	2	73	—	11,291	(16)	11,275
Retail, wholesale and repairs	—	11,071	1,441	12,512	307	2,404	902	—	16,125	(1,647)	14,478
Transport and storage	436	8,585	2,869	11,454	51	67	2,138	—	14,146	(200)	13,946
Health, education and leisure	—	8,734	757	9,491	45	8	744	—	10,288	(965)	9,323
Hotels and restaurants	—	5,599	569	6,168	14	—	662	—	6,844	(178)	6,666
Utilities	—	2,462	931	3,393	324	266	2,870	—	6,853	(450)	6,403
Other	51	16,946	1,606	18,552	1,062	3,947	3,943	453	28,008	(946)	27,062
Total third-party	66,323	287,115	44,889	332,004	102,900	10,664	322,732	43,837	878,460	(338,347)	540,113
Amounts due from holding company and fellow subsidiaries	—	26,782	41	26,823	785	—	8,119	—	35,727	—	35,727
Total gross of provisions	66,323	313,897	44,930	358,827	103,685	10,664	330,851	43,837	914,187	(338,347)	575,840
Provisions	—	(4,385)	(3,825)	(8,210)	(410)	(141)	—	—	(8,761)	n/a	(8,761)
Total excluding disposal groups	66,323	309,512	41,105	350,617	103,275	10,523	330,851	43,837	905,426	(338,347)	567,079
Disposal groups	—	18,676	3	18,679	—	—	430	100	19,209	—	19,209
Total including disposal groups	66,323	328,188	41,108	369,296	103,275	10,523	331,281	43,937	924,635	(338,347)	586,288
US											
Government (2)	—	176	4	180	22,069	—	9	1	22,259	—	22,259
Financial institutions - banks (3)	7,290	627	15	642	—	432	111,240	25,221	144,825	(108,043)	36,782
- other (4)	17,367	8,899	251	9,150	31,082	560	54,225	2,724	115,108	(60,573)	54,535
Personal - mortgages	—	20,311	2,926	23,237	—	—	—	—	23,237	—	23,237
- unsecured	—	7,505	936	8,441	—	—	—	—	8,441	—	8,441
Property	—	2,407	1,370	3,777	26	23	38	—	3,864	—	3,864
Construction	—	412	45	457	21	3	11	—	492	—	492
Manufacturing	—	6,511	42	6,553	101	12	452	—	7,118	—	7,118
Finance leases (2)	—	2,471	—	2,471	—	—	—	—	2,471	—	2,471
Retail, wholesale and repairs	—	4,932	98	5,030	52	—	63	—	5,145	—	5,145
Transport and storage	—	1,832	935	2,767	26	1	1,084	—	3,878	—	3,878
Health, education and leisure	—	2,947	88	3,035	74	4	93	—	3,206	—	3,206
Hotels and restaurants	—	627	57	684	93	3	1	—	781	—	781
Utilities	—	936	8	944	243	16	295	—	1,498	—	1,498
Other	29	4,993	405	5,398	695	107	1,427	—	7,656	—	7,656
Total third-party	24,686	65,586	7,180	72,766	54,482	1,161	168,938	27,946	349,979	(168,616)	181,363
Amounts due from holding company and fellow subsidiaries	—	307	8	315	17	—	1,019	—	1,351	—	1,351
Total gross of provisions	24,686	65,893	7,188	73,081	54,499	1,161	169,957	27,946	351,330	(168,616)	182,714
Provisions	—	(763)	(466)	(1,229)	(59)	—	—	—	(1,288)	n/a	(1,288)
Total excluding disposal groups	24,686	65,130	6,722	71,852	54,440	1,161	169,957	27,946	350,042	(168,616)	181,426
Disposal groups	—	—	25	25	—	5	9	15	54	—	54
Total including disposal groups	24,686	65,130	6,747	71,877	54,440	1,166	169,966	27,961	350,096	(168,616)	181,480

For the notes to this table refer to page 96.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

2011		Reverse repos £m	Lending Core £m	Lending Non-Core £m	Lending Total £m	Securities Debt £m	Securities Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
Group												
Europe												
Government (2)		—	114	444	558	333	—	58	—	949	—	949
Financial institutions	- banks (3)	247	2,680	26	2,706	—	28	—	815	3,796	—	3,796
	- other (4)	—	832	345	1,177	148	6	124	25	1,480	(1)	1,479
Personal	- mortgages	—	18,328	6	18,334	—	—	—	—	18,334	—	18,334
	- unsecured	—	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	10	—	4,716	(9)	4,707
Finance leases (2)		—	255	435	690	—	—	—	—	690	—	690
Retail, wholesale and repairs		—	1,910	435	2,345	4	2	5	—	2,356	(24)	2,332
Transport and storage		—	5,044	589	5,633	2	—	13	—	5,648	(6)	5,642
Health, education and leisure		—	1,134	301	1,435	—	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	33	—	1,677	—	1,677
Other		7	1,815	430	2,245	50	8	5	—	2,315	(56)	2,259
Total third-party		254	42,653	19,139	61,792	578	49	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	446	847	64,187	(143)	64,044
Provisions		—	(2,445)	(6,380)	(8,825)	—	—	—	—	(8,825)	n/a	(8,825)
Total excluding disposal groups		254	40,414	12,774	53,188	578	49	446	847	55,362	(143)	55,219
Disposal groups		—	—	—	—	—	—	—	17	17	—	17
Total including disposal groups		254	40,414	12,774	53,188	578	49	446	864	55,379	(143)	55,236
RoW												
Government (2)		117	35	44	79	8,185	—	190	—	8,571	—	8,571
Financial institutions	- banks (3)	5,680	2,965	—	2,965	—	11	27,700	2,087	38,443	(24,954)	13,489
	- other (4)	1,957	2,817	35	2,852	2,221	2	597	395	8,024	(2,785)	5,239
Personal	- mortgages	—	380	—	380	—	—	—	—	380	—	380
	- unsecured	—	1,507	—	1,507	—	—	—	—	1,507	—	1,507
Property		—	202	526	728	269	14	60	1	1,072	—	1,072
Construction		—	—	9	9	9	—	2	—	20	—	20
Manufacturing		—	381	31	412	4	—	778	306	1,500	—	1,500
Finance leases (2)		—	11	26	37	127	—	—	—	164	—	164
Retail, wholesale and repairs		—	262	26	288	3	—	75	—	366	—	366
Transport and storage		—	214	183	397	128	—	147	—	672	—	672
Health, education and leisure		—	356	225	581	—	—	32	—	613	—	613
Hotels and restaurants		—	14	—	14	—	—	—	—	14	—	14
Utilities		—	371	273	644	5	—	68	—	717	—	717
Other		—	573	24	597	14	2	667	2	1,282	—	1,282
Total third-party		7,754	10,088	1,402	11,490	10,965	29	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	31,553	2,791	65,247	(27,739)	37,508
Provisions		—	(158)	(132)	(290)	(117)	—	—	—	(407)	n/a	(407)
Total excluding disposal groups		7,754	10,595	1,270	11,865	10,848	29	31,553	2,791	64,840	(27,739)	37,101
Disposal groups		—	—	44	44	—	—	—	—	44	—	44
Total including disposal groups		7,754	10,595	1,314	11,909	10,848	29	31,553	2,791	64,884	(27,739)	37,145

For the notes to this table refer to page 96.

	Group										
	Reverse repos	Lending			Securities						
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
UK											
Government (2)	611	5,727	154	5,881	69,586	—	6,982	173	83,233	(3,916)	79,317
Financial institutions - banks (3)	26,839	35,003	14	35,017	—	78	205,862	28,089	295,885	(222,814)	73,071
- other (4)	29,854	25,194	5,966	31,160	25,776	136	32,482	1,938	121,346	(27,307)	94,039
Personal - mortgages	—	99,927	1,665	101,592	—	—	—	—	101,592	(14)	101,578
- unsecured	—	22,101	428	22,529	—	—	—	—	22,529	(11)	22,518
Property	—	34,970	30,492	65,462	2,222	174	3,639	28	71,525	(1,041)	70,484
Construction	—	7,026	2,296	9,322	39	—	724	—	10,085	(1,392)	8,693
Manufacturing	389	11,929	1,538	13,467	277	—	2,087	—	16,220	(2,150)	14,070
Finance leases (5)	—	5,589	7,785	13,374	10	2	14	—	13,400	(134)	13,266
Retail, wholesale and repairs	—	12,393	1,788	14,181	258	11	858	—	15,308	(2,452)	12,856
Transport and storage	—	7,890	4,040	11,930	195	3	1,477	—	13,605	(219)	13,386
Health, education and leisure	—	13,496	1,046	14,542	156	22	832	—	15,552	(1,047)	14,505
Hotels and restaurants	—	6,559	808	7,367	172	—	509	—	8,048	(249)	7,799
Utilities	—	3,067	1,019	4,086	488	5	1,753	2	6,334	(985)	5,349
Other	49	17,081	1,655	18,736	910	789	1,888	336	22,708	(1,448)	21,260
Total third-party	57,742	307,952	60,694	368,646	100,089	1,220	259,107	30,566	817,370	(265,179)	552,191
Amounts due from holding company and fellow subsidiaries	—	4,903	151	5,054	11	—	14,212	—	19,277	—	19,277
Total gross of provisions	57,742	312,855	60,845	373,700	100,100	1,220	273,319	30,566	836,647	(265,179)	571,468
Provisions	—	(4,879)	(3,709)	(8,588)	(387)	(120)	—	—	(9,095)	n/a	(9,095)
Total excluding disposal groups	57,742	307,976	57,136	365,112	99,713	1,100	273,319	30,566	827,552	(265,179)	562,373
Disposal groups	—	251	2,193	2,444	—	—	380	31	2,855	—	2,855
Total including disposal groups	57,742	308,227	59,329	367,556	99,713	1,100	273,699	30,597	830,407	(265,179)	565,228
US											
Government (2)	—	169	6	175	24,946	—	5	112	25,238	—	25,238
Financial institutions - banks (3)	8,978	780	12	792	—	310	87,612	16,798	114,490	(85,266)	29,224
- other (4)	16,023	9,372	452	9,824	23,858	562	34,105	4,574	88,946	(38,596)	50,350
Personal - mortgages	—	20,548	3,653	24,201	—	—	—	—	24,201	—	24,201
- unsecured	—	6,816	2,704	9,520	—	—	—	—	9,520	—	9,520
Property	—	1,595	3,318	4,913	95	4	23	—	5,035	—	5,035
Construction	—	441	79	520	5	—	16	—	541	—	541
Manufacturing	—	4,936	143	5,079	412	22	583	—	6,096	—	6,096
Finance leases (5)	—	2,315	—	2,315	—	—	—	—	2,315	—	2,315
Retail, wholesale and repairs	—	4,205	237	4,442	132	—	68	—	4,642	—	4,642
Transport and storage	—	1,786	1,404	3,190	99	2	929	—	4,220	—	4,220
Health, education and leisure	—	2,380	313	2,693	1,308	3	292	—	4,296	—	4,296
Hotels and restaurants	—	486	136	622	104	—	3	—	729	—	729
Utilities	—	986	6	992	567	2	244	—	1,805	—	1,805
Other	130	4,101	573	4,674	1,057	258	1,203	43	7,365	—	7,365
Total third-party	25,131	60,916	13,036	73,952	52,583	1,163	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	126,589	21,527	301,747	(123,862)	177,885
Provisions	—	(822)	(745)	(1,567)	(49)	—	—	—	(1,616)	n/a	(1,616)
Total excluding disposal groups	25,131	60,891	12,296	73,187	52,534	1,163	126,589	21,527	300,131	(123,862)	176,269
Disposal groups	—	—	1,069	1,069	—	17	4,768	815	6,669	—	6,669
Total including disposal groups	25,131	60,891	13,365	74,256	52,534	1,180	131,357	22,342	306,800	(123,862)	182,938

For the notes to this table refer to page 96.

Balance sheet analysis: **Credit concentration: Sector and geographic region** continued

	Group										
	Reverse repos	Lending			Securities		Derivatives	Other	Balance sheet value	Non-IFRS offset (1)	Exposure post offset
2010	£m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	£m	£m	£m	£m	£m
Europe											
Government (2)	—	211	507	718	676	—	64	—	1,458	—	1,458
Financial institutions - banks (3)	18	4,390	45	4,435	—	20	—	3,886	8,359	—	8,359
- other (4)	—	752	413	1,165	364	13	399	25	1,966	(1)	1,965
Personal - mortgages	—	19,467	8	19,475	—	—	—	—	19,475	(5)	19,470
- unsecured	—	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	—	—	5,771	(6)	5,765
Finance leases (5)	—	369	745	1,114	—	—	—	—	1,114	—	1,114
Retail, wholesale and repairs	—	1,787	441	2,228	5	2	—	—	2,235	(15)	2,220
Transport and storage	—	5,099	996	6,095	2	1	—	—	6,098	(5)	6,093
Health, education and leisure	—	1,263	362	1,625	—	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	—	—	1,705	—	1,705
Other	—	2,142	383	2,525	37	14	—	1	2,577	(44)	2,533
Total third-party	18	47,528	21,572	69,100	1,115	56	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	471	3,919	75,025	(99)	74,926
Provisions	—	(1,483)	(4,860)	(6,343)	—	—	—	—	(6,343)	n/a	(6,343)
Total excluding disposal groups	18	46,377	16,726	63,103	1,115	56	471	3,919	68,682	(99)	68,583
Disposal groups	—	—	—	—	—	—	—	—	—	—	—
Total including disposal groups	18	46,377	16,726	63,103	1,115	56	471	3,919	68,682	(99)	68,583
RoW											
Government (2)	15	366	—	366	9,527	—	177	—	10,085	—	10,085
Financial institutions - banks (3)	4,695	1,726	70	1,796	—	—	21,816	1,065	29,372	(21,186)	8,186
- other (4)	2,089	4,424	290	4,714	2,785	7	3,618	1,530	14,743	(1,234)	13,509
Personal - mortgages	—	409	—	409	—	—	—	—	409	—	409
- unsecured	—	1,452	—	1,452	—	—	—	—	1,452	—	1,452
Property	—	540	1,184	1,724	303	12	68	—	2,107	—	2,107
Construction	—	79	40	119	4	—	—	—	123	—	123
Manufacturing	—	195	236	431	—	—	210	—	641	—	641
Finance leases (5)	—	—	—	—	—	—	—	—	—	—	—
Retail, wholesale and repairs	—	250	85	335	9	—	131	—	475	—	475
Transport and storage	—	197	333	530	57	—	170	—	757	—	757
Health, education and leisure	—	128	16	144	—	—	27	—	171	—	171
Hotels and restaurants	—	65	—	65	—	—	3	—	68	—	68
Utilities	—	816	274	1,090	5	—	46	—	1,141	—	1,141
Other	—	630	609	1,239	26	2	617	9	1,893	—	1,893
Total third-party	6,799	11,277	3,137	14,414	12,716	21	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	28,626	2,604	65,772	(22,420)	43,352
Provisions	—	(165)	(107)	(272)	(49)	—	—	—	(321)	n/a	(321)
Total net of provisions	6,799	11,704	3,030	14,734	12,667	21	28,626	2,604	65,451	(22,420)	43,031

Notes:
(1) This reflects 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.
(2) Includes central and local government.
(3) Includes £74.5 billion (2011 - £68.5 billion; 2010 - £49.8 billion) relating to cash and balances at central banks.
(4) Loans made by the Group's consolidated conduits to asset owning companies are included within Financial institutions - other.
(5) Includes instalment credit.

The table below analyses the Bank's financial asset exposures, both gross and net of offset arrangements.

	Bank				
2012	Gross exposure £m	IFRS offset (1) £m	Balance sheet value £m	Non-IFRS offset (2) £m	Exposure post offset £m
Cash balances at central banks	70,374	—	70,374	—	70,374
Reverse repos	78,686	(10,097)	68,589	(14,762)	53,827
Lending	191,392	—	191,392	(27,788)	163,604
Debt securities	89,150	—	89,150	—	89,150
Equity shares	12,766	—	12,766	—	12,766
Derivatives	808,149	(373,264)	434,885	(407,183)	27,702
Settlement balances	3,562	(472)	3,090	(360)	2,730
Total	1,254,079	(383,833)	870,246	(450,093)	420,153
Amounts due from holding company, subsidiaries and fellow subsidiaries	169,389	—	169,389	—	169,389
Gross of short positions	1,423,468	(383,833)	1,039,635	(450,093)	589,542
Short positions	(14,074)	—	(14,074)	—	(14,074)
Net of short positions	1,409,394	(383,833)	1,025,561	(450,093)	575,468
2011					
Cash balances at central banks	64,261	—	64,261	—	64,261
Reverse repos	84,444	(16,986)	67,458	(9,867)	57,591
Lending	187,976	—	187,976	(33,252)	154,724
Debt securities	111,313	—	111,313	—	111,313
Equity shares	10,486	—	10,486	—	10,486
Derivatives	1,062,576	(543,736)	518,840	(477,226)	41,614
Settlement balances	4,500	(411)	4,059	(384)	3,675
Total excluding disposal groups	1,525,556	(561,163)	964,393	(520,729)	443,664
Total including disposal groups	1,544,175	(561,163)	983,012	(520,729)	462,283
Amounts due from holding company, subsidiaries and fellow subsidiaries	293,333	—	293,333	—	293,333
Gross of short positions	1,837,508	(561,163)	1,276,345	(520,729)	755,616
Short positions	(24,858)	—	(24,858)	—	(24,858)
Net of short positions	1,812,650	(561,163)	1,251,487	(520,729)	730,758
2010					
Cash balances at central banks	44,921	—	44,921	—	44,921
Reverse repos	83,177	(24,550)	58,627	(3,293)	55,334
Lending	223,573	—	223,573	(32,024)	191,549
Debt securities	114,482	—	114,482	—	114,482
Equity shares	1,016	—	1,016	—	1,016
Derivatives	858,777	(450,050)	408,727	(357,192)	51,535
Settlement balances	4,159	(630)	3,529	(148)	3,381
Total excluding disposal groups	1,330,105	(475,230)	854,875	(392,657)	462,218
Total including disposal groups	1,334,870	(475,230)	859,640	(392,657)	466,983
Amounts due from holding company, subsidiaries and fellow subsidiaries	266,755	—	266,755	—	266,755
Gross of short positions	1,601,625	(475,230)	1,126,395	(392,657)	733,738
Short positions	(25,687)	—	(25,687)	—	(25,687)
Net of short positions	1,575,938	(475,230)	1,100,708	(392,657)	708,051

For the notes to this table refer to page 88.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

The following tables provide an analysis of credit concentration of the Bank's financial assets by sector and geography. Geographical regions are based on the location of the lending or issuing office.

	Bank										
	Reverse repos	Lending			Securities		Derivatives	Other	Balance sheet value	Non-IFRS offset (1)	Exposure post offset
2012	£m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	£m	£m	£m	£m	£m
Government (2)	441	6,656	661	7,317	66,740	—	5,723	89	80,310	(4,498)	75,812
Financial institutions - banks (3)	25,594	18,355	59	18,414	4,710	1,151	334,278	70,374	454,521	(340,372)	114,149
- other (4)	42,210	29,007	1,445	30,452	16,343	2,555	78,317	2,700	172,577	(93,867)	78,710
Personal - mortgages	—	39,280	19	39,299	—	—	—	—	39,299	—	39,299
- unsecured	—	4,654	52	4,706	—	—	—	—	4,706	(5)	4,701
Property	—	20,275	11,630	31,905	315	235	3,375	—	35,830	(514)	35,316
Construction	—	2,770	1,239	4,009	14	256	782	—	5,061	(608)	4,453
Manufacturing	325	10,211	795	11,006	19	1,530	1,529	95	14,504	(2,327)	12,177
Finance leases (5)	—	197	81	278	49	—	4	—	331	—	331
Retail, wholesale and repairs	—	7,044	432	7,476	200	1,675	805	40	10,196	(558)	9,638
Transport and storage	—	10,760	3,301	14,061	220	373	3,017	2	17,673	(2,836)	14,837
Health, education and leisure	—	5,864	711	6,575	56	552	609	28	7,820	(264)	7,556
Hotels and restaurants	—	2,785	411	3,196	73	51	421	11	3,752	(223)	3,529
Utilities	—	3,158	1,338	4,496	295	556	2,838	39	8,224	(2,231)	5,993
Other	19	12,196	1,632	13,828	523	3,855	3,187	86	21,498	(1,790)	19,708
Total third-party	68,589	173,212	23,806	197,018	89,557	12,789	434,885	73,464	876,302	(450,093)	426,209
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	119,002	2,137	121,139	33,297	—	14,953	—	169,389	—	169,389
Total gross of provisions	68,589	292,214	25,943	318,157	122,854	12,789	449,838	73,464	1,045,691	(450,093)	595,598
Provisions	—	(2,548)	(3,078)	(5,626)	(407)	(23)	—	—	(6,056)	n/a	(6,056)
Total including provisions	68,589	289,666	22,865	312,531	122,447	12,766	449,838	73,464	1,039,635	(450,093)	589,542
2011											
Government (2)	2,247	5,863	505	6,368	82,888	—	5,410	548	97,461	(478)	96,983
Financial institutions - banks (3)	25,410	24,732	3	24,735	—	1,092	393,516	64,261	509,014	(382,395)	126,619
- other (4)	39,037	25,836	1,647	27,483	25,443	943	98,426	2,829	194,161	(135,796)	58,365
Personal - mortgages	—	34,665	1,423	36,088	—	—	—	—	36,088	—	36,088
- unsecured	—	3,225	113	3,338	—	—	—	—	3,338	(7)	3,331
Property	—	14,430	17,458	31,888	1,106	101	3,637	1	36,733	(360)	36,373
Construction	—	2,811	972	3,783	21	28	856	—	4,688	(173)	4,515
Manufacturing	254	7,606	3,615	11,221	340	1,918	3,223	306	17,262	(734)	16,528
Finance leases (5)	—	94	78	172	127	—	73	—	372	(16)	356
Retail, wholesale and repairs	—	3,972	1,390	5,362	311	2,403	936	—	9,012	(268)	8,744
Transport and storage	436	11,668	4,497	16,165	128	68	3,343	—	20,140	(38)	20,102
Health, education and leisure	—	3,560	942	4,502	45	—	576	—	5,123	(166)	4,957
Hotels and restaurants	—	2,881	508	3,389	14	2	585	—	3,990	(69)	3,921
Utilities	—	2,985	1,583	4,568	328	265	3,172	—	8,333	(13)	8,320
Other	74	12,141	1,396	13,537	1,134	3,718	5,087	375	23,925	(216)	23,709
Total third-party	67,458	156,469	36,130	192,599	111,885	10,538	518,840	68,320	969,640	(520,729)	448,911
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	201,276	3,453	204,729	70,147	—	18,457	—	293,333	—	293,333
Total gross of provisions	67,458	357,745	39,583	397,328	182,032	10,538	537,297	68,320	1,262,973	(520,729)	742,244
Provisions	—	(1,519)	(3,104)	(4,623)	(572)	(52)	—	—	(5,247)	n/a	(5,247)
Total excluding disposal groups	67,458	356,226	36,479	392,705	181,460	10,486	537,297	68,320	1,257,726	(520,729)	736,997
Disposal groups	—	18,063	48	18,111	—	—	414	94	18,619	—	18,619
Total including disposal groups	67,458	374,289	36,527	410,816	181,460	10,486	537,711	68,414	1,276,345	(520,729)	755,616

For the notes to this table refer to page 105.

2010		Bank										
	Reverse repos £m	Lending Core £m	Lending Non-Core £m	Lending Total £m	Securities Debt £m	Securities Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
Government (2)	626	3,891	647	4,538	78,575	—	7,223	173	91,135	(2,684)	88,451
Financial institutions - banks (3)	27,403	33,260	97	33,357	—	78	307,958	44,921	413,717	(300,058)	113,659
- other (4)	30,037	21,053	3,546	24,599	30,458	97	77,000	2,947	165,138	(87,358)	77,780
Personal - mortgages	—	42,430	1,665	44,095	—	—	—	—	44,095	(13)	44,082
- unsecured	—	5,260	419	5,679	—	—	—	—	5,679	(10)	5,669
Property	—	17,471	24,860	42,331	3,201	109	3,233	28	48,902	(427)	48,475
Construction	—	4,669	741	5,410	39	—	716	—	6,165	(433)	5,732
Manufacturing	389	8,626	4,917	13,543	288	14	2,749	—	16,983	(554)	16,429
Finance leases (5)	—	262	105	367	10	—	14	—	391	(42)	349
Retail, wholesale and repairs	—	4,869	1,701	6,570	278	11	947	—	7,806	(597)	7,209
Transport and storage	—	10,852	6,174	17,026	259	1	2,541	—	19,827	(77)	19,750
Health, education and leisure	—	7,416	1,197	8,613	156	3	930	—	9,702	(159)	9,543
Hotels and restaurants	—	3,642	781	4,423	172	—	460	—	5,055	(120)	4,935
Utilities	—	3,697	1,798	5,495	496	2	2,003	2	7,998	(10)	7,988
Other	172	11,121	1,987	13,108	1,018	744	2,953	379	18,374	(115)	18,259
Total third-party	58,627	178,519	50,635	229,154	114,950	1,059	408,727	48,450	860,967	(392,657)	468,310
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	160,957	6,987	167,944	74,726	—	24,085	—	266,755	—	266,755
Total gross of provisions	58,627	339,476	57,622	397,098	189,676	1,059	432,812	48,450	1,127,722	(392,657)	735,065
Provisions	—	(2,118)	(3,463)	(5,581)	(468)	(43)	—	—	(6,092)	n/a	(6,092)
Total excluding disposal groups	58,627	337,358	54,159	391,517	189,208	1,016	432,812	48,450	1,121,630	(392,657)	728,973
Disposal groups	—	—	2,602	2,602	—	2	1,757	404	4,765	—	4,765
Total including disposal groups	58,627	337,358	56,761	394,119	189,208	1,018	434,569	48,854	1,126,395	(392,657)	733,738

For the notes to this table refer to page 105.

Balance sheet analysis: **Credit concentration: Sector and geographic region** continued

The tables on pages 100 to 105 analyse total financial assets by industry and geography for the bank.

	Bank										
	Reverse repos	Lending			Securities						
2012	£m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
UK											
Government (2)	441	6,454	—	6,454	60,725	—	5,530	47	73,197	(4,375)	68,822
Financial institutions - banks (3)	24,850	14,810	—	14,810	4,057	1,075	193,860	39,490	278,142	(201,458)	76,684
- other (4)	42,200	25,227	1,040	26,267	14,967	2,381	60,648	2,024	148,487	(78,257)	70,230
Personal - mortgages	—	38,969	19	38,988	—	—	—	—	38,988	—	38,988
- unsecured	—	4,599	52	4,651	—	—	—	—	4,651	(5)	4,646
Property	—	19,102	10,125	29,227	96	211	3,299	—	32,833	(514)	32,319
Construction	—	2,392	891	3,283	14	248	769	—	4,314	(608)	3,706
Manufacturing	325	4,325	411	4,736	12	1,496	1,214	94	7,877	(2,103)	5,774
Finance leases (2)	—	142	28	170	49	—	—	—	219	—	219
Retail, wholesale and repairs	—	3,788	258	4,046	194	1,551	617	40	6,448	(385)	6,063
Transport and storage	—	6,345	2,403	8,748	120	361	1,992	2	11,223	(1,880)	9,343
Health, education and leisure	—	5,061	255	5,316	56	548	524	28	6,472	(194)	6,278
Hotels and restaurants	—	2,654	310	2,964	73	51	421	11	3,520	(223)	3,297
Utilities	—	2,076	775	2,851	282	440	2,508	19	6,100	(1,980)	4,120
Other	19	6,772	1,327	8,099	413	3,620	2,487	86	14,724	(1,325)	13,399
Total third-party	67,835	142,716	17,894	160,610	81,058	11,982	273,869	41,841	637,195	(293,307)	343,888
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	113,038	1,409	114,447	32,338	—	11,016	—	157,801	—	157,801
Total gross of provisions	67,835	255,754	19,303	275,057	113,396	11,982	284,885	41,841	794,996	(293,307)	501,689
Provisions	—	(2,202)	(2,661)	(4,863)	(260)	(23)	—	—	(5,146)	n/a	(5,146)
Total including disposal groups	67,835	253,552	16,642	270,194	113,136	11,959	284,885	41,841	789,850	(293,307)	496,543
US											
Government (2)	—	39	—	39	3,361	—	23	—	3,423	(17)	3,406
Financial institutions - banks (3)	13	88	—	88	—	—	116,711	9,748	126,560	(115,459)	11,101
- other (4)	—	1,503	167	1,670	932	10	13,305	462	16,379	(11,717)	4,662
Property	—	134	—	134	—	21	34	—	189	—	189
Construction	—	131	—	131	—	1	9	—	141	—	141
Manufacturing	—	1,380	—	1,380	—	12	217	—	1,609	(215)	1,394
Finance leases (5)	—	44	—	44	—	—	—	—	44	—	44
Retail, wholesale and repairs	—	381	—	381	—	—	66	—	447	(52)	395
Transport and storage	—	375	389	764	6	—	855	—	1,625	(800)	825
Health, education and leisure	—	220	6	226	—	—	73	—	299	(70)	229
Hotels and restaurants	—	61	—	61	—	—	—	—	61	—	61
Utilities	—	390	27	417	1	—	258	—	676	(251)	425
Other	—	1,899	11	1,910	70	3	333	—	2,316	(277)	2,039
Total third-party	13	6,645	600	7,245	4,370	47	131,884	10,210	153,769	(128,858)	24,911
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	2,188	—	2,188	—	—	1,893	—	4,081	—	4,081
Total gross of provisions	13	8,833	600	9,433	4,370	47	133,777	10,210	157,850	(128,858)	28,992
Provisions	—	(76)	(91)	(167)	(45)	—	—	—	(212)	n/a	(212)
Total net of provisions	13	8,757	509	9,266	4,325	47	133,777	10,210	157,638	(128,858)	28,780

For the notes to this table refer to page 105.

	Bank										
	Reverse	Lending			Securities				Balance	Non-IFRS	Exposure
	repos	Core	Non-Core	Total	Debt	Equity	Derivatives	Other	sheet value	offset (1)	post offset
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Europe											
Government (2)	—	133	619	752	313	—	38	—	1,103	(15)	1,088
Financial institutions - banks (3)	—	792	59	851	—	—	2	20,258	21,111	(2)	21,109
- other (4)	10	966	175	1,141	—	117	7	23	1,298	—	1,298
Personal - mortgages	—	3	—	3	—	—	—	—	3	—	3
- unsecured	—	53	—	53	—	—	—	—	53	—	53
Property	—	714	1,375	2,089	—	—	—	—	2,089	—	2,089
Construction	—	241	348	589	—	6	—	—	595	—	595
Manufacturing	—	3,347	357	3,704	—	16	7	1	3,728	—	3,728
Retail, wholesale and repairs	—	1,311	168	1,479	—	109	—	—	1,588	—	1,588
Transport and storage	—	3,823	387	4,210	—	10	1	—	4,221	—	4,221
Health, education and leisure	—	337	311	648	—	—	—	—	648	—	648
Hotels and restaurants	—	55	101	156	—	—	—	—	156	—	156
Utilities	—	390	404	794	—	112	1	20	927	—	927
Other	—	2,266	265	2,531	1	165	25	—	2,722	—	2,722
Total third-party	10	14,431	4,569	19,000	314	535	81	20,302	40,242	(17)	40,225
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	499	721	1,220	—	—	1	—	1,221	—	1,221
Total gross of provisions	10	14,930	5,290	20,220	314	535	82	20,302	41,463	(17)	41,446
Provisions	—	(162)	(196)	(358)	—	—	—	—	(358)	n/a	(358)
Total net of provisions	10	14,768	5,094	19,862	314	535	82	20,302	41,105	(17)	41,088
RoW											
Government (2)	—	30	42	72	2,341	—	132	42	2,587	(91)	2,496
Financial institutions - banks (3)	731	2,665	—	2,665	653	76	23,705	878	28,708	(23,453)	5,255
- other (4)	—	1,311	63	1,374	444	47	4,357	191	6,413	(3,893)	2,520
Personal - mortgages	—	308	—	308	—	—	—	—	308	—	308
- unsecured	—	2	—	2	—	—	—	—	2	—	2
Property	—	325	130	455	219	3	42	—	719	—	719
Construction	—	6	—	6	—	1	4	—	11	—	11
Manufacturing	—	1,159	27	1,186	7	6	91	—	1,290	(9)	1,281
Finance leases (5)	—	11	53	64	—	—	4	—	68	—	68
Retail, wholesale and repairs	—	1,564	6	1,570	6	15	122	—	1,713	(121)	1,592
Transport and storage	—	217	122	339	94	2	169	—	604	(156)	448
Health, education and leisure	—	246	139	385	—	4	12	—	401	—	401
Hotels and restaurants	—	15	—	15	—	—	—	—	15	—	15
Utilities	—	302	132	434	12	4	71	—	521	—	521
Other	—	1,259	29	1,288	39	67	342	—	1,736	(188)	1,548
Total third-party	731	9,420	743,	10,163	3,815	225	29,051	1,111	45,096	(27,911)	17,185
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	3,277	7	3,284	959	—	2,043	—	6,286	—	6,286
Total gross of provisions	731	12,697	750	13,447	4,774	225	31,094	1,111	51,382	(27,911)	23,471
Provisions	—	(108)	(130)	(238)	(102)	—	—	—	(340)	n/a	(340)
Total net of provisions	731	12,589	620	13,209	4,672	225	31,094	1,111	51,042	(27,911)	23,131

For the notes to this table refer to page 105.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

	Bank										
	Reverse repos	Lending			Securities				Balance	Non-IFRS	Exposure
2011	£m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Derivatives £m	Other £m	sheet value £m	offset (1) £m	post offset £m
UK											
Government (2)	2,130	5,767	17	5,784	76,347	—	5,190	548	89,999	(478)	89,521
Financial institutions - banks (3)	24,536	22,694	—	22,694	—	1,066	238,675	38,872	325,843	(233,038)	92,805
- other (4)	38,917	23,326	1,145	24,471	21,887	929	59,715	2,459	148,378	(94,787)	53,591
Personal - mortgages	—	34,284	1,423	35,707	—	—	—	—	35,707	—	35,707
- unsecured	—	3,221	113	3,334	—	—	—	—	3,334	(7)	3,327
Property	—	13,802	14,969	28,771	837	67	3,539	—	33,214	(360)	32,854
Construction	—	2,508	641	3,149	20	26	843	—	4,038	(173)	3,865
Manufacturing	254	4,754	531	5,285	336	1,908	1,993	—	9,776	(734)	9,042
Finance leases (5)	—	32	52	84	—	—	73	—	157	(16)	141
Retail, wholesale and repairs	—	3,146	1,232	4,378	307	2,403	798	—	7,886	(268)	7,618
Transport and storage	436	6,734	2,879	9,613	51	67	2,112	—	12,279	(38)	12,241
Health, education and leisure	—	2,628	466	3,094	45	—	454	—	3,593	(166)	3,427
Hotels and restaurants	—	2,669	403	3,072	14	—	584	—	3,670	(69)	3,601
Utilities	—	1,847	887	2,734	324	265	2,809	—	6,132	(13)	6,119
Other	51	9,593	1,047	10,640	1,056	3,715	3,834	375	19,671	(216)	19,455
Total third-party	66,324	137,005	25,805	162,810	101,224	10,446	320,619	42,254	703,677	(330,363)	373,314
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	193,673	1,550	195,223	69,531	—	14,888	—	279,642	—	279,642
Total gross of provisions	66,324	330,678	27,355	358,033	170,755	10,446	335,507	42,254	983,319	(330,363)	652,956
Provisions	—	(910)	(1,861)	(2,771)	(401)	(52)	—	—	(3,224)	n/a	(3,224)
Total excluding disposal groups	66,324	329,768	25,494	355,262	170,354	10,394	335,507	42,254	980,095	(330,363)	649,732
Disposal groups	—	18,063	3	18,066	—	—	414	94	18,574	—	18,574
Total including disposal groups	66,324	347,831	25,497	373,328	170,354	10,394	335,921	42,348	998,669	(330,363)	668,306
US											
Government (2)	—	44	—	44	2,162	—	9	—	2,215	—	2,215
Financial institutions - banks (3)	14	23	—	23	—	16	132,223	23,021	155,297	(129,001)	26,296
- other (4)	—	1,619	198	1,817	1,435	6	33,056	336	36,650	(33,626)	3,024
Property	—	117	104	221	—	20	38	—	279	—	279
Construction	—	124	16	140	—	2	11	—	153	—	153
Manufacturing	—	1,821	—	1,821	—	10	452	—	2,283	—	2,283
Finance leases (5)	—	51	—	51	—	—	—	—	51	—	51
Retail, wholesale and repairs	—	278	—	278	1	—	63	—	342	—	342
Transport and storage	—	460	921	1,381	11	1	1,084	—	2,477	—	2,477
Health, education and leisure	—	288	34	322	—	—	90	—	412	—	412
Hotels and restaurants	—	177	—	177	—	2	1	—	180	—	180
Utilities	—	362	8	370	4	—	295	—	669	—	669
Other	23	1,839	44	1,883	67	3	586	—	2,562	—	2,562
Total third-party	37	7,203	1,325	8,528	3,680	60	167,908	23,357	203,570	(162,627)	40,943
Amounts due from holding company, subsidiaries and fellow 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	170,049	23,357	208,365	(162,627)	45,738
Provisions	—	(30)	(62)	(92)	(57)	—	—	—	(149)	n/a	(149)
Total excluding disposal groups	37	9,813	1,277	11,090	3,623	60	170,049	23,357	208,216	(162,627)	45,589
Disposal groups	—	—	2	2	—	—	—	—	2	—	2
Total including disposal groups	37	9,813	1,279	11,092	3,623	60	170,049	23,357	208,218	(162,627)	45,591

For the notes to this table refer to page 105.

2011		Reverse repos £m	Lending Core £m	Lending Non-Core £m	Lending Total £m	Securities Debt £m	Securities Equity £m	Derivatives £m	Other £m	Bank Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
Europe												
Government (2)		—	17	444	461	—	—	21	—	482	—	482
Financial institutions	- banks (3)	—	141	3	144	—	10	—	281	435	—	435
	- other (4)	—	411	268	679	—	8	—	—	687	—	687
Personal	- mortgages	—	1	—	1	—	—	—	—	1	—	1
	- unsecured	—	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
Retail, wholesale and repairs		—	286	132	418	—	—	—	—	418	—	418
Transport and storage		—	4,260	514	4,774	—	—	—	—	4,774	—	4,774
Health, education and leisure		—	288	217	505	—	—	—	—	505	—	505
Hotels and restaurants		—	21	105	126	—	—	—	—	126	—	126
Utilities		—	405	415	820	—	—	—	—	820	—	820
Other		—	144	281	425	—	—	—	—	425	—	425
Total third-party		—	7,115	7,636	14,751	—	18	21	281	15,071	—	15,071
Amounts due from holding company, subsidiaries and fellow subsidiaries		—	4	1,720	1,724	—	—	—	—	1,724	—	1,724
Total gross of provisions		—	7,119	9,356	16,475	—	18	21	281	16,795	—	16,795
Provisions		—	(486)	(992)	(1,478)	—	—	—	—	(1,478)	n/a	(1,478)
Total net of provisions		—	6,633	8,364	14,997	—	18	21	281	15,317	—	15,317
RoW												
Government (2)		117	35	44	79	4,379	—	190	—	4,765	—	4,765
Financial institutions	- banks (3)	860	1,874	—	1,874	—	—	22,618	2,087	27,439	(20,356)	7,083
	- other (4)	120	480	36	516	2,121	—	5,655	34	8,446	(7,383)	1,063
Personal	- mortgages	—	380	—	380	—	—	—	—	380	—	380
	- unsecured	—	1	—	1	—	—	—	—	1	—	1
Property		—	202	488	690	269	14	60	1	1,034	—	1,034
Construction		—	—	8	8	1	—	2	—	11	—	11
Manufacturing		—	381	31	412	4	—	778	306	1,500	—	1,500
Finance leases (5)		—	11	26	37	127	—	—	—	164	—	164
Retail, wholesale and repairs		—	262	26	288	3	—	75	—	366	—	366
Transport and storage		—	214	183	397	66	—	147	—	610	—	610
Health, education and leisure		—	356	225	581	—	—	32	—	613	—	613
Hotels and restaurants		—	14	—	14	—	—	—	—	14	—	14
Utilities		—	371	273	644	—	—	68	—	712	—	712
Other		—	565	24	589	11	—	667	—	1,267	—	1,267
Total third-party		1,097	5,146	1,364	6,510	6,981	14	30,292	2,428	47,322	(27,739)	19,583
Amounts due from holding company, subsidiaries and fellow subsidiaries		—	4,959	169	5,128	616	—	1,428	—	7,172	—	7,172
Total gross of provisions		1,097	10,105	1,533	11,638	7,597	14	31,720	2,428	54,494	(27,739)	26,755
Provisions		—	(93)	(189)	(282)	(114)	—	—	—	(396)	n/a	(396)
Total excluding disposal groups		1,097	10,012	1,344	11,356	7,483	14	31,720	2,428	54,098	(27,739)	26,359
Disposal groups		—	—	43	43	—	—	—	—	43	—	43
Total including disposal groups		1,097	10,012	1,387	11,399	7,483	14	31,720	2,428	54,141	(27,739)	26,402

For the notes to this table refer to page 105.

Balance sheet analysis: Credit concentration: Sector and geographic region continued

	Bank										
	Reverse repos	Lending			Securities						
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Derivatives £m	Other £m	Balance sheet value £m	Non-IFRS offset (1) £m	Exposure post offset £m
UK											
Government (2)	611	3,368	140	3,508	69,649	—	6,977	173	80,918	(2,684)	78,234
Financial institutions - banks (3)	26,839	30,866	—	30,866	—	78	190,379	26,554	274,716	(194,236)	80,480
- other (4)	29,854	18,665	2,333	20,998	23,553	69	47,599	1,934	124,007	(55,537)	68,470
Personal - mortgages	—	42,017	1,665	43,682	—	—	—	—	43,682	(13)	43,669
- unsecured	—	5,257	419	5,676	—	—	—	—	5,676	(10)	5,666
Property	—	16,443	21,048	37,491	2,901	105	3,142	28	43,667	(427)	43,240
Construction	—	4,222	393	4,615	39	—	700	—	5,354	(433)	4,921
Manufacturing	389	6,039	1,193	7,232	274	—	1,956	—	9,851	(554)	9,297
Finance leases (5)	—	201	105	306	10	—	14	—	330	(42)	288
Retail, wholesale and repairs	—	3,884	1,433	5,317	258	11	748	—	6,334	(597)	5,737
Transport and storage	—	5,983	3,559	9,542	195	—	1,442	—	11,179	(77)	11,102
Health, education and leisure	—	6,795	671	7,466	156	—	611	—	8,233	(159)	8,074
Hotels and restaurants	—	3,393	592	3,985	172	—	454	—	4,611	(120)	4,491
Utilities	—	2,035	1,011	3,046	488	—	1,713	2	5,249	(10)	5,239
Other	48	8,899	1,142	10,041	905	698	1,830	336	13,858	(115)	13,743
Total third-party	57,741	158,067	35,704	193,771	98,600	961	257,565	29,027	637,665	(255,014)	382,651
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	151,816	5,061	156,877	74,726	—	19,291	—	250,894	—	250,894
Total gross of provisions	57,741	309,883	40,765	350,648	173,326	961	276,856	29,027	888,559	(255,014)	633,545
Provisions	—	(1,403)	(2,293)	(3,696)	(374)	(43)	—	—	(4,113)	n/a	(4,113)
Total excluding disposal groups	57,741	308,480	38,472	346,952	172,952	918	276,856	29,027	884,446	(255,014)	629,432
Disposal groups	—	—	2,193	2,193	—	—	380	—	2,573	—	2,573
Total including disposal groups	57,741	308,480	40,665	349,145	172,952	918	277,236	29,027	887,019	(255,014)	632,005
US											
Government (2)	—	47	—	47	2,900	—	5	—	2,952	—	2,952
Financial institutions - banks (3)	14	242	—	242	—	—	97,244	13,767	111,267	(87,520)	23,747
- other (4)	—	438	591	1,029	3,110	26	24,311	927	29,403	(27,703)	1,700
Property	—	191	132	323	—	1	23	—	347	—	347
Construction	—	133	7	140	—	—	16	—	156	—	156
Manufacturing	—	1,297	64	1,361	14	14	583	—	1,972	—	1,972
Finance leases (5)	—	56	—	56	—	—	—	—	56	—	56
Retail, wholesale and repairs	—	413	—	413	11	—	68	—	492	—	492
Transport and storage	—	514	1,385	1,899	8	1	929	—	2,837	—	2,837
Health, education and leisure	—	156	235	391	—	3	292	—	686	—	686
Hotels and restaurants	—	72	63	135	—	—	3	—	138	—	138
Utilities	—	484	6	490	3	2	244	—	739	—	739
Other	124	1,366	124	1,490	95	22	506	43	2,280	—	2,280
Total third-party	138	5,409	2,607	8,016	6,141	69	124,224	14,737	153,325	(115,223)	38,102
Amounts due from holding company, subsidiaries and fellow 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	126,982	14,737	159,810	(115,223)	44,587
Provisions	—	(496)	(812)	(1,308)	(47)	—	—	—	(1,355)	n/a	(1,355)
Total excluding disposal groups	138	8,509	1,926	10,435	6,094	69	126,982	14,737	158,455	(115,223)	43,232
Disposal groups	—	—	409	409	—	2	1,377	404	2,192	—	2,192
Total including disposal groups	138	8,509	2,335	10,844	6,094	71	128,359	15,141	160,647	(115,223)	45,424

For the notes to this table refer to page 105.

	Bank										
	Reverse	Lending			Securities				Balance	Non-IFRS	Exposure
	repos	Core	Non-Core	Total	Debt	Equity	Derivatives	Other	sheet value	offset (1)	post offset
2010	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Europe											
Government (2)	—	110	507	617	—	—	64	—	681	—	681
Financial institutions - banks (3)	—	1,059	27	1,086	—	—	—	3,536	4,622	—	4,622
- other (4)	—	441	332	773	43	2	—	—	818	—	818
Personal - mortgages	—	4	—	4	—	—	—	—	4	—	4
- unsecured	—	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
Finance leases (5)	—	5	—	5	—	—	—	—	5	—	5
Retail, wholesale and repairs	—	322	183	505	—	—	—	—	505	—	505
Transport and storage	—	4,158	897	5,055	—	—	—	—	5,055	—	5,055
Health, education and leisure	—	337	275	612	—	—	—	—	612	—	612
Hotels and restaurants	—	112	126	238	—	—	—	—	238	—	238
Utilities	—	362	507	869	—	—	—	—	869	—	869
Other	—	245	131	376	—	24	—	—	400	—	400
Total third-party	—	8,783	9,236	18,019	43	26	64	3,536	21,688	—	21,688
Amounts due from holding company, subsidiaries and fellow subsidiaries	—	17	1,462	1,479	—	—	—	—	1,479	—	1,479
Total gross of provisions	—	8,800	10,698	19,498	43	26	64	3,536	23,167	—	23,167
Provisions	—	(84)	(138)	(222)	—	—	—	—	(222)	n/a	(222)
Total net of provisions	—	8,716	10,560	19,276	43	26	64	3,536	22,945	—	22,945
RoW											
Government (2)	15	366	—	366	6,026	—	177	—	6,584	—	6,584
Financial institutions - banks (3)	550	1,093	70	1,163	—	—	20,335	1,064	23,112	(18,302)	4,810
- other (4)	183	1,509	290	1,799	3,752	—	5,090	86	10,910	(4,118)	6,792
Personal - mortgages	—	409	—	409	—	—	—	—	409	—	409
- unsecured	—	2	—	2	—	—	—	—	2	—	2
Property	—	540	1,154	1,694	300	3	68	—	2,065	—	2,065
Construction	—	79	40	119	—	—	—	—	119	—	119
Manufacturing	—	195	236	431	—	—	210	—	641	—	641
Finance leases (5)	—	—	—	—	—	—	—	—	—	—	—
Retail, wholesale and repairs	—	250	85	335	9	—	131	—	475	—	475
Transport and storage	—	197	333	530	56	—	170	—	756	—	756
Health, education and leisure	—	128	16	144	—	—	27	—	171	—	171
Hotels and restaurants	—	65	—	65	—	—	3	—	68	—	68
Utilities	—	816	274	1,090	5	—	46	—	1,141	—	1,141
Other	—	611	590	1,201	18	—	617	—	1,836	—	1,836
Total third-party	748	6,260	3,088	9,348	10,166	3	26,874	1,150	48,289	(22,420)	25,869
Amounts due from holding company, subsidiaries and fellow 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	28,910	1,150	56,186	(22,420)	33,766
Provisions	—	(135)	(220)	(355)	(47)	—	—	—	(402)	n/a	(402)
Total net of provisions	748	11,653	3,201	14,854	10,119	3	28,910	1,150	55,784	(22,420)	33,364

Notes:
(1) This reflects 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.
(2) Includes central and local government.
(3) Includes £70.4 billion (2011 - £64.3 billion; 2010 - £44.9 billion) relating to cash and balances at central banks.
(4) Loans made by the Group's consolidated conduits to asset owning companies are included within Financial institutions - other.
(5) Includes instalment credit.

Balance sheet analysis continued

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 and are therefore excluded from the following table and are set out on pages 117 to 120.

Exposures are allocated to asset quality bands on the basis of statistically driven models which produce an estimate of default rate. The variables included in the models vary by product and geography. For portfolios secured on residential property these models typically include measures of delinquency and loan to value as well as other differentiating characteristics such as bureau score, product features or associated account performance information.

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%

	Group													
		Loans and advances												
		Banks				Customers								
2012	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Settlement balances and other financial assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
Total														
AQ1	73,643	17,600	3,107	7,551	28,258	42,963	14,822	38,389	96,174	1,911	100,028	62,501	6,295	368,810
AQ2	12	3,556	4,351	494	8,401	710	704	12,804	14,218	185	108,092	19,260	2,455	152,623
AQ3	839	5,703	2,144	2,588	10,435	2,886	3,801	23,268	29,955	539	152,300	22,855	3,318	220,241
AQ4	29	6,120	1,509	2,333	9,962	14,079	2,111	102,129	118,319	1,202	56,917	39,589	5,119	231,137
AQ5	—	1,183	403	632	2,218	8,163	657	90,532	99,352	614	12,909	28,049	2,469	145,611
AQ6	—	282	39	356	677	86	50	39,359	39,495	72	2,165	13,762	1,271	57,442
AQ7	—	—	—	113	113	1,133	12	36,017	37,162	191	3,193	18,790	856	60,305
AQ8	—	—	—	28	28	—	2	12,653	12,655	8	237	5,652	179	18,759
AQ9	1	—	—	80	80	23	7	17,261	17,291	—	1,357	1,340	74	20,143
AQ10	—	—	—	—	—	—	—	760	760	—	703	1,402	236	3,101
Balances with holding company and fellow subsidiaries	—	—	—	21,875	21,875	—	—	1,866	1,866	—	7,200	538	2,901	34,380
Past due	—	—	—	—	—	—	249	10,281	10,530	995	—	—	—	11,525
Impaired	—	—	—	133	133	—	—	37,754	37,754	—	—	—	—	37,887
Impairment provision	—	—	—	(113)	(113)	—	—	(20,694)	(20,694)	—	—	—	—	(20,807)
Total excluding disposal groups	74,524	34,444	11,553	36,070	82,067	70,043	22,415	402,379	494,837	5,717	445,101	213,738	25,173	1,341,157
Disposal groups	—	—	—	20	20	—	—	263	263	—	3	—	—	286
Total including disposal groups	74,524	34,444	11,553	36,090	82,087	70,043	22,415	402,642	495,100	5,717	445,104	213,738	25,173	1,341,443

	Group													
		Loans and advances												
		Banks				Customers								
2012	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Settlement balances and other financial assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
Core														
AQ1	73,615	17,600	3,107	7,426	28,133	42,963	14,822	31,740	89,525	1,911	99,307	61,161	6,004	359,656
AQ2	12	3,556	4,351	494	8,401	710	704	10,254	11,668	185	107,633	19,134	2,437	149,470
AQ3	839	5,703	2,144	2,588	10,435	2,886	3,801	20,766	27,453	539	151,958	22,629	3,306	217,159
AQ4	29	6,120	1,509	2,333	9,962	14,079	2,111	98,785	114,975	1,202	55,911	39,230	5,031	226,340
AQ5	—	1,183	403	632	2,218	8,163	657	86,223	95,043	614	11,883	27,386	2,392	139,536
AQ6	—	282	39	356	677	86	50	36,544	36,680	72	1,467	13,100	1,244	53,240
AQ7	—	—	—	74	74	1,133	12	31,952	33,097	191	2,524	17,511	844	54,241
AQ8	—	—	—	28	28	—	2	10,667	10,669	8	231	5,573	144	16,653
AQ9	1	—	—	80	80	—	7	14,933	14,940	—	977	1,065	72	17,135
AQ10	—	—	—	—	—	—	—	667	667	—	379	808	148	2,002
Balances with holding company and fellow subsidiaries	—	—	—	21,841	21,841	—	—	1,852	1,852	—	7,118	538	2,901	34,250
Past due	—	—	—	—	—	—	249	9,527	9,776	991	—	—	—	10,767
Impaired	—	—	—	133	133	—	—	17,353	17,353	—	—	—	—	17,486
Impairment provision	—	—	—	(113)	(113)	—	—	(9,889)	(9,889)	—	—	—	—	(10,002)
Group	74,496	34,444	11,553	35,872	81,869	70,020	22,415	361,374	453,809	5,713	439,388	208,135	24,523	1,287,933
Non-Core														
AQ1	28	—	—	125	125	—	—	6,649	6,649	—	721	1,340	291	9,154
AQ2	—	—	—	—	—	—	—	2,550	2,550	—	459	126	18	3,153
AQ3	—	—	—	—	—	—	—	2,502	2,502	—	342	226	12	3,082
AQ4	—	—	—	—	—	—	—	3,344	3,344	—	1,006	359	88	4,797
AQ5	—	—	—	—	—	—	—	4,309	4,309	—	1,026	663	77	6,075
AQ6	—	—	—	—	—	—	—	2,815	2,815	—	698	662	27	4,202
AQ7	—	—	—	39	39	—	—	4,065	4,065	—	669	1,279	12	6,064
AQ8	—	—	—	—	—	—	—	1,986	1,986	—	6	79	35	2,106
AQ9	—	—	—	—	—	23	—	2,328	2,351	—	380	275	2	3,008
AQ10	—	—	—	—	—	—	—	93	93	—	324	594	88	1,099
Balances with holding company and fellow subsidiaries	—	—	—	34	34	—	—	14	14	—	82	—	—	130
Past due	—	—	—	—	—	—	—	754	754	4	—	—	—	758
Impaired	—	—	—	—	—	—	—	20,401	20,401	—	—	—	—	20,401
Impairment provision	—	—	—	—	—	—	—	(10,805)	(10,805)	—	—	—	—	(10,805)
Total excluding disposal groups	28	—	—	198	198	23	—	41,005	41,028	4	5,713	5,603	650	53,224
Disposal groups	—	—	—	20	20	—	—	263	263	—	3	—	—	286
Total including disposal groups	28	—	—	218	218	23	—	41,268	41,291	4	5,716	5,603	650	53,510

Balance sheet analysis: Asset quality continued

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
	Group								
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)
Total excluding disposal groups	68,487	95,670	489,399	6,902	532,807	32	223,975	24,141	1,441,413
Disposal groups	100	25	18,723	14	439	18	—	—	19,319
Total including disposal groups	68,587	95,695	508,122	6,916	533,246	50	223,975	24,141	1,460,732
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)
Total excluding disposal groups	68,435	95,590	427,496	6,893	521,853	32	210,297	22,995	1,353,591
Disposal groups	100	—	18,676	—	431	18	—	—	19,225
Total including disposal groups	68,535	95,590	446,172	6,893	522,284	50	210,297	22,995	1,372,816

For the note to this table refer to page 110.

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
	Group								
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)
Total excluding disposal groups	52	80	61,903	9	10,954	—	13,678	1,146	87,822
Disposal groups	—	25	47	14	8	—	—	—	94
Total including disposal groups	52	105	61,950	23	10,962	—	13,678	1,146	87,916

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
Total									
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)
Total excluding disposal groups	49,838	85,547	518,321	8,748	429,005	30	238,256	32,979	1,362,724
Disposal groups	—	629	2,884	555	5,148	291	—	—	9,507
Total including disposal groups	49,838	86,176	521,205	9,303	434,153	321	238,256	32,979	1,372,231

For the note to this table refer to the following page.

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								
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)
Total excluding disposal groups	49,838	85,294	429,147	8,697	412,351	30	217,595	32,372	1,235,324
Disposal groups	—	—	251	—	—	—	—	—	251
Total including disposal groups	49,838	85,294	429,398	8,697	412,351	30	217,595	32,372	1,235,575
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)
Total excluding disposal groups	—	253	89,174	51	16,654	—	20,661	607	127,400
Disposal groups	—	629	2,633	555	5,148	291	—	—	9,256
Total including disposal groups	—	882	91,807	606	21,802	291	20,661	607	136,656

Note:
(1) Excluding items in the course of collection (2011 - £1,470 million; 2010 - £1,958 million).

Key points

- In 2012, the RBS Group implemented updates to certain models, including those used for sovereign and financial institution counterparties, to incorporate more recent data and reflect new regulatory requirements applicable to wholesale internal ratings based modelling. This has resulted in ratings migration from AQ1, primarily to AQ2-AQ5. However, it is not practicable to quantify the impact of model updates on individual asset quality bands. The RBS Group had modified various risk frameworks, including risk appetite framework and latent loss assessment in anticipation of these changes. Further updates, primarily of models used for the corporate counterparties, are planned for 2013. The AQ composition of the corporate portfolio has not changed materially during the year.

- Loans and advances to banks (third party): AQ1 balances decreased by £34.4 billion reflecting the balance sheet reduction, mainly in Markets and also the impact of model changes which resulted in certain counterparties moving to lower AQ bands, primarily to AQ2-AQ4, which increased by £6.8 billion, £8.8 billion and £8.7 billion respectively.

- Loans and advances to customers (third party): Lower internal ratings due to model changes resulted in balances shifting from AQ1 to lower bands.

- Derivatives (third party): Balance sheet reductions in Markets and model updates resulted in a decrease in AQ1 balances. Increase in AQ2-AQ4 balances reflects the re-grading of counterparties previously included in AQ1.

- Impaired and past due assets, net of impairment provisions, comprise 20% of Non-Core third party balances. Continued weakness in commercial real estate market overall and difficult conditions in Ireland are significant contributors to this.

	Bank													
		Loans and advances												
		Banks				Customers								
2012	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Settlement balances and other financial assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
Total														
AQ1	69,498	9,956	3,107	3,619	16,682	27,334	14,822	16,072	58,228	979	99,307	50,040	5,585	300,319
AQ2	12	3,556	4,351	466	8,373	700	704	6,542	7,946	4	107,908	16,396	2,255	142,894
AQ3	836	4,676	2,142	928	7,746	2,221	3,801	12,202	18,224	536	152,178	18,143	2,793	200,456
AQ4	28	5,941	1,503	874	8,318	8,696	2,111	34,550	45,357	918	56,644	20,557	3,285	135,107
AQ5	—	1,183	403	503	2,089	2,919	657	37,358	40,934	243	12,243	11,044	1,249	67,802
AQ6	—	282	39	252	573	13	50	13,685	13,748	63	1,800	3,934	593	20,711
AQ7	—	—	—	57	57	1,089	12	12,323	13,424	173	2,943	7,956	496	25,049
AQ8	—	—	—	8	8	—	2	4,149	4,151	—	76	2,027	63	6,325
AQ9	—	—	—	35	35	23	7	4,545	4,575	—	1,162	541	20	6,333
AQ10	—	—	—	—	—	—	—	413	413	—	624	771	131	1,939
Balances with holding company and subsidiaries	—	—	—	65,671	65,671	—	—	55,468	55,468	—	14,953	5,515	2,901	144,508
Past due	—	—	—	—	—	—	249	2,030	2,279	174	—	—	—	2,453
Impaired	—	—	—	127	127	—	—	12,320	12,320	—	—	—	—	12,447
Impairment provision	—	—	—	(108)	(108)	—	—	(5,518)	(5,518)	—	—	—	—	(5,626)
Group	70,374	25,594	11,545	72,432	109,571	42,995	22,415	206,139	271,549	3,090	449,838	136,924	19,371	1,060,717

Balance sheet analysis: Asset quality continued

	Bank													
		Loans and advances												
		Banks				Customers								
2012	Cash and balances at central banks £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Reverse repos £m	Derivative cash collateral £m	Other £m	Total £m	Settlement balances and other financial assets £m	Derivatives £m	Commitments £m	Contingent liabilities £m	Total £m
Core														
AQ1	69,498	9,956	3,107	3,597	16,660	27,334	14,822	13,262	55,418	979	98,646	49,443	5,290	295,934
AQ2	12	3,556	4,351	466	8,373	700	704	5,638	7,042	4	107,452	16,373	2,237	141,493
AQ3	836	4,676	2,142	928	7,746	2,221	3,801	11,777	17,799	536	151,836	17,981	2,782	199,516
AQ4	28	5,941	1,503	874	8,318	8,696	2,111	32,966	43,773	918	55,663	20,303	3,204	132,207
AQ5	—	1,183	403	503	2,089	2,919	657	34,250	37,826	243	11,269	10,469	1,184	63,080
AQ6	—	282	39	252	573	13	50	11,856	11,919	63	1,109	3,359	566	17,589
AQ7	—	—	—	20	20	1,089	12	9,555	10,656	173	2,278	6,753	491	20,371
AQ8	—	—	—	8	8	—	2	3,023	3,025	—	70	1,970	63	5,136
AQ9	—	—	—	35	35	—	7	3,526	3,533	—	914	363	19	4,864
AQ10	—	—	—	—	—	—	—	334	334	—	302	401	46	1,083
Balances with holding company and subsidiaries	—	—	—	64,911	64,911	—	—	54,091	54,091	—	14,759	5,515	2,901	142,177
Past due	—	—	—	—	—	—	249	1,942	2,191	170	—	—	—	2,361
Impaired	—	—	—	127	127	—	—	4,313	4,313	—	—	—	—	4,440
Impairment provision	—	—	—	(108)	(108)	—	—	(2,440)	(2,440)	—	—	—	—	(2,548)
Group	70,374	25,594	11,545	71,613	108,752	42,972	22,415	184,093	249,480	3,086	444,298	132,930	18,783	1,027,703
Non-Core														
AQ1	—	—	—	22	22	—	—	2,810	2,810	—	661	597	295	4,385
AQ2	—	—	—	—	—	—	—	904	904	—	456	23	18	1,401
AQ3	—	—	—	—	—	—	—	425	425	—	342	162	11	940
AQ4	—	—	—	—	—	—	—	1,584	1,584	—	981	254	81	2,900
AQ5	—	—	—	—	—	—	—	3,108	3,108	—	974	575	65	4,722
AQ6	—	—	—	—	—	—	—	1,829	1,829	—	691	575	27	3,122
AQ7	—	—	—	37	37	—	—	2,768	2,768	—	665	1,203	5	4,678
AQ8	—	—	—	—	—	—	—	1,126	1,126	—	6	57	—	1,189
AQ9	—	—	—	—	—	23	—	1,019	1,042	—	248	178	1	1,469
AQ10	—	—	—	—	—	—	—	79	79	—	322	370	85	856
Balances with holding company and subsidiaries	—	—	—	760	760	—	—	1,377	1,377	—	194	—	—	2,331
Past due	—	—	—	—	—	—	—	88	88	4	—	—	—	92
Impaired	—	—	—	—	—	—	—	8,007	8,007	—	—	—	—	8,007
Impairment provision	—	—	—	—	—	—	—	(3,078)	(3,078)	—	—	—	—	(3,078)
Group	—	—	—	819	819	23	—	22,046	22,069	4	5,540	3,994	588	33,014

2011	Bank 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
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)
Total excluding disposal groups	64,261	108,724	351,123	4,059	537,297	145,531	17,269	1,228,264
Disposal groups	94	1	18,110	—	414	—	—	18,619
Total including disposal groups	64,355	108,725	369,233	4,059	537,711	145,531	17,269	1,246,883
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)
Total excluding disposal groups	64,261	108,697	314,559	4,050	526,775	137,890	16,190	1,172,422
Disposal groups	94	—	18,063	—	414	—	—	18,571
Total including disposal groups	64,355	108,697	332,622	4,050	527,189	137,890	16,190	1,190,993

For the note to this table refer to page 115.

Balance sheet analysis: Asset quality continued

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)
Total excluding disposal groups	—	27	36,564	9	10,522	7,641	1,079	55,842
Disposal groups	—	1	47	—	—	—	—	48
Total including disposal groups	—	28	36,611	9	10,522	7,641	1,079	55,890

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
Total								
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)
Total excluding disposal groups	44,921	100,502	349,179	3,529	432,812	145,400	25,171	1,101,514
Disposal groups	—	273	2,329	295	1,757	—	—	4,654
Total including disposal groups	44,921	100,775	351,508	3,824	434,569	145,400	25,171	1,106,168

For the note to this table refer to page 115.

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
	Bank							
Core								
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	—	4,006	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)
Total	44,921	100,289	296,783	3,478	416,097	131,703	24,601	1,017,872
Non-Core								
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)
Total excluding disposal groups	—	213	52,396	51	16,715	13,697	570	83,642
Disposal groups	—	273	2,329	295	1,757	—	—	4,654
Total including disposal groups	—	486	54,725	346	18,472	13,697	570	88,296

Note:
(1) Excluding items in the course of collection from other banks (2011 - £316 million; 2010 - £463 million).

Balance sheet analysis continued

Debt securities

IFRS measurement classification and issuer

The table below analyses debt securities by issuer and IFRS measurement classifications. US central and local government includes US Federal agencies; financial institutions include US government sponsored agencies and securitisation entities.

	Central and local government				Other			
	UK	US	Other	Banks	financial institutions	Corporate	Total	Of which ABS
2012	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading (HFT)	7,692	17,303	26,344	2,036	21,722	1,933	77,030	18,619
Designated as at fair value	—	—	—	86	610	1	697	516
Available-for-sale	7,950	17,514	10,083	2,933	15,967	114	54,561	18,953
Loans and receivables	5	—	—	327	3,683	282	4,297	3,663
Long positions	15,647	34,817	36,427	5,382	41,982	2,330	136,585	41,751
Of which US agencies	—	5,380	—	—	21,566	—	26,946	24,847
Short positions (HFT)	(1,538)	(10,658)	(11,333)	(1,035)	(1,578)	(798)	(26,940)	(17)
Available-for-sale								
Gross unrealised gains	944	861	579	17	582	8	2,991	647
Gross unrealised losses	—	(1)	—	(1)	(122)	—	(124)	(124)
2011								
Held-for-trading	9,004	18,770	35,146	3,649	22,577	2,615	91,761	20,815
Designated as at fair value	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
Long positions	19,669	37,539	49,133	8,358	51,034	3,408	169,141	52,286
Of which US agencies	—	4,896	—	—	25,924	—	30,820	28,558
Short positions (HFT)	(3,098)	(10,661)	(19,053)	(2,479)	(2,739)	(754)	(38,784)	(352)
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	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
Long positions	10,755	36,002	54,531	10,697	49,223	4,821	166,029	54,422
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)

Ratings

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

	Group								
	Central and local government								
2012	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Total (1) %	Of which ABS (2) £m
Total									
AAA	15,647	31	15,988	1,645	7,843	17	41,171	30	7,390
AA to AA+	—	34,785	5,951	344	25,054	234	66,368	49	27,059
A to AA-	—	—	9,997	2,103	2,792	153	15,045	11	2,242
BBB- to A-	—	—	4,046	882	1,677	1,002	7,607	6	1,582
Non-investment grade	—	—	443	95	3,077	603	4,218	3	2,391
Unrated	—	1	2	134	1,539	321	1,997	1	1,087
	15,647	34,817	36,427	5,203	41,982	2,330	136,406	100	41,751
Issued by holding company and fellow subsidiaries	—	—	—	179	—	—	179		—
	15,647	34,817	36,427	5,382	41,982	2,330	136,585		41,751
Core									
AAA	15,647	31	15,988	1,645	6,403	17	39,731	30	5,951
AA to AA+	—	34,711	5,951	344	23,531	234	64,771	50	25,539
A to AA-	—	—	9,997	2,103	1,473	153	13,726	11	948
BBB- to A-	—	—	4,046	882	1,163	963	7,054	5	1,000
Non-investment grade	—	—	435	95	2,335	485	3,350	3	1,893
Unrated	—	1	2	134	1,296	299	1,732	1	859
	15,647	34,743	36,419	5,203	36,201	2,151	130,364	100	36,190
Non-Core									
AAA	—	—	—	—	1,440	—	1,440	24	1,439
AA to AA+	—	74	—	—	1,523	—	1,597	27	1,520
A to AA-	—	—	—	—	1,319	—	1,319	22	1,294
BBB- to A-	—	—	—	—	514	39	553	9	582
Non-investment grade	—	—	8	—	742	118	868	14	498
Unrated	—	—	—	—	243	22	265	4	228
	—	74	8	—	5,781	179	6,042	100	5,561

For the notes to this table refer to page 120.

Balance sheet analysis: Debt securities continued

2011	Group: Central and local government UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Total (1) %	Of which ABS (2) £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

For the notes to this table refer to page 120.

2010	Central and local government UK £m	Central and local government US £m	Central and local government Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Total (1) %	Of which ABS (2) £m
	Group								
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
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

For the notes to this table refer to page 120.

Balance sheet analysis: Debt securities continued

	Bank								
	Central and local government								
	UK	US	Other	Banks	Other financial institutions	Corporate	Total	Total (1)	Of which ABS (2)
2012	£m	£m	£m	£m	£m	£m	£m	%	£m
AAA	15,642	24	15,690	1,501	7,100	12	39,969	45	6,586
AA to AA+	—	18,138	5,950	344	3,203	213	27,848	31	2,029
A to AA-	—	—	7,091	2,012	1,658	68	10,829	12	1,317
BBB- to A-	—	—	3,767	644	1,380	451	6,242	7	1,335
Non-investment grade	—	—	435	90	1,777	395	2,697	3	1,123
Unrated	—	1	2	119	1,225	218	1,565	2	805
	15,642	18,163	32,935	4,710	16,343	1,357	89,150	100	13,195
Issued by holding company and subsidiaries	—	—	—	147	33,150	—	33,297		32,486
	15,642	18,163	32,935	4,857	49,493	1,357	122,447		45,681
2011									
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 subsidiaries	—	—	—	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

Notes:
(1) Percentage calculated before balances with Group companies.
(2) Asset-backed securities.

Asset-backed securities

Introduction

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.

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 credit derivatives. The counterparties 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 the location of the underlying assets at 31 December 2012, 2011 and 2010 and by IFRS measurement classification of held-for-trading (HFT), designated at fair value (DFV), available-for-sale (AFS) and loans and receivables (LAR). 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 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.

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 in which the underlying mortgage assets are located 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 provided by monoline insurers.

The main categories of mortgages that serve as collateral to RMBS held by the Group are described in the Glossary on pages 336 to 343. 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 RMBS classifications include sub-prime and non-conforming. Non-conforming RMBS include Alt-A RMBS. Classification as sub-prime or Alt-A is based on 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 100%.

Balance sheet analysis: Asset-backed securities continued
Product, geography and IFRS measurement classification

						FVTPL (1)			
2012	US £m	UK £m	Europe £m	RoW £m	Total £m	HFT (2) £m	DFV (3) £m	AFS (4) £m	LAR (5) £m
Gross exposure									
RMBS: G10 government	22,162	—	—	18	22,180	13,961	—	8,219	—
RMBS: prime	819	2,818	1,161	403	5,201	753	509	3,871	68
RMBS: non-conforming	595	2,077	58	—	2,730	202	—	1,235	1,293
RMBS: sub-prime	968	99	66	5	1,138	1,027	—	5	106
CMBS	3,352	1,113	656	3	5,124	1,992	—	2,327	805
CDOs	4,002	42	274	—	4,318	3,111	—	1,177	30
CLOs	2,705	44	702	—	3,451	1,049	—	2,336	66
ABS	1,589	1,572	1,004	306	4,471	1,667	7	1,330	1,467
	36,192	7,765	3,921	735	48,613	23,762	516	20,500	3,835
Carrying value									
RMBS: G10 government	22,460	—	—	18	22,478	13,959	—	8,519	—
RMBS: prime	717	2,549	896	389	4,551	569	509	3,416	57
RMBS: non-conforming	477	1,918	58	—	2,453	150	—	1,010	1,293
RMBS: sub-prime	660	73	46	4	783	682	—	—	101
CMBS	3,274	814	410	3	4,501	1,489	—	2,284	728
CDOs	480	22	97	—	599	104	—	467	28
CLOs	2,550	12	391	—	2,953	697	—	2,193	63
ABS	1,357	954	827	295	3,433	969	7	1,064	1,393
	31,975	6,342	2,725	709	41,751	18,619	516	18,953	3,663
Net exposure									
RMBS: G10 government	22,460	—	—	18	22,478	13,959	—	8,519	—
RMBS: prime	513	2,546	894	383	4,336	554	509	3,216	57
RMBS: non-conforming	277	1,908	58	—	2,243	110	—	840	1,293
RMBS: sub-prime	417	73	46	4	540	439	—	—	101
CMBS	2,535	814	410	3	3,762	750	—	2,284	728
CDOs	162	22	91	—	275	79	—	168	28
CLOs	879	12	386	—	1,277	639	—	575	63
ABS	1,214	860	827	163	3,064	601	7	1,064	1,392
	28,457	6,235	2,712	571	37,975	17,131	516	16,666	3,662

For the notes to this table refer to page 124.

2011	US £m	UK £m	Europe £m	RoW £m	Total £m	FVTPL (1) HFT (2) £m	FVTPL (1) DFV (3) £m	AFS (4) £m	LAR (5) £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 to this table refer to page 124.

Balance sheet analysis: **Asset-backed securities** continued

2010	US £m	UK £m	Europe £m	RoW £m	Total £m	FVTPL (1) HFT (2) £m	FVTPL (1) DFV (3) £m	AFS (4) £m	LAR (5) £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

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

Ratings

The table below summarises the rating levels of ABS carrying values.

2012	RMBS (1) Government sponsored or similar (2) £m	Prime £m	Non-conforming £m	Sub-prime £m	CMBS (3) £m	CDOS (4) £m	CLOS (5) £m	ABS £m	Total £m
AAA	18	2,853	1,487	11	396	92	1,181	1,352	7,390
AA to AA+	22,460	613	88	26	2,541	7	887	437	27,059
A to AA-	—	299	275	33	799	74	146	616	2,242
BBB- to A-	—	41	141	86	441	32	217	624	1,582
Non-investment grade (6)	—	638	454	330	301	299	133	236	2,391
Unrated (7)	—	107	8	297	23	95	389	168	1,087
	22,478	4,551	2,453	783	4,501	599	2,953	3,433	41,751
2011									
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

Notes:
(1) Residential mortgage-backed securities.
(2) Includes US agency and Dutch government guaranteed securities.
(3) Commercial mortgage-backed securities.
(4) Collateralised debt obligations.
(5) Collateralised loan obligations.
(6) Includes held-for-trading.
(7) Includes held-for-trading.

Balance sheet analysis: Asset-backed securities continued

Equity shares

The table below analyses holdings of equity shares for eurozone countries and other countries with balances more than £100 million by country, issuer and measurement classification. The HFT portfolios in Markets comprise positions in the Markets Derivative Products Solutions business primarily for economic hedging of liabilities including debt issuances and equity derivatives. The AFS portfolios include capital stock in the Federal Home Loans Bank (a government sponsored entity, included in Other financial institutions) and the Federal Reserve Bank together £0.7 billion, that US Retail & Commercial are required to hold and a number a number of individually small holdings in unlisted companies, mainly acquired through loan renegotiations in GRG.

	2012										
	HFT/DFV (1)				AFS						
Countries	Banks £m	Other financial institutions (2) £m	Corporate £m	Total HFT/DFV £m	Banks £m	Other financial institutions £m	Corporate £m	Total AFS £m	Total £m	AFS reserves £m	HFT short positions £m
Ireland	—	126	35	161	—	16	—	16	177	—	(3)
Spain	18	—	110	128	—	—	33	33	161	(41)	—
Italy	7	1	33	41	—	5	—	5	46	—	(15)
Greece	—	—	6	6	—	—	—	—	6	—	—
Portugal	—	—	5	5	—	—	—	—	5	—	—
Eurozone periphery	25	127	189	341	—	21	33	54	395	(41)	(18)
Netherlands	14	105	365	484	—	—	—	—	484	—	(20)
France	10	75	140	225	—	—	104	104	329	22	(10)
Luxembourg	14	195	69	278	—	—	3	3	281	—	(1)
Germany	33	1	70	104	—	—	—	—	104	—	(54)
Belgium	—	13	6	19	—	—	—	—	19	—	(1)
Other	18	2	110	130	—	—	—	—	130	—	(14)
Total eurozone	114	518	949	1,581	—	21	140	161	1,742	(19)	(118)
US	208	586	2,603	3,397	307	411	—	718	4,115	6	(126)
UK	342	117	2,648	3,107	35	41	62	138	3,245	28	(33)
Japan	24	66	973	1,063	—	2	—	2	1,065	—	(1)
South Korea	32	72	880	984	—	—	—	—	984	—	—
China	208	3	257	468	—	14	3	17	485	7	(3)
Taiwan	2	31	259	292	—	—	—	—	292	—	(11)
Australia	77	45	159	281	—	—	—	—	281	—	(17)
Canada	14	25	200	239	—	—	2	2	241	2	(277)
Hong Kong	2	81	97	180	—	—	4	4	184	1	—
Romania	16	4	158	178	—	—	—	—	178	—	—
Russia	—	123	—	123	—	—	—	—	123	—	—
Switzerland	4	—	71	75	—	34	—	34	109	31	(13)
MDB and supranationals (3)	—	—	156	156	—	—	—	—	156	—	—
Other	84	49	538	671	—	1	—	1	672	1	(2)
Total excluding discontinued operations	1,127	1,720	9,948	12,795	342	524	211	1,077	13,872	57	(601)
Discontinued operations	—	—	—	—	—	5	—	5	5	(2)	—
Total including discontinued operations	1,127	1,720	9,948	12,795	342	529	211	1,082	13,877	55	(601)

For the notes to this table refer to the following page.

	2011										
	HFT/DFV (1)				AFS						
Countries	Banks £m	Other financial institutions (2) £m	Corporate £m	Total HFT/DFV £m	Banks £m	Other financial institutions £m	Corporate £m	Total AFS £m	Total £m	AFS reserves £m	HFT short positions £m
Ireland	—	—	208	208	—	6	—	6	214	—	(4)
Spain	54	2	73	129	—	—	72	72	201	(4)	(16)
Italy	11	—	49	60	—	5	—	5	65	—	(4)
Portugal	—	—	—	—	—	—	5	5	5	—	(1)
Eurozone periphery	65	2	330	397	—	11	77	88	485	(4)	(25)
Netherlands	—	17	455	472	—	—	—	—	472	—	(22)
France	11	2	110	123	3	—	97	100	223	19	(59)
Luxembourg	—	1	59	60	—	—	—	—	60	—	—
Germany	23	1	91	115	—	—	—	—	115	—	(151)
Belgium	—	1	3	4	—	5	1	6	10	5	(4)
Other	18	12	90	120	—	—	—	—	120	—	(57)
Total eurozone	117	36	1,138	1,291	3	16	175	194	1,485	20	(318)
US	118	67	1,375	1,560	323	494	52	869	2,429	62	(544)
UK	383	209	2,744	3,336	33	136	64	233	3,569	55	(141)
Japan	43	82	1,284	1,409	—	1	—	1	1,410	—	(3)
South Korea	2	47	244	293	—	—	—	—	293	—	(1)
China	320	132	380	832	—	12	—	12	844	4	(6)
Taiwan	2	37	209	248	—	—	—	—	248	—	—
Australia	18	5	76	99	—	—	14	14	113	2	(120)
Canada	—	4	139	143	—	—	2	2	145	2	(448)
Hong Kong	9	36	76	121	—	—	3	3	124	1	(2)
Romania	25	—	184	209	—	—	—	—	209	—	(2)
Russia	—	9	—	9	—	—	—	—	9	—	—
Switzerland	9	8	199	216	—	—	14	14	230	14	(42)
MDB and supranationals (3)	—	—	233	233	—	—	—	—	233	—	—
Other	43	154	218	415	—	—	1	1	416	(5)	(35)
Total excluding discontinued operations	1,089	826	8,499	10,414	359	659	325	1,343	11,757	155	(1,662)
Discontinued operations	—	5	—	5	—	—	—	—	5	(2)	—
Total including discontinued operations	1,089	831	8,499	10,419	359	659	325	1,343	11,762	153	(1,662)

Notes:
(1) Designated as at fair value through profit or loss (DFV) balances are £484 million (2011 - £575 million) of which nil banks (2011 - nil), £13 million other financial institutions (2011 - £10 million) and £471 million corporate (2011 - £565 million).
(2) Includes government sponsored entities (GSEs).
(3) MDB - Multilateral Development Banks.

Balance sheet analysis continued

Derivatives

Summary

The table below analyses the fair value of the Group's derivatives by type of contract. Master netting arrangements in respect of mark-to-market (mtm) positions and collateral shown below do not result in a net presentation in the Group's balance sheet under IFRS.

	2012			2011			2010		
	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m	Notional £bn	Assets £m	Liabilities £m
Interest rate (1)	33,368	360,928	343,328	38,569	418,971	403,391	39,492	304,402	292,547
Exchange rate	4,637	61,707	69,102	4,364	71,465	78,138	4,669	80,318	86,465
Credit	551	10,918	10,290	1,047	26,739	26,417	1,316	25,169	24,130
Equity and commodity contracts	112	4,348	7,785	114	5,252	8,513	35	1,647	3,572
		437,901	430,505		522,427	516,459		411,536	406,714
Counterparty mtm netting		(373,767)	(373,767)		(440,947)	(440,947)		(327,725)	(327,725)
Cash collateral		(33,440)	(24,546)		(36,358)	(30,345)		(29,556)	(28,245)
Securities collateral		(5,616)	(8,264)		(5,312)	(8,585)		(2,904)	(3,343)
		25,078	23,928		39,810	36,582		51,351	47,401
Balances with Group companies	134	7,200	5,580	231	10,380	11,377	365	17,469	14,255

Note:
(1) Interest rate notional includes £15,863 billion (2011 - £16,374 billion) relating to contracts with central clearing houses.

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.

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
Group	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn	Bought £bn	Sold £bn
Client-led trading and residual risk	250.5	240.4	3.4	3.2	400.3	390.4	17.0	16.5	383.9	362.5	8.4	6.7
Credit hedging - banking book (1)	5.4	0.4	0.1	—	14.8	4.3	0.1	0.1	8.4	4.3	0.1	—
Credit hedging - trading book												
- rates	9.4	5.8	0.1	0.1	21.0	17.1	0.9	1.7	21.6	10.3	(0.9)	0.2
- credit and mortgage markets	21.6	15.6	0.9	0.6	40.7	25.7	2.1	1.3	159.3	169.5	1.7	2.0
- other	1.2	0.4	—	—	0.9	0.1	—	—	0.7	0.1	—	—
Total excluding APS	288.1	262.6	4.5	3.9	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	—
	288.1	262.6	4.5	3.9	609.5	437.6	19.9	19.6	769.7	546.7	9.9	8.9
Core												
Client-led trading	231.1	228.1	3.0	2.8	370.5	369.4	14.6	14.0	344.8	343.0	5.2	4.4
Credit hedging - banking book (1)	1.7	—	—	—	2.2	0.9	—	0.1	1.0	1.0	—	—
Credit hedging - trading book												
- rates	7.8	4.6	0.1	0.1	19.7	16.2	0.9	1.7	21.4	10.2	(0.8)	0.2
- credit and mortgage markets	13.7	13.6	0.2	0.2	3.9	3.1	0.2	0.1	4.1	4.0	0.3	0.5
- other	1.1	0.3	—	—	0.8	0.1	—	—	0.6	0.1	—	—
	255.4	246.6	3.3	3.1	397.1	389.7	15.7	15.9	371.9	358.3	4.7	5.1
Non-Core												
Residual risk	19.4	12.3	0.4	0.4	29.8	21.0	2.4	2.5	39.1	19.5	3.2	2.3
Credit hedging - banking book (1)	3.7	0.4	0.1	—	12.6	3.4	0.1	—	7.4	3.3	0.1	—
Credit hedging - trading book												
- rates	1.6	1.2	—	—	1.3	0.9	—	—	0.2	0.1	(0.1)	—
- credit and mortgage markets	7.9	2.0	0.7	0.4	36.8	22.6	1.9	1.2	155.2	165.5	1.4	1.5
- other	0.1	0.1	—	—	0.1	—	—	—	0.1	—	—	—
	32.7	16.0	1.2	0.8	80.6	47.9	4.4	3.7	202.0	188.4	4.6	3.8

By counterparty	2012 Notional Bought £bn	2012 Notional Sold £bn	2012 Fair value Bought £bn	2012 Fair value Sold £bn	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 government (APS)	—	—	—	—	131.8	—	(0.2)	—	195.8	—	0.6	—
Monoline insurers	4.2	—	0.3	—	8.0	—	0.6	—	9.3	—	0.9	—
CDPCs (2)	21.0	—	0.2	—	24.5	—	0.9	—	25.0	—	0.8	—
Banks	127.0	128.4	2.5	2.8	203.5	200.5	8.5	9.9	365.0	358.9	5.0	5.4
Other financial institutions	135.2	134.2	1.3	1.1	232.9	230.6	10.2	9.5	171.4	186.5	3.6	3.5
Corporates	0.7	—	0.2	—	8.8	6.5	(0.1)	0.2	3.2	1.3	(1.0)	—
	288.1	262.6	4.5	3.9	609.5	437.6	19.9	19.6	769.7	546.7	9.9	8.9

Notes:
(1) Credit hedging in the banking book principally relates to portfolio management in Non-Core.
(2) Credit derivative product company.

Monoline insurers

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

	2012 £m	2011 £m	2010 £m
Gross exposure to monolines	533	1,668	1,781
Hedges with financial institutions	(12)	(71)	(71)
Credit valuation adjustment	(181)	(1,012)	(800)
Net exposure to monolines	340	585	910
Credit valuation adjustment as a % of gross exposure	34%	61%	45%
Counterparty and credit risk RWAs*	£1.2bn	£3.5bn	£2.8bn

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

2012	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-	3,082	2,666	416	117	—	299
Non-investment grade	1,155	1,038	117	64	12	41
	4,237	3,704	533	181	12	340
Of which:						
CMBS	104	92	12	2		
CLOs	2,777	2,563	214	47		
Other ABS	936	760	176	85		
Other	420	289	131	47		
	4,237	3,704	533	181		
2011						
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		

** unaudited*

Balance sheet analysis: Monoline insurers continued

2010	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-	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		

Credit derivative product companies (CDPCs)

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

	2012 £m	2011 £m	2010 £m
Gross exposure to CDPCs	554	1,896	1,244
Credit valuation adjustment	(314)	(1,034)	(490)
Net exposure to CDPCs	240	862	754
Credit valuation adjustment as a % of gross exposure	57%	55%	39%
Counterparty and credit risk RWAs*	£2.0bn	£8.4bn	£7.2bn
Capital deductions*	—	£245m	£280m

The table below details CDPC exposures by rating.

2012	Notional: protected assets £m	Fair value: reference protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Net exposure £m
AAA	43	43	—	—	—
A to AA-	619	612	7	7	—
Non-investment grade	16,254	15,841	413	173	240
Unrated	4,073	3,939	134	134	—
	20,989	20,435	554	314	240
2011					
AAA	213	212	1	—	1
BBB- to A-	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
AA to AA+	644	629	15	4	11
A to AA-	20,066	19,050	1,016	401	615
BBB- to A-	4,165	3,953	212	85	127
	25,088	23,844	1,244	490	754

** unaudited*

REIL, provisions and AFS reserves

Divisional analysis

The following tables analyse loans and advances to banks and customers (excluding reverse repos) and the related debt management measures and ratios by division.

	Group							
	Gross loans to				Credit metrics			
2012	Banks £m	Customers £m	REIL £m	Provisions £m	REIL as a % of gross loans to customers %	Provisions as a % of REIL %	Impairment charge £m	Amounts written-off £m
UK Retail	640	113,599	4,569	2,629	4.0	58	529	599
UK Corporate	746	107,025	5,452	2,432	5.1	45	836	514
Wealth	1,545	17,062	248	109	1.5	44	46	15
International Banking	4,432	39,011	358	336	0.9	94	131	332
Ulster Bank	632	32,652	7,533	3,910	23.1	52	1,364	72
US Retail & Commercial	435	51,271	1,146	285	2.2	25	83	391
Retail & Commercial	8,430	360,620	19,306	9,701	5.4	50	2,989	1,923
Markets	15,247	29,046	394	301	1.4	76	(12)	14
Other	2,021	2,159	—	—	—	—	—	—
Core	25,698	391,825	19,700	10,002	5.0	51	2,977	1,937
Non-Core	164	51,796	20,824	10,805	40.2	52	2,304	1,950
Total third-party	25,862	443,621	40,524	20,807	9.1	51	5,281	3,887
Amounts due from fellow subsidiaries	21,875	1,866	—	—	—	—	—	—
	47,737	445,487	40,524	20,807	9.1	51	5,281	3,887
2011								
UK Retail	628	103,377	4,087	2,344	4.0	57	788	823
UK Corporate	806	98,430	3,988	1,623	4.1	41	790	658
Wealth	2,422	16,913	211	81	1.2	38	25	11
International Banking	2,122	39,562	982	329	2.5	34	(16)	84
Ulster Bank	2,079	34,052	5,523	2,749	16.2	50	1,384	124
US Retail & Commercial	208	51,562	1,007	455	2.0	45	248	373
Retail & Commercial	8,265	343,896	15,798	7,581	4.6	48	3,219	2,073
Markets	23,569	29,346	214	170	0.7	79	(27)	12
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 holding company and fellow subsidiaries	27,232	792	—	—	—	—	—	—
	59,465	446,611	39,072	18,554	8.7	47	6,969	4,183

Balance sheet analysis: REIL, provisions and AFS reserves continued

	Group							
	Gross loans to				Credit metrics			
2010	Banks £m	Customers £m	REIL £m	Provisions £m	REIL as a % of gross loans to customers %	Provisions as a % of REIL %	Impairment charge £m	Amounts written-off £m
UK Retail	407	108,405	4,620	2,741	4.3	59	1,160	1,135
UK Corporate	126	113,541	3,981	1,746	3.5	44	768	357
Wealth	2,220	16,130	223	66	1.4	30	18	9
International Banking	1,546	41,789	1,018	439	2.4	43	237	9
Ulster Bank	2,928	36,858	3,619	1,633	9.8	45	1,161	48
US Retail & Commercial	145	48,602	914	509	1.9	56	485	550
Retail & Commercial	7,372	365,325	14,375	7,134	3.9	50	3,829	2,108
Markets	34,831	20,726	194	215	0.9	111	52	12
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 fellow subsidiaries	4,848	1,946	—	—	—	—	—	—
	47,063	485,843	36,630	16,770	7.5	46	9,299	4,375

Commercial real estate lending metrics were as follows:

	Total		Non-Core	
	2012	2011	2012	2011
Lending (gross)	£63.0bn	£74.8bn	£26.4bn	£34.3bn
Of which REIL	£22.1bn	£22.9bn	£17.1bn	£18.8bn
Provisions	£10.1bn	£9.5bn	£8.3bn	£8.2bn
REIL as a % of gross loans to customers	35.1%	30.6%	64.8%	54.8%
Provisions as a % of REIL	46%	41%	49%	44%

Note:
(1) Excludes property related lending to customers in other sectors managed by Real Estate Finance.

Ulster Bank is a significant contributor to Non-Core commercial real estate lending. For further information refer to the section on Ulster Bank Group (Core and Non-Core).

REIL, provisions and AFS reserves Sector and geographical region analyses: Group

The following tables analyse gross loans and advances to banks and customers (excluding reverse repos) and the related debt management measures and ratios by sector and geography (by location of lending office) for the Group, Core and Non-Core.

	Group							
				Credit metrics				
2012	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
Government (1)	9,126	—	—	—	—	—	—	—
Finance	41,037	503	218	1.2	43	0.5	88	205
Personal - mortgages	149,210	6,498	1,779	4.4	27	1.2	943	434
- unsecured	31,219	2,820	2,340	9.0	83	7.5	617	785
Property	72,109	21,179	9,822	29.4	46	13.6	2,232	1043
Construction	8,010	1,480	647	18.5	44	8.1	92	174
Manufacturing	21,928	616	349	2.8	57	1.6	108	146
Finance leases (2)	13,520	442	294	3.3	67	2.2	44	263
Retail, wholesale and repairs	21,425	1,117	624	5.2	56	2.9	222	170
Transport and storage	17,822	832	334	4.7	40	1.9	288	77
Health, education and leisure	16,685	1,187	520	7.1	44	3.1	144	95
Hotels and restaurants	7,820	1,597	726	20.4	45	9.3	176	102
Utilities	6,288	35	13	0.6	37	0.2	—	—
Other	27,422	2,084	1,106	7.6	53	4.0	329	379
Latent	—	—	1,921	—	—	—	(13)	—
Total third-party	443,621	40,390	20,693	9.1	51	4.7	5,270	3,873
Amounts due from fellow subsidiaries	1,866	—	—	—	—	—	—	—
	445,487	40,390	20,693	9.1	51	4.6	5,270	3,873
of which:								
UK								
- residential mortgages	109,530	2,439	456	2.2	19	0.4	122	32
- personal lending	19,691	2,477	2,152	12.6	87	10.9	479	610
- property	53,704	10,495	3,935	19.5	37	7.3	960	490
- construction	6,507	1,166	481	17.9	41	7.4	100	158
- other	120,808	3,719	2,608	3.1	70	2.2	675	823
Europe								
- residential mortgages	17,451	3,060	1,125	17.5	37	6.4	521	24
- personal lending	1,727	143	139	8.3	97	8.0	29	12
- property	14,571	10,349	5,758	71.0	56	39.5	1,288	404
- construction	1,109	300	160	27.1	53	14.4	(13)	4
- other	25,099	4,231	2,834	16.9	67	11.3	816	331
US								
- residential mortgages	21,911	972	190	4.4	20	0.9	298	376
- personal lending	8,748	199	48	2.3	24	0.5	109	162
- property	3,343	170	29	5.1	17	0.9	(11)	83
- construction	388	8	1	2.1	13	0.3	—	12
- other	28,959	316	597	1.1	189	2.1	(107)	135
RoW								
- residential mortgages	318	27	8	8.5	30	2.5	2	2
- personal lending	1,053	1	1	0.1	100	0.1	—	1
- property	491	165	100	33.6	61	20.4	(5)	66
- construction	6	6	5	100.0	83	83.3	5	—
- other	8,207	147	66	1.8	45	0.8	2	148
Total third-party	443,621	40,390	20,693	9.1	51	4.7	5,270	3,873
Amounts due from fellow subsidiaries	1,866	—	—	—	—	—	—	—
	445,487	40,390	20,693	9.1	51	4.6	5,270	3,873
Banks	47,737	134	114	0.3	85	0.2	11	14

For the notes to this table refer to page 141.

Balance sheet analysis: REIL, provisions and AFS reserves continued

Sector and geographical region analyses: Group continued

2011	Group Gross loans £m	REIL £m	Provisions £m	Credit metrics REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Government (1)	8,854	—	—	—	—	—	—	—
Finance	45,070	432	238	1.0	55	0.5	(121)	50
Personal - mortgages	142,676	5,000	1,313	3.5	26	0.9	1,046	516
- unsecured	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
Finance leases (2)	14,414	794	508	5.5	64	3.5	112	170
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 leisure	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	26,792	2,191	966	8.2	44	3.6	737	245
Latent	—	—	1,884	—	—	—	(497)	—
Total third-party	445,819	38,978	18,469	8.7	47	4.1	6,969	4,183
Amounts due from fellow subsidiaries	792	—	—	—	—	—	—	—
	446,611	38,978	18,469	8.7	47	4.1	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
- construction	7,173	1,245	502	17.4	40	7.0	190	228
- other	123,114	3,598	2,456	2.9	68	2.0	536	658
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
- construction	1,042	382	181	36.7	47	17.4	(60)	(1)
- other	21,751	3,795	2,155	17.4	57	9.9	997	240
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
- construction	457	122	10	26.7	8	2.2	9	17
- other	36,212	392	821	1.1	209	2.3	(193)	166
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
- construction	9	—	—	—	—	—	—	—
- other	5,901	213	136	3.6	64	2.3	(7)	6
Total third-party	445,819	38,978	18,469	8.7	47	4.1	6,969	4,183
Amounts due from fellow subsidiaries	792	—	—	—	—	—	—	—
	446,611	38,978	18,469	8.7	47	4.1	6,969	4,183
Banks	59,465	94	85	0.3	90	0.3	—	—

For the notes to this table refer to page 141.

2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Credit metrics: Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Government (1)	7,140	—	—	—	—	—	—	—
Finance	46,740	637	278	1.4	44	0.6	147	102
Personal - mortgages	145,677	4,230	854	2.9	20	0.6	1,008	668
- unsecured	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
Finance leases (2)	16,803	847	555	5.0	66	3.3	252	113
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 leisure	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	27,122	1,230	576	4.5	47	2.1	391	267
Latent	—	—	2,500	—	—	—	113	—
Total third-party	483,897	36,532	16,682	7.5	46	3.4	9,299	4,375
Amounts due from fellow subsidiaries	1,946	—	—	—	—	—	—	—
	485,843	36,532	16,682	7.5	46	3.4	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
- construction	9,322	1,747	604	18.7	35	6.5	371	110
- other	134,565	3,732	2,865	2.8	77	2.1	942	586
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
- construction	1,294	660	248	51.0	38	19.2	139	—
- other	24,461	2,354	1,481	9.6	63	6.1	864	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
- construction	520	50	15	9.6	30	2.9	26	34
- other	34,006	685	1,042	2.0	152	3.1	(50)	437
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
- construction	119	—	—	—	—	—	9	—
- other	8,914	247	163	2.8	66	1.8	88	17
Total third-party	483,897	36,532	16,682	7.5	46	3.4	9,299	4,375
Amounts due from fellow subsidiaries	1,946	—	—	—	—	—	—	—
	485,843	36,532	16,682	7.5	46	3.4	9,299	4,375
Banks	47,063	98	88	0.2	90	0.2	—	—

Group

For the notes to this table refer to page 141.

Balance sheet analysis: REIL, provisions and AFS reserves continued

Sector and geographical region analyses: Core

	Group							
					Credit metrics			
2012	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
Government (1)	8,457	—	—	—	—	—	—	—
Other finance	38,886	179	93	0.5	52	0.2	9	172
Personal - mortgages	146,758	6,227	1,690	4.2	27	1.2	786	234
- unsecured	30,438	2,717	2,306	8.9	85	7.6	568	718
Property	43,599	4,671	1,674	10.7	36	3.8	750	209
Construction	6,001	757	350	12.6	46	5.8	119	53
Manufacturing	20,794	459	255	2.2	56	1.2	93	56
Finance leases (2)	9,123	159	107	1.7	67	1.2	35	41
Retail, wholesale and repairs	20,532	776	427	3.8	55	2.1	172	126
Transport and storage	14,450	440	112	3.0	25	0.8	72	21
Health, education and leisure	15,767	762	299	4.8	39	1.9	109	64
Hotels and restaurants	6,887	1,042	473	15.1	45	6.9	138	56
Utilities	4,949	10	5	0.2	50	0.1	—	—
Other	25,184	1,367	788	5.4	58	3.1	223	173
Latent	—	—	1,309	—	—	—	(108)	—
Total third-party	391,825	19,566	9,888	5.0	51	2.5	2,966	1,923
Amounts due from fellow subsidiaries	1,852	—	—	—	—	—	—	—
	393,677	19,566	9,888	5.0	51	2.5	2,966	1,923
of which:								
UK								
- residential mortgages	109,511	2,439	456	2.2	19	0.4	122	32
- personal lending	19,636	2,454	2,133	12.5	87	10.9	474	594
- property	35,531	2,777	897	7.8	32	2.5	394	181
- construction	5,101	671	300	13.2	45	5.9	109	47
- other	108,105	2,652	1,734	2.5	65	1.6	495	379
Europe								
- residential mortgages	17,446	3,059	1,124	17.5	37	6.4	521	24
- personal lending	1,540	143	138	9.3	97	9.0	29	11
- property	4,896	1,653	685	33.8	41	14.0	353	1
- construction	510	75	45	14.7	60	8.8	4	3
- other	21,151	2,254	1,676	10.7	74	7.9	379	102
US								
- residential mortgages	19,483	702	102	3.6	15	0.5	141	176
- personal lending	8,209	119	34	1.4	29	0.4	65	112
- property	2,847	112	13	3.9	12	0.5	3	27
- construction	384	5	—	1.3	0	0.0	1	3
- other	28,177	247	429	0.9	174	1.5	(132)	80
RoW								
- residential mortgages	318	27	8	8.5	30	2.5	2	2
- personal lending	1,053	1	1	0.1	100	0.1	—	1
- property	325	129	79	39.7	61	24.3	—	—
- construction	6	6	5	100.0	83	83.3	5	—
- other	7,596	41	29	0.5	71	0.4	1	148
Total third-party	391,825	19,566	9,888	5.0	51	2.5	2,966	1,923
Amounts due from fellow subsidiaries	1,852	—	—	—	—	—	—	—
	393,677	19,566	9,888	5.0	51	2.5	2,966	1,923
Banks	47,539	134	114	0.3	85	0.2	11	14

For the notes to this table refer to page 141.

2011	Group Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Credit metrics: Provisions as a % of REIL %	Credit metrics: Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Government (1)	8,337	—	—	—	—	—	—	—
Finance	42,155	239	167	0.6	70	0.4	(8)	30
Personal - mortgages	138,321	4,704	1,182	3.4	25	0.9	776	198
- unsecured	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
Finance leases (2)	8,355	172	110	2.1	64	1.3	31	68
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 leisure	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	24,327	1,111	603	4.6	54	2.5	529	183
Latent	—	—	1,281	—	—	—	(218)	—
Total third-party	373,253	15,918	7,666	4.3	48	2.1	3,192	2,085
Amounts due from fellow subsidiaries	764	—	—	—	—	—	—	—
	374,017	15,918	7,666	4.3	48	2.0	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
- construction	5,291	474	178	9.0	38	3.4	160	138
- other	106,245	2,076	1,280	2.0	62	1.2	370	399
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
- construction	466	81	42	17.4	52	9.0	18	(1)
- other	14,699	1,767	1,246	12.0	71	8.5	679	147
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
- construction	412	98	1	23.8	1	0.2	—	6
- other	34,324	299	559	0.9	187	1.6	15	90
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	5,034	114	103	2.3	90	2.0	(11)	6
Total third-party	373,253	15,918	7,666	4.3	48	2.1	3,192	2,085
Amounts due from fellow subsidiaries	764	—	—	—	—	—	—	—
	374,017	15,918	7,666	4.3	48	2.0	3,192	2,085
Banks	59,385	94	85	0.2	90	0.1	—	—

For the notes to this table refer to page 141.

Balance sheet analysis: REIL, provisions and AFS reserves continued

Sector and geographical region analyses: Core continued

	Group							
				Credit metrics				
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
Government (1)	6,473	—	—	—	—	—	—	—
Finance	39,619	304	210	0.8	69	0.5	119	21
Personal - mortgages	140,351	3,998	691	2.8	17	0.5	578	242
- unsecured	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
Finance leases (2)	8,273	244	141	2.9	58	1.7	63	42
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 leisure	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	23,902	639	315	2.7	49	1.3	197	96
Latent	—	—	1,559	—	—	—	178	—
Total third-party	385,599	14,471	7,261	3.8	50	1.9	3,881	2,120
Amounts due from fellow subsidiaries	1,888	—	—	—	—	—	—	—
	387,487	14,471	7,261	3.7	50	1.9	3,881	2,120
of which:								
UK								
- residential mortgages	99,927	2,010	305	2.0	15	0.3	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
- construction	7,026	534	182	7.6	34	2.6	148	29
- other	108,766	2,024	1,477	1.9	73	1.4	542	290
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
- construction	617	61	25	9.9	41	4.1	36	—
- other	16,026	985	771	6.1	78	4.8	506	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
- construction	441	8	6	1.8	75	1.4	6	10
- other	30,736	354	641	1.2	181	2.1	65	154
RoW								
- residential mortgages	409	23	9	5.6	39	2.2	5	—
- personal lending	1,452	2	1	0.1	50	0.1	—	—
- property	540	58	35	10.7	60	6.5	20	—
- construction	79	—	—	—	—	—	—	—
- other	7,071	103	120	1.5	117	1.7	110	5
Total third-party	385,599	14,471	7,261	3.8	50	1.9	3,881	2,120
Amounts due from fellow subsidiaries	1,888	—	—	—	—	—	—	—
	387,487	14,471	7,261	3.7	50	1.9	3,881	2,120
Banks	46,810	98	88	0.2	90	0.2	—	—

For the notes to this table refer to page 141.

Sector and geographical region analyses: Non-Core

	Group							
				Credit metrics				
2012	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
Government (1)	669	—	—	—	—	—	—	—
Other finance	2,151	324	125	15.1	39	5.8	79	33
Personal - mortgages	2,452	271	89	11.1	33	3.6	157	200
- unsecured	781	103	34	13.2	33	4.4	49	67
Property	28,510	16,508	8,148	57.9	49	28.6	1,482	834
Construction	2,009	723	297	36.0	41	14.8	(27)	121
Manufacturing	1,134	157	94	13.8	60	8.3	15	90
Finance leases (2)	4,397	283	187	6.4	66	4.3	9	222
Retail, wholesale and repairs	893	341	197	38.2	58	22.1	50	44
Transport and storage	3,372	392	222	11.6	57	6.6	216	56
Health, education and leisure	918	425	221	46.3	52	24.1	35	31
Hotels and restaurants	933	555	253	59.5	46	27.1	38	46
Utilities	1,339	25	8	1.9	32	0.6	—	—
Other	2,238	717	318	32.0	44	14.2	106	206
Latent	—	—	612	—	—	—	95	—
Total third-party	51,796	20,824	10,805	40.2	52	20.9	2,304	1,950
Amounts due from fellow subsidiaries	14	—	—	—	—	—	—	—
	51,810	20,824	10,805	40.2	52	20.9	2,304	1,950
of which:								
UK								
- residential mortgages	19	—	—	—	—	—	—	—
- personal lending	55	23	19	41.8	83	34.5	5	16
- property	18,173	7,718	3,038	42.5	39	16.7	566	309
- construction	1,406	495	181	35.2	37	12.9	(9)	111
- other	12,703	1,067	874	8.4	82	6.9	180	444
Europe								
- residential mortgages	5	1	1	20.0	100	20.0	—	—
- personal lending	187	—	1	—		0.5	—	1
- property	9,675	8,696	5,073	89.9	58	52.4	935	403
- construction	599	225	115	37.6	51	19.2	(17)	1
- other	3,948	1,977	1,158	50.1	59	29.3	437	229
US								
- residential mortgages	2,428	270	88	11.1	33	3.6	157	200
- personal lending	539	80	14	14.8	18	2.6	44	50
- property	496	58	16	11.7	28	3.2	(14)	56
- construction	4	3	1	75.0	33	25.0	(1)	9
- other	782	69	168	8.8	243	21.5	25	55
RoW								
- property	166	36	21	21.7	58	12.7	(5)	66
- construction	—	—	—				—	—
- other	611	106	37	17.3	35	6.1	1	—
Total third-party	51,796	20,824	10,805	40.2	52	20.9	2,304	1,950
Amounts due from fellow subsidiaries	14	—	—	—	—	—	—	—
	51,810	20,824	10,805	40.2	52	20.9	2,304	1,950
Banks	198	—	—	—	—	—	—	—

For the notes to this table refer to page 141.

Balance sheet analysis: REIL, provisions and AFS reserves continued

Sector and geographical region analyses: Non-Core continued

	Group							
					Credit metrics			
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
Government (1)	517	—	—	—	—	—	—	—
Finance	2,915	193	71	6.6	37	2.4	(113)	20
Personal - mortgages	4,355	296	131	6.8	44	3.0	270	318
- unsecured	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
Finance leases (2)	6,059	622	398	10.3	64	6.6	81	102
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 leisure	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	2,465	1,080	363	43.8	34	14.7	208	62
Latent	—	—	603	—	—	—	(279)	—
Total third-party	72,566	23,060	10,803	31.8	47	14.9	3,777	2,098
Amounts due from fellow subsidiaries	28	—	—	—	—	—	—	—
	72,594	23,060	10,803	31.8	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
- construction	1,882	771	324	41.0	42	17.2	30	90
- other	16,869	1,522	1,176	9.0	77	7.0	166	259
Europe								
- residential mortgages	6	—	—	—	—	—	—	—
- personal lending	267	—	—	—	—	—	—	—
- property	11,212	11,974	5,332	106.8	45	47.6	2,172	497
- construction	576	301	139	52.3	46	24.1	(78)	—
- other	7,052	2,028	909	28.8	45	12.9	318	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
- construction	45	24	9	53.3	38	20.0	9	11
- other	1,888	93	262	4.9	282	13.9	(208)	76
RoW								
- property	526	311	99	59.1	32	18.8	50	35
- construction	9	—	—	—	—	—	—	—
- other	867	99	33	11.4	33	3.8	4	—
Total third-party	72,566	23,060	10,803	31.8	47	14.9	3,777	2,098
Amounts due from fellow subsidiaries	28	—	—	—	—	—	—	—
	72,594	23,060	10,803	31.8	47	14.9	3,777	2,098
Banks	80	—	—	—	—	—	—	—

For the notes to this table refer to page 141.

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
	Group			Credit metrics				
Government (1)	667	—	—	—	—	—	—	—
Finance	7,121	333	68	4.7	20	1.0	28	81
Personal - mortgages	5,326	232	163	4.4	70	3.1	430	426
- unsecured	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
Finance leases (2)	8,530	603	414	7.1	69	4.9	189	71
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 leisure	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	3,220	591	261	18.4	44	8.1	194	171
Latent	—	—	941	—	—	—	(65)	—
Total third-party	98,298	22,061	9,421	22.4	43	9.6	5,418	2,255
Amounts due from fellow subsidiaries	58	—	—	—	—	—	—	—
	98,356	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
- construction	2,296	1,213	422	52.8	35	18.4	223	81
- other	25,799	1,708	1,388	6.6	81	5.4	400	296
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
- construction	677	599	223	88.5	37	32.9	103	0
- other	8,435	1,369	710	16.2	52	8.4	358	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
- construction	79	42	9	53.2	21	11.4	20	24
- other	3,270	331	401	10.1	121	12.3	(115)	283
RoW								
- residential mortgages	—	—	—	—	—	—	—	1
- property	1,184	241	64	20.4	27	5.4	(33)	182
- construction	40	—	—	—	—	—	9	—
- other	1,843	144	43	7.8	30	2.3	(22)	12
Total third-party	98,298	22,061	9,421	22.4	43	9.6	5,418	2,255
Amounts due from fellow subsidiaries	58	—	—	—	—	—	—	—
	98,356	22,061	9,421	22.4	43	9.6	5,418	2,255
Banks	253	—	—	—	—	—	—	—

Notes:
(1) Includes central and local government.
(2) Includes instalment credit.

Balance sheet analysis: REIL, provisions and AFS reserves continued

Provisions and AFS reserves methodology

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.

Analyses of provisions are set out on pages 144 to 145.

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 judgement. 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.

Analyses of AFS debt securities and related AFS reserves are set out on page 146.

REIL flow statement

REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked. The table below details the movement in REIL excluding disposal groups.

	UK Retail £m	UK Corporate £m	Wealth £m	International Banking £m	Ulster Bank £m	US R&C (1) £m	Markets £m	Core £m	Non-Core £m	Group £m
At 1 January 2012	4,087	3,988	211	982	5,523	1,007	214	16,012	23,060	39,072
Transfers from disposal groups	482	964	—	—	—	—	—	1,446	—	1,446
Transfers from fellow subsidiaries	—	—	—	253	—	—	119	372	179	551
Currency translation and other adjustments	83	43	(1)	(9)	(115)	(47)	76	30	(419)	(389)
Additions	1,771	4,362	111	252	3,299	660	19	10,474	5,622	16,096
Transfers	(33)	7	—	(109)	—	—	—	(135)	52	(83)
Disposals and restructurings	—	(133)	(8)	(624)	—	—	(9)	(774)	(1,026)	(1,800)
Repayments	(1,222)	(3,265)	(50)	(55)	(1,102)	(83)	(11)	(5,788)	(4,694)	(10,482)
Amounts written-off	(599)	(514)	(15)	(332)	(72)	(391)	(14)	(1,937)	(1,950)	(3,887)
At 31 December 2012	4,569	5,452	248	358	7,533	1,146	394	19,700	20,824	40,524

Non-Core (by donating divisions)	UK Corporate £m	International Banking £m	Ulster Bank £m	US R&C (1) £m	Other £m	Total £m
At 1 January 2012	3,685	7,210	11,611	486	68	23,060
Transfers from fellow subsidiaries	—	179	—	—	—	179
Currency translation and other adjustments	(57)	(64)	(229)	(21)	(48)	(419)
Additions	1,542	2,092	1,658	325	5	5,622
Transfers	11	41	—	—	—	52
Disposals and restructurings	(171)	(855)	—	—	—	(1,026)
Repayments	(1,798)	(1,248)	(1,585)	(63)	—	(4,694)
Amounts written-off	(590)	(903)	(139)	(309)	(9)	(1,950)
At 31 December 2012	2,622	6,452	11,316	418	16	20,824

Note:
(1) Retail & Commercial.

REIL summary

The table below analyses REIL between UK and overseas, based on the location of the lending office.

	2012			2011			2010		
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
Impaired loans									
- UK	9,323	9,054	18,377	8,291	7,253	15,544	8,564	7,731	16,295
- overseas	8,163	11,347	19,510	6,300	15,270	21,570	4,353	13,143	17,496
	17,486	20,401	37,887	14,591	22,523	37,114	12,917	20,874	33,791
Accruing loans past due 90 days or more									
- UK	1,758	248	2,006	1,192	508	1,700	1,436	939	2,375
- overseas	456	175	631	229	29	258	216	248	464
	2,214	423	2,637	1,421	537	1,958	1,652	1,187	2,839
Total REIL	19,700	20,824	40,524	16,012	23,060	39,072	14,569	22,061	36,630
REIL as a % of gross loans to customers (1)	5.0%	40.2%	9.0%	4.4%	31.8%	8.7%	3.8%	21.9%	7.5%
Provisions as a % of REIL	51%	52%	51%	49%	47%	48%	50%	43%	46%

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

Past due analysis

The table below shows loans and advances to customers that were past due at the balance sheet date but are not considered impaired.

	2012			2011			2010		
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
Past due 1-29 days	5,349	250	5,599	5,502	682	6,184	6,391	788	7,179
Past due 30-59 days	1,062	55	1,117	1,472	161	1,633	1,710	377	2,087
Past due 60-89 days	1,151	26	1,177	904	100	1,004	911	251	1,162
Past due 90 days or more	2,214	423	2,637	1,421	537	1,958	1,652	1,187	2,839
	9,776	754	10,530	9,299	1,480	10,779	10,664	2,603	13,267

Balance sheet analysis: REIL, provisions and AFS reserves continued

Impairment provision flow statement

The movement in loan impairment provision by division is shown in the table below.

2012	UK Retail £m	UK Corporate £m	Wealth £m	International Banking £m	Ulster Bank £m	US R&C (1) £m	Total R&C (1) £m	Markets £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,344	1,623	81	329	2,749	455	7,581	170	7,751	10,803	18,554
Transfers from disposal groups	311	453	—	—	—	—	764	—	764	—	764
Currency translation and other adjustments	36	72	—	(17)	(54)	53	90	86	176	(351)	(175)
Transfers from fellow subsidiaries	—	—	—	222	—	—	222	70	292	123	415
Disposals	—	—	—	—	—	—	—	—	—	(1)	(1)
Amounts written-off	(599)	(514)	(15)	(332)	(72)	(391)	(1,923)	(14)	(1,937)	(1,950)	(3,887)
Recoveries of amounts previously written-off	96	18	—	7	2	85	208	1	209	123	332
Charge to income statement	529	836	46	131	1,364	83	2,989	(12)	2,977	2,304	5,281
Unwind of discount (2)	(88)	(56)	(3)	(4)	(79)	—	(230)	—	(230)	(246)	(476)
At 31 December	2,629	2,432	109	336	3,910	285	9,701	301	10,002	10,805	20,807
Individually assessed											
- banks	—	—	—	7	—	—	7	107	114	—	114
- customers	—	1,025	96	227	1,213	46	2,607	188	2,795	9,502	12,297
Collectively assessed	2,439	1,110	—	—	2,110	125	5,784	—	5,784	691	6,475
Latent	190	297	13	102	587	114	1,303	6	1,309	612	1,921
	2,629	2,432	109	336	3,910	285	9,701	301	10,002	10,805	20,807

2011	UK Retail £m	UK Corporate £m	Wealth £m	International Banking £m	Ulster Bank £m	US R&C (1) £m	Total R&C (1) £m	Markets £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,741	1,746	66	439	1,633	509	7,134	215	7,349	9,421	16,770
Transfers to disposal groups	(335)	(436)	—	(2)	—	—	(773)	—	(773)	—	(773)
Intra-group transfers	—	177	—	—	—	—	177	—	177	(177)	—
Currency translation and other adjustments	—	23	3	2	(79)	(6)	(57)	(8)	(65)	(196)	(261)
Transfers from fellow subsidiaries	—	—	—	—	—	—	—	3	3	—	3
Amounts written-off	(823)	(658)	(11)	(84)	(124)	(373)	(2,073)	(12)	(2,085)	(2,098)	(4,183)
Recoveries of amounts previously written-off	69	17	—	3	1	76	166	—	166	342	508
Charge to income statement	788	790	25	(16)	1,384	249	3,220	(28)	3,192	3,777	6,969
Unwind of discount (2)	(96)	(36)	(2)	(13)	(66)	—	(213)	—	(213)	(266)	(479)
At 31 December	2,344	1,623	81	329	2,749	455	7,581	170	7,751	10,803	18,554
Individually assessed											
- banks	—	—	2	7	—	—	9	76	85	—	85
- customers	—	679	70	207	991	73	2,020	87	2,107	9,440	11,547
Collectively assessed	2,157	676	—	—	1,282	162	4,277	—	4,277	760	5,037
Latent	187	268	9	115	476	220	1,275	7	1,282	603	1,885
	2,344	1,623	81	329	2,749	455	7,581	170	7,751	10,803	18,554

For the note to the table refer to the following page.

2010	UK Retail £m	UK Corporate £m	Wealth £m	International Banking £m	Ulster Bank £m	US R&C (1) £m	Total R&C (1) £m	Markets £m	Total Core £m	Non-Core £m	Group £m
At 1 January	2,677	1,287	55	397	962	482	5,860	207	6,067	5,953	12,020
Transfers to disposal groups	—	—	—	—	—	—	—	—	—	(72)	(72)
Intra-group transfers	—	—	—	(217)	(351)	—	(568)	—	(568)	568	—
Currency translation and other adjustments	—	71	4	34	(22)	20	107	(33)	74	(79)	(5)
Disposals	—	—	—	—	—	—	—	—	—	(13)	(13)
Amounts written-off	(1,135)	(357)	(9)	(9)	(48)	(550)	(2,108)	(12)	(2,120)	(2,255)	(4,375)
Recoveries of amounts previously written-off	128	8	—	2	1	72	211	1	212	148	360
Charge to income statement	1,160	768	18	237	1,161	485	3,829	52	3,881	5,418	9,299
Unwind of discount (2)	(89)	(31)	(2)	(5)	(70)	—	(197)	—	(197)	(247)	(444)
At 31 December	2,741	1,746	66	439	1,633	509	7,134	215	7,349	9,421	16,770
Individually assessed											
- banks	—	—	2	7	—	—	9	79	88	—	88
- customers	—	546	57	274	502	56	1,435	129	1,564	7,453	9,017
Collectively assessed	2,526	703	—	—	733	177	4,139	—	4,139	1,027	5,166
Latent	215	497	7	158	398	276	1,551	7	1,558	941	2,499
	2,741	1,746	66	439	1,633	509	7,134	215	7,349	9,421	16,770

Notes:
(1) Retail & Commercial.
(2) Recognised in interest income.

Non-Core (by donating divisions)	UK Corporate £m	International Banking £m	Ulster Bank £m	US R&C £m	Other £m	Total £m
At 1 January 2012	1,633	2,420	6,302	416	32	10,803
Currency translation and other adjustments	(100)	(42)	(109)	(89)	(11)	(351)
Transfers from fellow subsidiaries	—	123	—	—	—	123
Disposals	—	—	—	(1)	—	(1)
Amounts written-off	(590)	(903)	(139)	(309)	(9)	(1,950)
Recoveries of amounts previously written-off	21	33	4	63	2	123
Charge to income statement	241	906	976	177	4	2,304
Unwind of discount (2)	(38)	(38)	(170)	—	—	(246)
At 31 December 2012	1,167	2,499	6,864	257	18	10,805
Individually assessed						
- customers	688	2,311	6,478	24	1	9,502
Collectively assessed	422	—	160	92	17	691
Latent	57	188	226	141	—	612
	1,167	2,499	6,864	257	18	10,805

Impairment charge analysis

The table below analyses the impairment charge for loans and securities.

	2012 £m	2011 £m	2010 £m
Individually assessed	3,100	4,896	6,203
Collectively assessed	2,183	2,570	2,983
Latent loss	(13)	(497)	113
Loans and advances to customers	5,270	6,969	9,299
Loans and advances to banks	11	—	—
Securities	(67)	207	101
Charge to income statement	5,214	7,176	9,400
Charge as a % of gross loans (1)	1.2%	1.5%	1.9%

Note:
(1) Customer loan impairment charge as a percentage of gross loans and advances to customers including assets of disposal groups and excluding reverse repurchase agreements.

Balance sheet analysis: **REIL, provisions and AFS reserves** continued

	2012			2011			2010		
	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m	Core £m	Non-Core £m	Group £m
Loan impairment losses									
- customers	2,966	2,304	5,270	3,192	3,777	6,969	3,881	5,418	9,299
- banks	11	—	11	—	—	—	—	—	—
	2,977	2,304	5,281	3,192	3,777	6,969	3,881	5,418	9,299
Impairment losses on securities									
- debt securities	15	(112)	(97)	111	61	172	40	31	71
- equity shares	13	17	30	4	31	35	3	27	30
	28	(95)	(67)	115	92	207	43	58	101
Charge to income statement	3,005	2,209	5,214	3,307	3,869	7,176	3,924	5,476	9,400

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.

	2012 £m	2011 £m	2010 £m
Potential problem loans	760	553	512

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.

AFS reserves

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

	2012				2011				2010			
	US £m	UK £m	Other (1) £m	Total £m	US £m	UK £m	Other (1) £m	Total £m	US £m	UK £m	Other (1) £m	Total £m
Central and local government	17,514	7,950	10,083	35,547	18,769	10,654	13,987	43,410	20,266	5,651	14,559	40,476
Banks	56	509	2,368	2,933	41	640	3,943	4,624	183	3,076	3,774	7,033
Other financial institutions	10,571	2,815	2,581	15,967	17,453	3,079	2,375	22,907	15,963	1,480	2,309	19,752
Corporate	—	29	85	114	5	45	401	451	4	17	155	176
Total	28,141	11,303	15,117	54,561	36,268	14,418	20,706	71,392	36,416	10,224	20,797	67,437
Of which ABS	14,117	2,913	1,923	18,953	20,102	3,153	2,741	25,996	20,720	3,444	2,132	26,296
AFS reserves (gross)	1,123	603	546	2,272	1,537	773	550	2,860	908	221	34	1,163

Note:
(1) Includes eurozone countries as detailed in the Country risk section.

Market risk

148 Introduction
148 Governance
148 Risk measurement
148 Key principles
149 Risk appetite
149 Risk models
151 Stress testing
151 Pricing models
152 Trading book
153 VaR non-trading portfolios
153 VaR
154 Structured credit portfolio
155 Market risk capital
155 Minimum capital requirements

Market risk

Introduction

Market risk arises from fluctuations in interest rates, foreign currency, credit spreads, equity prices, commodity prices and risk related factors such as market volatilities. The Group manages market risk within its trading and non-trading portfolios through a comprehensive market risk management framework. This control framework includes qualitative and quantitative guidance in the form of comprehensive policy statements, dealing authorities, limits based on, but not limited to, value-at-risk (VaR), stressed VaR (SVaR), stress testing and sensitivity analyses.

Governance

Business structure

The primary focus of the RBS Group's trading activities is to provide an extensive range of 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 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.

In 2011, the RBS Group announced plans to transfer a substantial part of its business from RBS N.V. to the Group, in an effort to simplify the structure and reduce risk. During 2012, a substantial part of the business was transferred to the Bank, a key element of this was the Financial Services Authority (FSA) approval of the Netherlands trading branch location into the scope of the regulatory models.

Organisation structure

Independent oversight and support is provided to the divisions by the Global Head of Market & Insurance Risk, assisted by the Group and divisional market risk teams. The head of each division, assisted by a divisional 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 quarterly and is chaired by the Global Head of Market & Insurance Risk. Attendees include respective divisional market risk managers and Group Market Risk.

Regulatory Risk

Trading activities will indirectly be impacted by regulatory proposals that will change market participants behaviours. These are discussed in more detail in the Regulatory risk section (refer to page 188). Developments specific to market risk include the Fundamental Review of the Trading Book (FRTB) and the Fundamental Review of the Securitisation Treatments. The FRTB remains at a conceptual stage and there is currently insufficient practical detail available to provide a meaningful assessment of what may eventually be implemented. The Basel Committee's review of the treatment of securitisation positions is further advanced and the Group is currently reviewing how it can participate to assess the impact on trading book activities.

Risk measurement

Key principles

The 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 Group. All teams involved in the management and control of market risk are required to fully comply with the policy statements to ensure the 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 Group;
- An independent market risk management process;
- 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;
- A market risk measurement methodology that captures correlation effects and allows aggregation of market risk across risk types, markets and business lines;
- Use of VaR as a measure of the one-day and SVaR as a measure of the ten-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 framework to identify, quantify and capitalise risks not captured within the VaR model; and
- A product approval process that requires market risk teams to assess and quantify market risk associated with proposed new products.

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 Group level, the risk appetite is expressed in the form of a combination of VaR, SVaR, sensitivity and stress testing limits.

A daily report summarises the 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, divisional Chief Risk Officers and appropriate divisional 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 Group level limits and tailored to the particular division and business.

The market risk control framework has been enhanced further during 2012 with the implementation of SVaR and portfolio gap risk limits. The portfolio gap risk takes into consideration the possibility of the joint occurrence of losses across different gap risk products.

In line with the overall business strategy to reduce risk exposures, the Group's market risk limits were adjusted down during 2012. The majority of the Group's market risk exposure is in the Markets, International Banking and Non-Core divisions and Group Treasury. The Group is also exposed to market risk through interest rate risk and foreign exchange risk on its non-trading activities in the retail and commercial businesses. These aspects are discussed in more detail in Risk and balance sheet management - Non-traded interest rate risk on page 55 and Structural foreign currency exposures on page 56.

In 2012, a market risk economic capital model was developed. It is planned to use this model for performance measurement within Markets and to assess the risks of the Group from a consolidated economic perspective. The results of the model will be consolidated with other risk types and reported during 2013. The model calculates the market and default risk in the trading book using an extended historic simulation approach with multiple liquidity horizons (differentiated by portfolio and asset class). The results are annualised to be consistent with the other Group economic capital models.

Risk models*

Risk models are developed both within divisional units and by 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.

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 for those legal entities under its jurisdiction. Within RBS Group, these legal entities are The Royal Bank of Scotland plc; National Westminster Bank Plc; RBS Financial Products Inc; and RBS Securities Inc. Regulatory VaR differs from the internal VaR as it is based on a ten-day holding period. 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 to asses the ongoing model performance is 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 RBS Group's trading book, a green model status was maintained throughout 2012.

The 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 forecast of portfolio losses based on events that occurred in the two-year time series. Therefore, events that are more severe than those in the historical data series are not represented.

- 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 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 Group cannot guarantee that losses will not exceed the VaR.

** unaudited*

Market risk: Risk management continued

During 2012, an improved methodology was implemented for interest rates, to more realistically represent the distribution of rate changes. The enhanced model introduced a level-dependent scaling methodology for interest rates, which removes the overestimation of rate fluctuations in regimes of declining rates and leads to a swifter adaptation to changing circumstances in times of increasing rates. At the point of implementation the impact on the trading VaR was a decrease of £2.8 million, while the interest rate VaR saw an increase of £1.5 million. The non-trading total and interest rate VaR decreased by £0.5 million and £1.2 million respectively.

SVaR - is applied to the trading portfolio and utilises data from a specific one year period of stress. As with VaR, the technique produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence level. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed and a confidence level of 99%.

In December 2012, the FSA confirmed the European Banking Authority guidelines relating to SVaR. The FSA now requires the use of 'Dynamic' SVaR, where the worst one year period of stress is determined on a daily basis.

Risks not in VaR (RNIV) - The RNIV framework has been developed to quantify those market risks not adequately captured by VaR and SVaR methodologies. The RNIV approach is used for market risks that fall within the scope of VaR, but which are insufficiently captured by the model methodology, for example due to the lack of sufficient historical data. These risks are therefore assessed outside the VaR model.

The Group adopts two approaches to the quantification of risks not in VaR (RNIVs):

- Some RNIVs are quantified using a (standalone) VaR approach. For these RNIVs, two values are calculated: (i) the VaR RNIV; and (ii) the SVaR RNIV.
- Some RNIVs are quantified using a stress scenario approach. For these RNIVs, an assessment of ten-day extreme, but plausible, market moves is used in combination with position sensitivities to give a stress-type loss number - the stressed RNIV value.

For each legal entity covered by the FSA VaR model waiver, all RNIVs are aggregated to obtain the following three measures: (i) Total VaR RNIV; (ii) Total SVaR RNIV; and (iii) Total stressed RNIV.

In each case, no allowance is made for potential diversification in respect of material RNIVs.

Incremental risk charge (IRC) - The IRC model aims to quantify the impact of defaults and rating changes on the market value of bonds, credit derivatives, and other related positions held in the trading book. It is calculated over a one year horizon to a 99.9% confidence level, and therefore represents a 1-in-1,000 loss over the following year. The modelling framework differentiates between the liquidity of different underlying instruments, with a minimum liquidity horizon of three months. It also captures basis risks between different products referencing the same underlying credit (e.g. bonds and credit default swaps (CDS)), and between similar products with different contractual terms (e.g. CDS in different currencies). The portfolio impact of correlated defaults and rating changes is assessed with reference to the resulting market value change of positions, which is determined using stressed recovery rates and modelled credit spread changes. The average liquidity horizon at the year end was 4.6 months.

In 2012, the IRC model was enhanced further: i) to better capture the risk characteristics of sovereign exposure migrations and defaults; and ii) to align the recovery rates for sovereign exposures to the banking book internal ratings based approach.

All price risk (APR) - The APR model is applied to the corporate credit correlation trading portfolio, subject to certain eligibility constraints (principally that the underlying names are liquid corporate CDS positions). The measure is calibrated to a 99.9% confidence level over a one year time horizon. All material price risks, including defaults and credit rating changes, are within the scope of the model. Of these, the most significant are credit spread risk, credit correlation risk, index basis risk, default risk, and recovery rate risk. In addition, losses due to both hedging costs and hedge slippage are modelled. The overall APR capital charge is floored at 8% of the corresponding standard rules charge for the same portfolio. The average liquidity horizon at the year end was 12 months.

Model validation - A model assessment is performed before a new or changed model element is implemented, and before a change is made to a market data mapping. Depending on the results, it may be necessary to notify the FSA before implementation. The form of internal validation depends on the type of model and the materiality of the change.

In the case of VaR models, the following steps are considered. In some cases, for example a minor change to a market data mapping, it will not be necessary to perform all of the steps. However, in all cases there will be an independent review and validation.

- Perform accuracy testing of the valuation methods used within VaR on appropriately chosen test portfolios. Ensure that tests capture the effect of using external data proxies where these are used.
- Back-test the approach using the relevant portfolio.
- Back-test the approach using hypothetical portfolio(s) where this is helpful for isolating the performance of specific areas of the model.
- Identify all risks not adequately captured in VaR, and ensure that such risks are captured via the risks not in VaR process.
- Identify any model weaknesses or scope limitations, their effect and how they have been addressed.
- Identify ongoing model testing designed to give early warning of market or portfolio weakness becoming significant.
- Perform impact assessment. Estimate the impact on total one-day and ten-day 99% VaR at the total legal entity level and the major business level, and individual risk factor level one-day and ten-day 99% VaR at the total legal entity level.

Additionally, Group Risk Analytics (GRA) assess the appropriateness of all new or amended models prior to their introduction. Existing approved models are re-assessed on a periodic basis to ensure they remain fit-for-purpose, for example, following significant market developments or portfolio changes. The models required to be reviewed by GRA (in relation to market risk) include VaR, SVaR, IRC, APR and economic capital. The independent validation review process will consider some or all of the following areas as appropriate:

- Test and challenge the logical and conceptual soundness of the methodology;
- The assumptions underlying the model will be tested, where feasible against actual behaviour. The validation report will judge the reasonableness and stability of the assumptions and specify which assumptions, if any, should be routinely monitored in production;
- Compare model results with independent model replication;
- Compare outcome with results from alternative methods;
- Test parameter selection and calibration;
- Ensure that model outputs are sufficiently conservative in areas where there is significant model uncertainty;
- Confirm applicability of tests for accuracy, and stability; recalculate; and ensure that results are robust; and
- Ensure appropriate factor sensitivity analysis has been performed and documented.

Stress testing*

The 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 severe and extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of the Group's trading and available-for-sale portfolios. The 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 Group Market Risk limit framework.

Historical stress tests calculate the changes in the portfolio valuations that would be generated if the extreme market movements that occurred during significant historical market events were repeated. Historical stress tests also form part of the Group Market Risk limit framework.

Bottom-up stress testing requires analysis of the market risk exposures by risk factors and different liquidity horizons, to identify the key risks. Stresses for these risks are then designed following 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 Group Risk Committee, the ERF and the Board. Breaches in the Group's market risk stress testing limits are monitored and reported.

Reverse stress testing is designed to assess the plausibility of scenarios derived by stressing market risk factors until the loss reaches a given threshold. Market Risk contributes to the firm wide, cross risk reverse stress tests.

In addition to VaR and stress testing, the 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.

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. These committees prioritise models for independent validation by 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). 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.

Marking-to-market

To ensure that the risks associated with trading activity are reflected in the financial and management statements, assets and liabilities in the trading book are measured at their fair value. Any profits or losses on the revaluation of positions are recognised in the income statement on a daily basis.

The fair value is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair values are determined following IAS 39 'Financial Instruments: Recognition and Measurement' guidance, which requires banks to use quoted market prices or valuation techniques (models) that make the maximum use of observable inputs.

When marking-to-market using a model, the valuation methodologies must be approved by all stakeholders (trading, finance, market risk, model development and model review) prior to use for profit and loss and risk management purposes.

Traders are responsible for marking-to-market their trading book positions on a daily basis. Traders can either:

- directly mark a position with a price (e.g. spot foreign exchange); or
- indirectly mark a position through the marking of inputs to an approved model, which will in turn generate a price.

** unaudited*

Market risk: Risk management continued

Independent price verification

Independent price verification is a key additional control over front office marking of positions.

Key elements of the independent price verification framework include:

- *Appropriate financial controls* - business unit controllers are responsible for ensuring that independent price verification processes are in place covering all trading book positions held by their business. The independent pricing verification policy requires that daily independent price verification is performed for positions where prices/model inputs are readily available on a daily basis. For positions where prices/model inputs are available on a less regular basis, verification may occur on a frequency that is less than daily. Where practical, verification is performed to a frequency that matches the availability of this independent price information.

- *Compliance statements* - business unit control is required to prepare and maintain compliance statements that benchmark price verification procedures against the independent pricing policy. Each compliance statement requires review and sign-off from the relevant financial controller, market risk manager and front office management every six months at least.

For more information on independent price verification, refer to Valuation of financial instruments carried at fair value on page 243.

Trading book

The table below analyses the VaR for the Group's trading portfolios segregated by type of market risk exposure.

	2012				2011				2010			
	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	63.3	75.7	95.7	41.4	52.9	68.3	77.8	28.1	51.0	54.5	80.9	32.2
Credit spread	69.4	74.4	94.7	45.0	82.4	73.7	150.6	47.6	161.7	130.6	237.0	109.0
Currency	10.7	8.0	23.7	2.9	9.6	16.1	18.8	5.2	17.7	9.8	28.6	8.9
Equity	5.9	3.9	12.3	1.9	6.7	7.2	11.1	3.5	6.1	6.9	13.2	2.5
Commodity	1.7	1.4	5.2	0.6	1.0	2.5	6.0	—	9.6	0.4	18.1	0.3
Diversification (1)		(55.6)				(51.1)				(55.3)		
Total	98.2	107.8	139.7	68.3	107.8	116.7	174.9	61.8	170.1	146.9	254.7	110.8

Note:
(1) The Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, currencies and markets. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time.

Key points

- The Group's average and maximum credit spread VaR for 2012 were lower than for 2011. This reflected the credit spread volatility experienced during the financial crisis dropping out of the time series window, combined with a reduction in the asset-backed securities trading inventory in Core and the sale of unencumbered asset-backed securities assets following the prior restructuring of some monoline hedges in the Non-Core banking book.

- The average and period end interest rate VaR for 2012 were higher than for 2011 due to pre-hedging and positioning activity ahead of government bond auctions and syndications, together with an increase in exposure to 'safe haven' assets in December 2012, as the US 'Fiscal Cliff' negotiations continued without resolution.

VaR non-trading portfolios

VaR

The table below details VaR for the Group's non-trading portfolios, excluding the structured credit portfolio and loans and receivables.

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 or run-off.

In order to better represent the risk of the non-trading portfolios, the table below analyses the VaR for the non-trading portfolios but excludes the Non-Core structured credit portfolio. 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 portfolios are the loans and receivable products that are managed within the credit risk management framework.

	2012				2011				2010			
	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	4.6	9.1	4.1	6.3	9.0	9.1	4.2	8.0	6.1	19.1	4.5
Credit spread	9.8	8.7	12.5	6.7	14.4	11.2	26.1	8.4	32.5	13.3	101.2	12.1
Currency	2.3	0.4	4.0	0.2	2.0	3.9	5.5	—	2.1	1.9	6.1	0.3
Equity	—	—	0.1	—	—	0.1	0.2	—	—	—	0.7	—
Diversification (1)		(4.3)				(12.4)				(5.2)		
Total	9.6	9.4	12.1	7.8	14.8	11.8	26.4	9.3	31.2	16.1	98.2	14.4

Note:
(1) The Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, currencies and markets. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time.

Key points

- The total and credit spread VaR were lower in 2012, due to reduced volatility in the market data time series, position reductions and a decrease in the size of the collateral portfolio. The reduction in collateral was driven by the restructuring of certain Dutch residential mortgage-backed securities during the first half of 2012, enabling their eligibility as European Central Bank collateral. This allowed the disposal of additional collateral purchased during the corresponding period in 2011.
- The period end interest rate VaR was lower in 2012, due to the implementation of an enhanced rates re-scaling methodology.

Market risk: VaR non-trading portfolios continued

Structured credit portfolio

The structured credit portfolio is within Non-Core. The risk in this portfolio is not disclosed using VaR, as the 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 risk-weighted assets basis. The table below shows the open market risk in the structured credit portfolio.

	Drawn notional					Fair value				
2012	CDOs (1) £m	CLOs (2) £m	MBS (3) £m	Other ABS (4) £m	Total £m	CDOs (1) £m	CLOs (2) £m	MBS (3) £m	Other ABS (4) £m	Total £m
1-2 years	—	—	—	80	80	—	—	—	74	74
3-4 years	—	—	27	82	109	—	—	24	76	100
4-5 years	—	—	95	—	95	—	—	86	—	86
5-10 years	—	310	92	—	402	—	295	44	—	339
>10 years	289	279	380	398	1,346	116	256	253	254	879
	289	589	594	560	2,032	116	551	407	404	1,478
2011										
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

Notes:
(1) Collateralised debt obligations.
(2) Collateralised loan obligations.
(3) Mortgage-backed securities.
(4) Asset-backed securities.

Key point

- The structured credit portfolio drawn notional and fair values declined across all asset classes from 31 December 2011 to 31 December 2012. Key drivers were: (i) during the first half of 2012, the liquidation of legacy trust preferred securities and commercial real estate CDOs and subsequent sale of the underlying assets; and (ii) during the second half of 2012, the sale of underlying assets from CDO collateral pools and legacy conduits.

Market risk capital*

Minimum capital requirements

The following table analyses the Group's market risk minimum capital requirement, calculated in accordance with Basel 2.5.

	2012 £m	2011 £m
Interest rate position risk requirement	224	1,106
Equity position risk requirement	1	3
Option position risk requirement	9	26
Commodity position risk requirement	2	2
Foreign currency position risk requirement	10	8
Specific interest rate risk of securitisation positions	156	250
Total (standard method)	402	1,395
Pillar 1 model based position risk requirement	2,739	3,357
Total position risk requirement	3,141	4,752

The principal contributors to the Pillar 1 model based position risk requirement (PRR) are:

	2012				
	Average (1) £m	Maximum (1) £m	Minimum (1) £m	Period end £m	2011 £m
Value-at-risk (VaR)	891	1,124	723	793	815
Stressed VaR (SVaR)	1,365	1,573	1,044	1,115	1,526
Incremental risk charge (IRC)	421	549	243	390	329
All price risk (APR)	148	290	12	12	297

Note:
(1) The average, maximum and minimum are based on the monthly Pillar 1 model based capital requirements.

Key points

- The FSA approved the inclusion of the Group's US trading subsidiary RBS Securities Inc. in the regulatory models in March 2012. This resulted in the model-based charges for VaR, SVaR and IRC increasing at that time and the standardised interest rate PRR decreasing significantly.
- SVaR decreased during the remainder of 2012, due to the disposal of assets in Non-Core and general de-risking in sovereign and agency positions in Markets.
- The APR decreased significantly due to the disposal of assets and unwinding of trades.

** unaudited*

Country risk

157	Introduction
157	External environment
158	Governance, monitoring and management
159	Country risk exposure
159	Definitions
160	Summary
164	Total eurozone
165	Eurozone periphery - total
166	Eurozone periphery - by country
177	Eurozone non-periphery - total
178	Eurozone non-periphery - by country

Country risk

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, expropriation or nationalisation); and 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 environment*

Country risk, notably in the eurozone, remained elevated in 2012, particularly in the first half of the year. Economic growth projections were lowered, predominantly for Europe, but also for a number of major emerging markets. However, important first steps towards achieving longer-term stabilisation in the eurozone led to some notable easing of crisis risks. Growth data from major non-European economies, such as China, were more encouraging towards the end of the year. The ability of policymakers to tackle fiscal challenges and restore confidence and growth in both the US and Europe will be a key factor in determining the pace of recovery.

Eurozone risks

Eurozone risks continued to dominate, as concerns about the impact of banking sector problems on government balance sheets led to further capital flight from periphery countries and a rise in sovereign bond yields until August, particularly for Spain. To break the feedback loop between banks and their sovereigns, eurozone leaders agreed at their June summit that the European Stability Mechanism (ESM), the eurozone's permanent crisis fund, could lend to banks directly once a single eurozone-wide banking regulator had been established. They also approved the provision by the ESM of significant financial support to Spain to recapitalise its banks.

In the second half of the year, the ESM became fully operational and the European Central Bank (ECB) announced a major new facility, Outright Monetary Transactions. This facility allows secondary market purchases by the ECB of bonds issued by eurozone sovereigns that are subject to a European Union (EU)/International Monetary Fund (IMF) support programme. Following these steps, sovereign bond yields fell markedly.

Meanwhile, in Greece, private sector claims on the government were restructured in early 2012, but political risks remained acute as two successive parliamentary elections eventually resulted in a narrow victory for the pro-bailout New Democracy party. As the electoral process delayed policy implementation and the recession, contrary to earlier expectations, deepened further, additional reforms became necessary and the European Commission, the IMF and the ECB (known collectively as the Troika) further eased Greece's targets.

Elsewhere, Ireland continued to make progress towards targets set out in its Troika programme, notably allowing the government to resume a degree of market financing. Talks with the European authorities on ways to relieve the government of some of the costs of past banking sector support continued, resulting in a favourable restructuring of the Anglo Irish promissory note in early 2013, reducing related fiscal costs somewhat. Notwithstanding these developments, Irish growth remained very weak and reliant on external demand. Portugal also made progress in a number of areas, though it had greater structural constraints to address to boost longer-term growth prospects. Towards the end of the year, Cyprus also entered negotiations with the EU and IMF on a support programme. The eurozone as a whole entered recession in the second half of the year, although divergence within the currency union continued, with the core considerably stronger than the periphery.

Emerging markets

Emerging markets performed better on the whole. In developing Asia, the economies of China and India both continued to slow from a strong base, but risks remained held in check by healthy external balance sheets.

Emerging countries in Europe started to be affected by very weak growth in the eurozone, with the most export-focused economies being worst hit. However, countries that took significant action in the wake of the financial crisis to stabilise their banking sectors, saw an easing of risk. Turkey was upgraded by one rating agency to investment grade.

General political instability seen in the Middle East and North Africa in 2011 moderated in 2012 in most countries except Syria, although transition to democratic rule was only partial in some cases. Excluding Bahrain, Gulf Cooperation Council countries were generally more stable, underpinned by high oil prices.

Latin America continued to be characterised by greater stability, due to generally healthier sovereign balance sheets. However, growth prospects deteriorated because of weaker external demand, notably in the region's largest economy, Brazil.

Outlook

Overall, the outlook for 2013 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 on whether growth headwinds in larger advanced economies, particularly the US and Japan, persist. Emerging market balance sheet risks remain lower, despite structural and political constraints, but it is expected that these economies will continue to be affected by events elsewhere through financial markets and trade channels.

** unaudited*

Country risk continued

Governance, monitoring and management*

The RBS Group's country risk framework is set by the RBS Group Executive Risk Forum (ERF), which has delegated authority to the RBS Group Country Risk Committee (GCRC) to manage exposures within the framework and deal with any limit breaches, with escalation where needed to ERF. Under this framework, exposures to all countries are monitored. Countries with material exposures are included in the RBS Group's country risk Watchlist process to identify emerging issues and facilitate the development of mitigation strategies. Detailed portfolio reviews are undertaken on a regular basis to ensure that country portfolio compositions remain aligned to the RBS Group's country risk appetite in light of evolving economic and political developments.

Limits on total exposure are set for individual countries based on a risk assessment taking into account the country's economic and political situation and outlook, as well as the RBS Group's portfolio composition in that country. Sub-limits are set on medium-term (greater than one year) exposure since this exposure can, by nature, not be reduced as rapidly as short-term exposure in the event of deterioration of a country's creditworthiness.

During 2012, in addition to all emerging markets and the vulnerable eurozone countries, the RBS Group brought nearly all advanced countries under country limits. The exceptions were the UK (and related European special territories of Guernsey, Jersey, the Isle of Man and Gibraltar) and the US, given their home country status.

Also in 2012, an enhanced country risk appetite framework was introduced. The RBS Group's risk appetite for a particular country is now guided by global risk appetite, the country's internal rating and strategic importance to the RBS Group, the portfolio composition by tenors and clients, an assessment of the potential for losses arising from a number of possible key country risk events, and other country-specific considerations such as funding profile, risk/return analysis, business opportunities and reputational risk. The actual country limits continue to be set by GCRC (or the ERF above certain benchmark levels).

Further enhancements included improved divisional country risk operating models and the implementation of a new sovereign rating model.

Eurozone crisis preparedness

An RBS Group executive steering group is driving eurozone crisis preparedness. Its agenda in 2012 included operational preparations for possible sovereign defaults and/or eurozone exits. The steering group also considered initiatives to determine and reduce redenomination risk. Further actions to mitigate risks and strengthen control in the eurozone typically included taking guarantees or insurance, updating collateral agreements, and tightening certain credit pre-approval processes.

Redenomination risk

The overall impact of redenomination risk on the Group is difficult to determine with certainty, but would be shaped by: the scope and reach of any new legislation introduced by an exiting country; its applicability to the facility documentation; and whether there are any appropriate offsets to the exposures. For the purposes of estimating funding mismatches at risk of redenomination (detailed below), the Group takes, as its starting point balance sheet exposure as defined on page 159 and excludes exposures at low risk of redenomination. The latter are identified through consideration of the relevant documentation, particularly the currency of exposure, governing law, court of jurisdiction, precise definition of the contract currency (for euro facilities), and location of payment. The Group also deducts offsets for provisions taken and liabilities that would be expected to redenominate at the same time.

A redenomination event would also be accompanied by increased credit risk, for two reasons. First, capital controls would likely be introduced in the affected country, resulting in any non-redenominated assets, including non-euro assets, potentially becoming harder to service. Second, a sharp devaluation could imply payment difficulties for counterparties with large debts denominated in foreign currency and counterparties that are heavily dependent on imports.

The Group's focus continues to be on reducing its asset exposures and funding mismatches in the eurozone periphery countries. During 2012, exposures to these countries decreased by 7.6% to £52.1 billion, most of this in Ireland. The estimated funding mismatch at risk of redenomination was £8.5 billion for Ireland and £0.5 billion for Italy at 31 December 2012. These mismatches can fluctuate due to volatility in trading book positions and changes in bond prices. In Spain, the mismatch was eliminated, in part as a result of more than £3 billion of repo facilities that were put in place in the fourth quarter of the year. The net positions for Greece, Portugal and Cyprus were all minimal.

Refer to pages 160 to 184 for discussion on the Group's exposure to banks, financial institutions and other sectors in a number of eurozone countries.

Credit default swaps

The Group uses credit default swap (CDS) contracts to service customer activity as well as to manage counterparty and country exposure. The latter is done to hedge portfolios or specific exposures. 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. CDS positions are monitored on a daily basis as part of regular market risk management.

The terms of the Group's CDS contracts are covered by standard International Swaps and Derivatives Association (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 or interest. Under the terms of a CDS contract, one of the regional Credit Derivatives Determinations Committees of the ISDA is empowered to decide whether or not a credit event has occurred.

** unaudited*

The Group transacts CDS contracts primarily on a collateralised basis with investment-grade global financial institutions who are active participants in the CDS market. These transactions are subject to regular margining, which usually takes the form of cash collateral. 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 and monitored on a weekly basis.

Country risk exposure

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

The tables that follow show the Group's exposure by country of incorporation of the counterparty at 31 December 2012. Countries shown are those where the Group's balance sheet exposure (as defined in this section) to counterparties incorporated in the country exceeded £1 billion and the country had an external rating of A+ or below from Standard and Poor's, Moody's or Fitch at 31 December 2012, as well as selected eurozone countries. The exposures are stated before taking into account mitigants, such as collateral (with the exception of reverse repos), insurance or guarantees, which 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.

Definitions

Lending - Comprises gross loans and advances to: central and local government (Govt); central banks, including cash balances; other banks and financial institutions (FI), incorporating overdraft and other short-term facilities; corporates, in large part loans and leases; and individuals, comprising mortgages, personal loans and credit card balances. Lending includes risk elements in lending.

Risk elements in lending (REIL) - Comprises impaired loans and accruing past due 90 days or more as to principal or interest. Impaired loans are all loans (including renegotiated) for which an impairment provision has been established. Accruing past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

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. 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 (net) - Comprise the mark-to-market (mtm) value of such contracts after the effect of legally enforceable netting agreements but before the effect of collateral. Figures shown include the effect of counterparty netting used within the regulatory capital model.

Repos (net) - Comprises the mtm value of repo and reverse repo contracts after the effect of legally enforceable netting agreements and collateral. Counterparty netting is applied within the regulatory capital model used.

In addition and as a memorandum item, the mtm value of derivatives and repos gross of netting referred to above are disclosed.

Balance sheet - Comprises lending, debt securities, derivatives (net) and repo (net) exposures, as defined above.

Off-balance sheet - Comprises letters of credit, guarantees, other contingent obligations and committed undrawn facilities.

Credit default swaps (CDSs) - Under a CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. The fair value, or mtm value, 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 value 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 instantaneous increase in exposure arising from sold positions netted against the decrease arising from bought positions should the CDS contracts be triggered by a credit event and assuming there is a zero recovery rate on the reference exposure. For a sold position, the change in exposure equals the notional less fair value amount and represents the amount the Group would owe to its CDS counterparties. Positive recovery rates would tend to reduce the gross components (increases and decreases) of those numbers.

Due to their bespoke nature, exposures relating to credit derivative product companies and related hedges have not been included, as they cannot be meaningfully attributed to a particular country or a reference entity. Nth-to-default basket swaps have also been excluded as they cannot be meaningfully attributed to a particular reference entity. Exposures to CDPCs are disclosed on page 130.

Government - Comprises central, regional and local government.

Asset quality (AQ) - For the probability of default range relating to each internal asset quality band, refer to page 106.

Eurozone periphery - Comprises Ireland, Spain, Italy, Portugal, Greece and Cyprus.

Other eurozone - Comprises Austria, Estonia, Finland, Malta, Slovakia and Slovenia.

Refer to page 126 for country analysis of equity shares.

Country risk: Country risk exposure continued

Summary

2012	Lending: Govt £m	Lending: Central banks £m	Lending: Other banks £m	Lending: Other FI £m	Lending: Corporate £m	Lending: Personal £m	Lending: Total lending £m	Lending: Of which Non-Core £m	Debt securities £m	Net: Derivatives £m	Net: Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	CDS notional less fair value £m	Gross: Derivatives £m	Gross: Repos £m
Eurozone																	
Ireland	42	73	98	532	17,847	17,893	36,485	9,446	408	1,684	554	39,131	2,907	42,038	(136)	17,059	7,968
Spain	—	6	1	59	4,216	340	4,622	2,729	526	1,754	—	6,902	1,510	8,412	(372)	5,695	610
Italy	9	21	161	150	1,334	23	1,698	774	987	1,706	—	4,391	2,539	6,930	(346)	9,005	3
Portugal	—	—	—	—	336	7	343	251	77	404	—	824	259	1,083	(94)	498	26
Greece	—	7	—	1	179	14	201	68	1	359	—	561	27	588	(3)	623	—
Cyprus	—	—	—	2	201	15	218	79	4	35	—	257	15	272	—	54	15
Eurozone periphery	51	107	260	744	24,113	18,292	43,567	13,347	2,003	5,942	554	52,066	7,257	59,323	(951)	32,934	8,622
Germany	—	20,018	619	459	3,620	83	24,799	2,727	10,606	9,366	304	45,075	6,858	51,933	(1,325)	57,073	8,318
France	494	9	2,437	122	2,332	71	5,465	1,523	4,556	7,279	450	17,750	8,977	26,727	(2,176)	44,743	14,320
Netherlands	7	140	303	1,595	3,544	26	5,615	1,827	2,696	8,613	354	17,278	7,795	25,073	(1,449)	23,430	5,409
Luxembourg	—	13	99	712	1,789	4	2,617	940	250	1,362	145	4,374	2,044	6,418	(303)	3,051	5,166
Belgium	—	—	186	29	408	22	645	142	565	2,994	50	4,254	1,252	5,506	(231)	4,812	1,256
Other	126	—	19	90	856	14	1,105	88	666	1,737	11	3,519	1,233	4,752	(193)	6,029	2,324
Total eurozone	678	20,287	3,923	3,751	36,662	18,512	83,813	20,594	21,342	37,293	1,868	144,316	35,416	179,732	(6,628)	172,072	45,415
Other																	
Japan	—	832	315	193	319	15	1,674	123	6,373	2,881	199	11,127	585	11,712	(69)	13,265	16,350
India	—	—	978	—	1,489	35	2,502	—	16	13	—	2,531	363	2,894	(43)	60	80
Turkey	115	163	23	94	916	12	1,323	253	181	93	—	1,597	442	2,039	(36)	114	449
China	2	—	419	—	13	29	463	14	6	866	94	1,429	392	1,821	60	900	3,833
Russia	—	—	814	—	376	55	1,245	55	139	18	—	1,402	243	1,645	(254)	18	—
Brazil	—	—	950	—	57	3	1,010	1	77	28	—	1,115	187	1,302	393	41	—
Poland	—	164	—	16	536	6	722	26	277	36	—	1,035	801	1,836	(84)	53	29

2011	Lending Govt £m	Lending Central banks £m	Lending Other banks £m	Lending Other FI £m	Lending Corporate £m	Lending Personal £m	Lending Total lending £m	Lending Of which Non-Core £m	Debt securities £m	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	CDS notional less fair value £m	Gross Derivatives £m	Gross Repos £m
Eurozone																	
Ireland	45	1,460	123	333	18,868	18,858	39,687	10,090	427	2,229	547	42,890	2,568	45,458	(108)	21,412	7,406
Spain	9	—	127	153	5,095	362	5,746	3,677	(306)	2,389	—	7,829	1,313	9,142	(979)	6,772	587
Italy	—	70	217	216	1,332	23	1,858	941	326	1,729	—	3,913	2,375	6,288	(358)	10,355	304
Portugal	—	—	2	—	468	5	475	341	(34)	457	—	898	212	1,110	58	571	220
Greece	—	—	—	31	45	14	90	51	97	354	—	541	32	573	1	540	—
Cyprus	—	—	—	23	175	14	212	77	—	53	—	265	17	282	—	54	200
Eurozone periphery	54	1,530	469	756	25,983	19,276	48,068	15,177	510	7,211	547	56,336	6,517	62,853	(1,386)	39,704	8,717
Germany	—	18,033	517	291	5,982	84	24,907	5,148	10,690	10,006	103	45,706	4,859	50,565	(2,285)	68,299	5,965
France	481	3	1,198	253	2,990	79	5,004	2,058	5,214	8,543	251	19,012	8,452	27,464	(2,633)	45,873	22,028
Netherlands	—	—	313	827	2,885	20	4,045	2,108	3,151	9,416	245	16,857	4,343	21,200	(1,179)	25,209	8,557
Luxembourg	—	—	101	862	1,966	2	2,931	1,404	159	1,615	787	5,492	1,737	7,229	(331)	3,260	3,942
Belgium	—	—	239	27	306	20	592	157	(87)	2,795	51	3,351	718	4,069	(89)	8,767	1,949
Other	121	—	14	74	971	12	1,192	159	89	1,893	—	3,174	1,010	4,184	(15)	10,407	1,253
Total eurozone	656	19,566	2,851	3,090	41,083	19,493	86,739	26,211	19,726	41,479	1,984	149,928	27,636	177,564	(7,918)	201,519	52,411
Other																	
Japan	—	2,073	651	96	431	26	3,277	338	12,407	2,430	191	18,305	391	18,696	(365)	15,405	12,678
India	—	—	164	—	376	16	556	61	81	25	—	662	555	1,217	(105)	89	72
Turkey	—	—	1	3	87	16	107	33	303	30	—	440	97	537	10	39	139
China	—	—	7	—	16	26	49	1	51	326	3	429	199	628	(62)	409	6,187
Russia	—	—	633	—	273	62	968	6	10	24	—	1,002	101	1,103	(343)	24	703
Brazil	—	—	936	—	42	4	982	—	100	19	—	1,101	308	1,409	(377)	58	—
Poland	—	—	2	—	52	6	60	18	10	47		117	11	128	(99)	69	1

Country risk: Country risk exposure: Summary continued

2010	Lending Govt £m	Lending Central banks £m	Lending Other banks £m	Lending Other FI £m	Lending Corporate £m	Lending Personal £m	Lending Total lending £m	Lending Of which Non-Core £m	Debt securities £m	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	CDS notional less fair value £m	Gross Derivatives £m	Gross Repos £m
Eurozone																	
Ireland	61	2,113	74	735	19,727	20,228	42,938	10,684	825	2,395	229	46,387	3,263	49,650	(40)	18,288	7,120
Spain	19	—	139	91	6,275	407	6,931	4,470	164	2,012	1	9,108	1,383	10,491	(475)	5,853	515
Italy	8	76	635	263	1,947	27	2,956	1,399	2,642	1,454	1	7,053	2,109	9,162	(509)	8,886	58
Portugal	86	—	47	—	584	6	723	315	42	345	—	1,110	407	1,517	56	481	782
Greece	—	13	1	32	74	16	136	74	79	224	—	439	42	481	182	357	181
Cyprus	—	—	1	2	190	13	206	81	—	44	—	250	22	272	—	54	218
Eurozone periphery	174	2,202	897	1,123	28,797	20,697	53,890	17,023	3,752	6,474	231	64,347	7,226	71,573	(786)	33,919	8,874
Germany	—	10,847	912	391	6,751	84	18,985	6,158	7,348	7,869	6,263	40,465	5,353	45,818	(397)	56,765	11,805
France	511	3	961	451	3,588	102	5,616	2,496	10,816	7,091	169	23,692	8,699	32,391	(883)	36,953	17,951
Netherlands	914	—	275	673	3,046	22	4,930	2,466	2,877	7,384	137	15,328	5,875	21,203	(939)	19,705	1,896
Luxembourg	—	—	21	594	2,051	3	2,669	1,381	277	1,293	53	4,292	1,759	6,051	(371)	2,432	1,309
Belgium	102	—	154	4	512	21	793	179	35	2,169	—	2,997	646	3,643	72	7,220	1,352
Other	124	—	123	78	1,102	11	1,438	179	3	1,244	8	2,693	1,068	3,761	(54)	6,645	450
Total eurozone	1,825	13,052	3,343	3,314	45,847	20,940	88,321	29,882	25,108	33,524	6,861	153,814	30,626	184,440	(3,358)	163,639	43,637
Other																	
Japan	—	1,379	368	311	807	24	2,889	792	12,072	1,779	15	16,755	521	17,276	(93)	15,998	12,535
India	—	—	1	—	213	16	230	91	4	14	—	248	137	385	(85)	40	—
Turkey	—	—	13	—	147	12	172	89	459	36	—	667	147	814	(91)	36	21
China	—	22	14	4	119	30	189	109	(1)	207	2	397	266	663	(100)	214	1,762
Russia	—	—	1	—	105	55	161	42	14	6	24	205	71	276	(121)	6	882
Brazil	—	—	824	—	56	5	885	44	74	4	—	963	106	1,069	(355)	25	—
Poland	—	—	7	—	89	6	102	77	68	55	—	225	23	248	(94)	80	16

Key points*

Reported exposures are affected by currency movements. Over 2012, sterling appreciated 4.4% against the US dollar and 2.6% against the euro, resulting in exposures denominated in these currencies (and in other currencies linked to the same) decreasing in sterling terms.

- Exposure to most countries declined as the Group maintained a cautious stance and many bank clients reduced debt levels. Decreases were seen in balance sheet exposures in many countries. Non-Core lending exposure declined as the strategy for disposal progressed, particularly in Germany, Spain and Ireland. Most of Group's country risk exposure was in International Banking (primarily lending and off-balance sheet exposure to corporates), Markets (mostly derivatives and repos with financial institutions), Ulster Bank (mostly lending exposure to corporates and consumers in Ireland) and Group Treasury (liquidity with central banks).

- There were increases in some country exposures and products reflecting the transfer of a substantial part of the international activities of RBS N.V. to the Group during the year and particularly in the third quarter (hereafter 'RBS N.V. transfers').

- *Total eurozone -* Balance sheet exposure declined by £5.6 billion or 4% during 2012 to £144.3 billion, with exposure reductions seen primarily in periphery countries but also in France, Luxembourg and Germany. This reflected exchange rate movements, write-offs, active exposure management and debt reduction efforts by bank clients.

- *Eurozone periphery -* Balance sheet exposure decreased in most countries to a combined £52.1 billion, a reduction of £4.3 billion or 8%, caused in large part by exposure reductions through run-offs, write-offs and disposals in Ireland and Spain. Most of the Group's exposure arises from the activities of Markets, International Banking and Ulster Bank (with respect to Ireland). International Banking provides trade finance facilities to clients across Europe, including the eurozone periphery. Balance sheet exposure to Cyprus amounted to £0.3 billion at 31 December 2012, comprising mainly lending exposure to special purpose vehicles incorporated in Cyprus, but with assets and cash flows largely elsewhere.

- *Japan -* Exposure decreased during 2012, principally in the first half of the year, reflecting a reduction in International Banking's cash management business and a change in Japanese yen clearing status from direct (self-clearing) membership to agency. The Group no longer needs to hold positions resulting in a £2.2 billion reduction in AFS Japanese government bonds.

CDS protection bought and sold

- The Group uses CDS contracts to service customer activity as well as manage counterparty and country exposure. During 2012, eurozone gross notional CDS contracts, bought and sold, decreased significantly. This was caused by maturing contracts and by efforts to reduce counterparty credit exposures and risk-weighted assets mainly through derivative compression trades. The fair value of bought and sold CDS contracts also decreased due to the reduction in gross notional CDS positions and a narrowing of CDS spreads over the year for a number of eurozone countries, including Portugal and Ireland. All in all, net bought CDS protection referencing entities in eurozone countries taken by the Group in terms of CDS notional less fair value, decreased to £6.6 billion, from £7.9 billion at 31 December 2011.

- During 2012 the credit quality of CDS bought protection counterparties shown in the individual country tables, deteriorated primarily reflecting rating model changes in the fourth quarter resulting in more conservative internal ratings (refer to Changes to wholesale credit risk models on page 62). There was also an actual downgrading of some of these counterparties during the year.

For more specific commentary on the Group's exposure to each of the eurozone periphery countries, refer to pages 166 to 176. For commentary on the Group's exposure to other eurozone countries, see page 184.

** unaudited*

Country risk: Country risk exposure continued

Total eurozone

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	678	—	—	7,195	517	17,430	8,469	16,156	1,761	—	18,595	741	19,336	5,271	—
Central bank	20,287	—	—	—	—	—	—	—	35	—	20,322	—	20,322	36	—
Other banks	3,923	—	—	1,298	5	1,050	611	1,737	24,931	1,161	31,752	844	32,596	147,413	28,666
Other FI	3,751	—	—	2,094	(18)	1,252	142	3,204	7,073	683	14,711	4,576	19,287	14,510	16,017
Corporate	36,662	14,159	7,426	49	—	311	115	245	3,492	24	40,423	28,512	68,935	4,841	732
Personal	18,512	3,348	1,713	—	—	—	—	—	1	—	18,513	743	19,256	1	—
	83,813	17,507	9,139	10,636	504	20,043	9,337	21,342	37,293	1,868	144,316	35,416	179,732	172,072	45,415
2011															
Government	656	—	—	9,838	639	19,596	15,049	14,385	1,884	—	16,925	581	17,506	4,938	791
Central bank	19,566	—	—	—	—	—	—	—	35	—	19,601	—	19,601	38	—
Other banks	2,851	—	—	1,756	(16)	1,195	1,433	1,518	28,061	944	33,374	598	33,972	174,212	30,857
Other FI	3,090	—	—	2,578	(78)	1,093	419	3,252	7,624	1,037	15,003	6,000	21,003	15,932	20,050
Corporate	41,083	13,379	6,676	102	2	528	59	571	3,874	3	45,531	19,692	65,223	6,398	713
Personal	19,493	2,258	1,048	—	—	—	—	—	1	—	19,494	765	20,259	1	—
	86,739	15,637	7,724	14,274	547	22,412	16,960	19,726	41,479	1,984	149,928	27,636	177,564	201,519	52,411
2010															
Government	1,825	—	—	8,936	109	24,985	14,256	19,665	1,490	—	22,980	90	23,070	4,663	18
Central bank	13,052	—	—	—	—	7	—	7	13	6,174	19,246	1	19,247	25	7,922
Other banks	3,343	—	—	1,955	—	1,617	1,187	2,385	22,381	388	28,497	1,198	29,695	141,497	24,966
Other FI	3,314	—	—	1,803	(62)	908	83	2,628	5,987	299	12,228	6,823	19,051	11,647	10,340
Corporate	45,847	11,769	4,920	52	—	631	260	423	3,652	—	49,922	21,739	71,661	5,806	391
Personal	20,940	1,638	534	—	—	—	—	—	1	—	20,941	775	21,716	1	—
	88,321	13,407	5,454	12,746	47	28,148	15,786	25,108	33,524	6,861	153,814	30,626	184,440	163,639	43,637

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	39,996	38,580	1,390	(1,405)	36,959	36,691	6,471	(6,369)	28,825	29,075	2,899	(2,843)
Other banks	13,195	12,965	261	(212)	19,620	19,213	2,286	(2,223)	16,325	16,155	1,035	(1,027)
Other FI	10,360	9,062	74	(61)	17,384	15,973	646	(582)	11,576	11,353	116	(128)
Corporate	39,592	35,851	(455)	465	76,397	70,032	2,219	(1,915)	66,415	62,956	(279)	471
	103,143	96,458	1,270	(1,213)	150,360	141,909	11,622	(11,089)	123,141	119,539	3,771	(3,527)

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
2012	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
Banks	8,827	126	34,864	597	8,004	199	—	—	51,695	922
Other FI	23,659	70	22,909	290	3,949	(17)	931	5	51,448	348
Total	32,486	196	57,773	887	11,953	182	931	5	103,143	1,270
2011										
Banks	67,548	5,581	1,085	131	145	14	—	—	68,778	5,726
Other FI	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

Eurozone periphery

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	51	—	—	—	—	3,686	2,698	988	134	—	1,173	2	1,175	361	—
Central bank	107	—	—	—	—	—	—	—	—	—	107	—	107	—	—
Other banks	260	—	—	8	—	165	131	42	3,445	476	4,223	22	4,245	29,050	4,186
Other FI	744	—	—	419	(1)	465	40	844	708	78	2,374	1,312	3,686	1,519	4,110
Corporate	24,113	12,130	6,755	41	—	128	40	129	1,654	—	25,896	5,310	31,206	2,003	326
Personal	18,292	3,347	1,713	—	—	—	—	—	1	—	18,293	611	18,904	1	—
	43,567	15,477	8,468	468	(1)	4,444	2,909	2,003	5,942	554	52,066	7,257	59,323	32,934	8,622
2011															
Government	54	—	—	—	—	4,854	5,652	(798)	236	—	(508)	38	(470)	380	—
Central bank	1,530	—	—	—	—	—	—	—	—	—	1,530	—	1,530	—	—
Other banks	469	—	—	8	(1)	434	315	127	4,253	478	5,327	10	5,337	34,184	4,082
Other FI	756	—	—	722	(6)	227	56	893	1,230	69	2,948	1,507	4,455	3,083	4,635
Corporate	25,983	11,894	6,220	50	—	238	—	288	1,491	—	27,762	4,325	32,087	2,056	—
Personal	19,276	2,258	1,048	—	—	—	—	—	1	—	19,277	637	19,914	1	—
	48,068	14,152	7,268	780	(7)	5,753	6,023	510	7,211	547	56,336	6,517	62,853	39,704	8,717
2010															
Government	174	—	—	53	2	6,562	4,672	1,943	179	—	2,296	49	2,345	300	—
Central bank	2,202	—	—	—	—	7	—	7	1	125	2,335	1	2,336	1	1,160
Other banks	897	—	—	365	(4)	345	181	529	3,832	95	5,353	224	5,577	29,262	4,238
Other FI	1,123	—	—	798	(4)	295	7	1,086	1,097	11	3,317	1,552	4,869	2,485	3,476
Corporate	28,797	10,465	4,679	11	—	198	22	187	1,364	—	30,348	4,753	35,101	1,870	—
Personal	20,697	1,638	534	—	—	—	—	—	1	—	20,698	647	21,345	1	—
	53,890	12,103	5,213	1,227	(6)	7,407	4,882	3,752	6,474	231	64,347	7,226	71,573	33,919	8,874

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	24,627	24,600	1,435	(1,459)	25,804	26,148	5,965	(5,922)	20,494	20,440	2,762	(2,705)
Other banks	6,021	5,996	230	(202)	9,327	9,154	1,651	(1,622)	7,845	8,015	890	(885)
Other FI	2,257	2,016	75	(65)	3,694	3,308	289	(261)	2,559	2,360	134	(141)
Corporate	5,818	5,141	52	(47)	10,727	9,320	994	(858)	10,440	9,570	416	(304)
	38,723	37,753	1,792	(1,773)	49,552	47,930	8,899	(8,663)	41,338	40,385	4,202	(4,035)

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	3,517	153	14,725	781	5,101	208	—	—	23,343	1,142
Other FI	5,522	228	8,860	400	734	22	264	—	15,380	650
Total	9,039	381	23,585	1,181	5,835	230	264	—	38,723	1,792
2011										
Banks	25,988	4,603	604	112	40	5	—	—	26,632	4,720
Other FI	21,961	3,967	233	50	726	162	—	—	22,920	4,179
Total	47,949	8,570	837	162	766	167	—	—	49,552	8,899

Country risk: Country risk exposure continued

Ireland

	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
2012															
Government	42	—	—	—	—	79	56	23	2	—	67	2	69	6	—
Central bank	73	—	—	—	—	—	—	—	—	—	73	—	73	—	—
Other banks	98	—	—	8	—	18	1	25	687	476	1,286	—	1,286	15,251	3,547
Other FI	532	—	—	38	—	324	2	360	583	78	1,553	569	2,122	1,365	4,095
Corporate	17,847	11,058	6,226	—	—	—	—	—	411	—	18,258	1,821	20,079	436	326
Personal	17,893	3,286	1,686	—	—	—	—	—	1	—	17,894	515	18,409	1	—
	36,485	14,344	7,912	46	—	421	59	408	1,684	554	39,131	2,907	42,038	17,059	7,968
2011															
Government	45	—	—	—	—	20	19	1	92	—	138	2	140	102	—
Central bank	1,460	—	—	—	—	—	—	—	—	—	1,460	—	1,460	—	—
Other banks	123	—	—	—	—	195	14	181	946	478	1,728	—	1,728	19,049	3,441
Other FI	333	—	—	29	—	116	35	110	782	69	1,294	456	1,750	1,831	3,965
Corporate	18,868	10,224	5,655	—	—	135	—	135	408	—	19,411	1,571	20,982	429	—
Personal	18,858	2,258	1,048	—	—	—	—	—	1	—	18,859	539	19,398	1	—
	39,687	12,482	6,703	29	—	466	68	427	2,229	547	42,890	2,568	45,458	21,412	7,406
2010															
Government	61	—	—	4	—	93	88	9	20	—	90	1	91	20	—
Central bank	2,113	—	—	—	—	7	—	7	1	125	2,246	—	2,246	1	1,160
Other banks	74	—	—	264	(5)	96	45	315	1,196	93	1,678	80	1,758	15,815	2,702
Other FI	735	—	—	152	(2)	205	—	357	826	11	1,929	701	2,630	2,084	3,258
Corporate	19,727	8,246	4,036	3	—	140	6	137	351	—	20,215	1,937	22,152	367	—
Personal	20,228	1,638	534	—	—	—	—	—	1	—	20,229	544	20,773	1	—
	42,938	9,884	4,570	423	(7)	541	139	825	2,395	229	46,387	3,263	49,650	18,288	7,120

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	2,486	2,525	72	(71)	2,145	2,223	466	(481)	1,872	2,014	360	(387)
Other banks	43	32	1	(2)	110	107	21	(21)	317	312	103	(95)
Other FI	437	355	21	(32)	362	308	63	(73)	242	269	34	(73)
Corporate	236	165	(17)	17	425	322	(11)	10	481	338	(20)	17
	3,202	3,077	77	(88)	3,042	2,960	539	(565)	2,912	2,933	477	(538)

CDS bought protection: counterparty analysis by internal asset quality band

	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
2012										
Banks	214	6	1,461	41	32	(1)	—	—	1,707	46
Other FI	529	17	809	6	157	8	—	—	1,495	31
Total	743	23	2,270	47	189	7	—	—	3,202	77
2011										
Banks	1,586	300	2	—	—	—	—	—	1,588	300
Other FI	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 (UBG). The portfolio primarily comprises personal lending of £17.9 billion (largely mortgages) and corporate lending of £17.8 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 derivatives of £0.5 billion over the year, as a result of currency movements and de-risking in the portfolio.

Government and central bank

- Exposure to the central bank fluctuates, driven by regulatory requirements and deposits of excess liquidity. It was reduced as part of assets and liabilities management.

Financial institutions

- Markets, International Banking and UBG account for the large majority of the Group's exposure to financial institutions. Exposure to the financial sector fell by £0.2 billion during the year, caused by reductions of £0.5 billion in derivatives, partly offset by an increase of £0.2 billion in lending.

Corporate

- Lending exposure fell approximately by £1.0 billion over the year, driven by exchange rate movements and write-offs. Commercial real estate lending amounted to £10.4 billion at 31 December 2012, down £0.5 billion from 31 December 2011 amid continuing adverse market conditions. The commercial real estate lending was nearly all in UBG (£7.7 billion of this in Non-Core) and included REIL of £8.0 billion which were 55% covered by provisions.

Personal

- The Ulster Bank retail portfolio mainly consists of mortgages (approximately 95% of Ulster Bank personal lending at 31 December 2012), with the remainder comprising credit card and other personal lending. Overall personal lending exposure fell approximately £1.0 billion over the year as a result of exchange rate fluctuations, amortisation, write-offs and a lack of demand in the market.

** unaudited*

Country risk: Country risk exposure continued

Spain

	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
2012															
Government	—	—	—	—	—	786	403	383	18	—	401	—	401	56	—
Central bank	6	—	—	—	—	—	—	—	—	—	6	—	6	—	—
Other banks	1	—	—	—	—	100	76	24	1,254	—	1,279	8	1,287	5,116	610
Other FI	59	—	—	23	—	96	18	101	26	—	186	90	276	51	—
Corporate	4,216	598	244	—	—	36	18	18	456	—	4,690	1,356	6,046	472	—
Personal	340	61	27	—	—	—	—	—	—	—	340	56	396	—	—
	4,622	659	271	23	—	1,018	515	526	1,754	—	6,902	1,510	8,412	5,695	610
2011															
Government	9	—	—	—	—	360	751	(391)	35	—	(347)	36	(311)	40	—
Other banks	127	—	—	8	(1)	162	214	(44)	1,618	—	1,701	6	1,707	5,177	120
Other FI	153	—	—	45	—	65	8	102	282	—	537	—	537	1,084	467
Corporate	5,095	1,183	439	—	—	27	—	27	454	—	5,576	1,214	6,790	471	—
Personal	362	—	—	—	—	—	—	—	—	—	362	57	419	—	—
	5,746	1,183	439	53	(1)	614	973	(306)	2,389	—	7,829	1,313	9,142	6,772	587
2010															
Government	19	—	—	49	2	1,172	1,248	(27)	53	—	45	—	45	60	—
Other banks	139	—	—	38	—	142	118	62	1,453	1	1,655	5	1,660	5,087	515
Other FI	91	—	—	67	(1)	34	7	94	22	—	207	—	207	145	—
Corporate	6,275	1,865	570	—	—	43	8	35	484	—	6,794	1,316	8,110	561	—
Personal	407	—	—	—	—	—	—	—	—	—	407	62	469	—	—
	6,931	1,865	570	154	1	1,391	1,381	164	2,012	1	9,108	1,383	10,491	5,853	515

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	5,934	5,905	361	(359)	5,151	5,155	538	(522)	3,820	3,923	436	(435)
Other banks	1,583	1,609	34	(30)	1,965	1,937	154	(152)	2,087	2,159	133	(135)
Other FI	1,208	1,061	47	(28)	2,411	2,199	157	(128)	1,569	1,354	71	(44)
Corporate	2,261	2,011	7	(4)	4,794	3,956	446	(398)	4,691	4,184	202	(156)
	10,986	10,586	449	(421)	14,321	13,247	1,295	(1,200)	12,167	11,620	842	(770)

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
2012										
Banks	646	27	3,648	169	1,409	64	—	—	5,703	260
Other FI	2,332	72	2,539	109	324	8	88	—	5,283	189
Total	2,978	99	6,187	278	1,733	72	88	—	10,986	449
2011										
Banks	6,595	499	68	5	32	4	—	—	6,695	508
Other FI	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 good relationships with multinational banks, other financial institutions and large corporate clients.

- Exposure to Spain is driven by corporate lending which fell further during 2012 as a result of steps taken to de-risk the portfolio.

Government and central bank

- The Group has an active portfolio of Spanish government debt and CDS exposures that can result in fluctuations between long and short positions for HFT 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 decreased by £0.6 billion in 2012.

- Lending to financial institutions decreased to less than £0.1 billion at 31 December 2012 from £0.3 billion at 31 December 2011.

Corporate

- Lending exposure to corporate clients declined by £0.9 billion during 2012, due to reductions primarily in the commercial real estate and electricity sectors. Commercial real estate lending amounted to £1.7 billion at 31 December 2012, predominantly in Non-Core. The majority of REIL and loan provisions relates to commercial real estate lending and further decreased during 2012, reflecting disposals and restructurings.

** unaudited*

Country risk: Country risk exposure continued

Italy

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	9	—	—	—	—	2,781	2,224	557	80	—	646	—	646	131	—
Central bank	21	—	—	—	—	—	—	—	—	—	21	—	21	—	—
Other banks	161	—	—	—	—	42	54	(12)	865	—	1,014	14	1,028	7,839	3
Other FI	150	—	—	357	(1)	23	1	379	97	—	626	650	1,276	97	—
Corporate	1,334	21	5	—	—	85	22	63	664	—	2,061	1,863	3,924	938	—
Personal	23	—	—	—	—	—	—	—	—	—	23	12	35	—	—
	1,698	21	5	357	(1)	2,931	2,301	987	1,706	—	4,391	2,539	6,930	9,005	3
2011															
Government	—	—	—	—	—	4,336	4,725	(389)	90	—	(299)	—	(299)	142	—
Central bank	70	—	—	—	—	—	—	—	—	—	70	—	70	—	—
Other banks	217	—	—	—	—	65	85	(20)	1,023	—	1,220	2	1,222	9,068	304
Other FI	216	—	—	643	(6)	39	13	669	155	—	1,040	1,051	2,091	157	—
Corporate	1,332	318	86	8	—	58	—	66	461	—	1,859	1,309	3,168	988	—
Personal	23	—	—	—	—	—	—	—	—	—	23	13	36	—	—
	1,858	318	86	651	(6)	4,498	4,823	326	1,729	—	3,913	2,375	6,288	10,355	304
2010															
Government	8	—	—	—	—	5,113	3,175	1,938	70	—	2,016	5	2,021	152	—
Central bank	76	—	—	—	—	—	—	—	—	—	76	—	76	—	—
Other banks	635	—	—	63	1	61	16	108	733	1	1,477	135	1,612	7,667	58
Other FI	263	—	—	532	(1)	49	—	581	238	—	1,082	848	1,930	242	—
Corporate	1,947	179	30	8	—	15	8	15	413	—	2,375	1,109	3,484	825	—
Personal	27	—	—	—	—	—	—	—	—	—	27	12	39	—	—
	2,956	179	30	603	—	5,238	3,199	2,642	1,454	1	7,053	2,109	9,162	8,886	58

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	13,023	13,034	700	(754)	12,046	12,192	1,736	(1,704)	8,998	8,519	641	(552)
Other banks	3,535	3,488	163	(139)	6,033	5,933	1,209	(1,186)	4,335	4,418	420	(409)
Other FI	604	595	7	(4)	879	762	60	(51)	704	696	19	(13)
Corporate	2,577	2,295	28	(20)	4,711	4,293	347	(280)	4,203	3,937	143	(88)
	19,739	19,412	898	(917)	23,669	23,180	3,352	(3,221)	18,240	17,570	1,223	(1,062)

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	2,113	81	7,755	432	3,200	100	—	—	13,068	613
Other FI	1,997	83	4,344	194	218	8	112	—	6,671	285
Total	4,110	164	12,099	626	3,418	108	112	—	19,739	898
2011										
Banks	12,884	1,673	487	94	8	1	—	—	13,379	1,768
Other FI	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 good 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 and to mitigate these risks through increased collateral requirements, in line with its evolving appetite for Italian risk. Lending exposure to Italian counterparties was reduced by a further £0.2 billion during 2012, to £1.7 billion.

Government and central bank

- The Group is an active market-maker in Italian government bonds and has an active CDS portfolio, resulting in large and fluctuating gross long and short positions in HFT debt securities.

Financial institutions

- The majority of exposure relates to the top five banks. The Group's product offering consists largely of collateralised trading products and to a lesser extent, short-term uncommitted lending lines for liquidity purposes. During 2012, derivative exposure decreased by £0.2 billion due to market movements. Risk is mitigated since most facilities are fully collateralised. Lending declined by £0.1 billion to £0.3 billion.

- The AFS bond exposure was reduced by £0.3 billion due to sales.

Corporate

- Derivatives and off-balance exposure increased by £0.2 billion and £0.6 billion respectively, driven in part by RBS N.V. transfers.

** unaudited*

Country risk: Country risk exposure continued

Portugal

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	—	—	—	—	—	28	15	13	17	—	30	—	30	17	—
Other banks	—	—	—	—	—	5	—	5	330	—	335	—	335	421	26
Other FI	—	—	—	1	—	21	11	11	2	—	13	3	16	2	—
Corporate	336	253	188	41	—	7	—	48	55	—	439	248	687	58	—
Personal	7	—	—	—	—	—	—	—	—	—	7	8	15	—	—
	343	253	188	42	—	61	26	77	404	—	824	259	1,083	498	26
2011															
Government	—	—	—	—	—	36	152	(116)	19	—	(97)	—	(97)	25	—
Other banks	2	—	—	—	—	12	2	10	371	—	383	2	385	479	217
Other FI	—	—	—	5	—	7	—	12	8	—	20	—	20	8	3
Corporate	468	—	—	42	—	18	—	60	59	—	587	202	789	59	—
Personal	5	—	—	—	—	—	—	—	—	—	5	8	13	—	—
	475	—	—	47	—	73	154	(34)	457	—	898	212	1,110	571	220
2010															
Government	86	—	—	—	—	66	122	(56)	29	—	59	43	102	45	—
Other banks	47	—	—	—	—	46	2	44	272	—	363	1	364	392	782
Other FI	—	—	—	47	—	7	—	54	7	—	61	—	61	7	—
Corporate	584	—	—	—	—	—	—	—	37	—	621	355	976	37	—
Personal	6	—	—	—	—	—	—	—	—	—	6	8	14	—	—
	723	—	—	47	—	119	124	42	345	—	1,110	407	1,517	481	782

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	3,182	3,134	302	(275)	3,304	3,413	997	(985)	2,844	2,923	471	(460)
Other banks	856	863	31	(30)	1,197	1,155	264	(260)	1,085	1,107	231	(243)
Other FI	8	5	—	(1)	8	5	1	(1)	9	6	(1)	—
Corporate	426	353	3	(7)	363	321	68	(48)	554	495	47	(28)
	4,472	4,355	336	(313)	4,872	4,894	1,330	(1,294)	4,492	4,531	748	(731)

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	480	34	1,805	133	460	45	—	—	2,745	212
Other FI	534	38	1,126	88	35	(2)	32	—	1,727	124
Total	1,014	72	2,931	221	495	43	32	—	4,472	336
2011										
Banks	2,922	786	46	12	—	—	—	—	2,968	798
Other FI	1,871	517	—	—	33	15	—	—	1,904	532
Total	4,793	1,303	46	12	33	15	—	—	4,872	1,330

Key points*

- The Portuguese portfolio, which is managed out of Spain, mainly consists of corporate lending and derivative trading with the largest local banks. Medium-term activity has ceased with the exception of collateralised business.

- Exposure declined further during 2012, with continued reductions in lending and derivatives.

Government and central bank

- Exposure to the Portuguese government at 31 December 2012 was £30 million, comprising a small derivative exposure and a small net long debt securities position, an increase from the net short debt securities position at 31 December 2011.

Financial institutions

- The remaining exposure is largely focused on the top four systemically important banks. Exposures generally consist of collateralised trading products.

Corporate

- The largest exposure is to the land transport and logistics, electricity and telecommunications sectors, concentrated on a few large, highly creditworthy clients.

** unaudited*

Country risk: Country risk exposure continued

Greece

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	—	—	—	—	—	9	—	9	17	—	26	—	26	151	—
Central bank	7	—	—	—	—	—	—	—	—	—	7	—	7	—	—
Other banks	—	—	—	—	—	—	—	—	298	—	298	—	298	411	—
Other FI	1	—	—	—	—	—	8	(8)	—	—	(7)	—	(7)	—	—
Corporate	179	38	38	—	—	—	—	—	44	—	223	18	241	61	—
Personal	14	—	—	—	—	—	—	—	—	—	14	9	23	—	—
	201	38	38	—	—	9	8	1	359	—	561	27	588	623	—
2011															
Government	—	—	—	—	—	102	5	97	—	—	97	—	97	71	—
Other banks	—	—	—	—	—	—	—	—	289	—	289	—	289	404	—
Other FI	31	—	—	—	—	—	—	—	2	—	33	—	33	2	—
Corporate	45	—	—	—	—	—	—	—	63	—	108	22	130	63	—
Personal	14	—	—	—	—	—	—	—	—	—	14	10	24	—	—
	90	—	—	—	—	102	5	97	354	—	541	32	573	540	—
2010															
Government	—	—	—	—	—	118	39	79	7	—	86	—	86	23	—
Central bank	13	—	—	—	—	—	—	—	—	—	13	—	13	—	—
Other banks	1	—	—	—	—	—	—	—	166	—	167	—	167	282	181
Other FI	32	—	—	—	—	—	—	—	3	—	35	3	38	3	—
Corporate	74	—	—	—	—	—	—	—	48	—	122	29	151	49	—
Personal	16	—	—	—	—	—	—	—	—	—	16	10	26	—	—
	136	—	—	—	—	118	39	79	224	—	439	42	481	357	181

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	—	—	—	—	3,158	3,165	2,228	(2,230)	2,960	3,061	854	(871)
Other banks	—	—	—	—	22	22	3	(3)	21	19	3	(3)
Other FI	4	4	1	(1)	34	34	8	(8)	35	35	11	(11)
Corporate	318	317	31	(33)	434	428	144	(142)	511	616	44	(49)
	322	321	32	(34)	3,648	3,649	2,383	(2,383)	3,527	3,731	912	(934)

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
2012	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
Banks	64	5	54	6	—	—	—	—	118	11
Other FI	130	18	42	3	—	—	32	—	204	21
Total	194	23	96	9	—	—	32	—	322	32
2011										
Banks	2,001	1,345	1	1	—	—	—	—	2,002	1,346
Other FI	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*

- Exposure to Greece increased slightly to £0.6 billion during 2012 as a result of the RBS N.V. transfers. The exposure is actively managed, in line with the Group's de-risking strategy that has been in place since early 2010. Much of the remaining exposure is collateralised or guaranteed and comprises derivative exposure to banks and corporate lending including exposure to local subsidiaries of international companies.

Financial institutions

- Activity with Greek financial institutions is largely collateralised derivative and repo exposure, and remains under close scrutiny.

Corporate

- Lending exposure to Greek corporates increased to £0.2 billion during 2012 as a result of the RBS N.V. transfers.
- The focus is on short-term trade facilities to the domestic subsidiaries of international clients, increasingly supported by parental guarantees.

** unaudited*

Country risk: Country risk exposure continued

Cyprus

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	—	—	—	—	—	3	—	3	—	—	3	—	3	—	—
Other banks	—	—	—	—	—	—	—	—	11	—	11	—	11	12	—
Other FI	2	—	—	—	—	1	—	1	—	—	3	—	3	4	15
Corporate	201	162	54	—	—	—	—	—	24	—	225	4	229	38	—
Personal	15	—	—	—	—	—	—	—	—	—	15	11	26	—	—
	218	162	54	—	—	4	—	4	35	—	257	15	272	54	15
2011															
Other banks	—	—	—	—	—	—	—	—	6	—	6	—	6	7	—
Other FI	23	—	—	—	—	—	—	—	1	—	24	—	24	1	200
Corporate	175	169	40	—	—	—	—	—	46	—	221	7	228	46	—
Personal	14	—	—	—	—	—	—	—	—	—	14	10	24	—	—
	212	169	40	—	—	—	—	—	53	—	265	17	282	54	200
2010															
Central bank	—	—	—	—	—	—	—	—	—	—	—	1	1	—	—
Other banks	1	—	—	—	—	—	—	—	12	—	13	3	16	19	—
Other FI	2	—	—	—	—	—	—	—	1	—	3	—	3	4	218
Corporate	190	175	43	—	—	—	—	—	31	—	221	7	228	31	—
Personal	13	—	—	—	—	—	—	—	—	—	13	11	24	—	—
	206	175	43	—	—	—	—	—	44	—	250	22	272	54	218

Eurozone non-periphery

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	627	—	—	7,195	517	13,744	5,771	15,168	1,627	—	17,422	739	18,161	4,910	—
Central bank	20,180	—	—	—	—	—	—	—	35	—	20,215	—	20,215	36	—
Other banks	3,663	—	—	1,290	5	885	480	1,695	21,486	685	27,529	822	28,351	118,363	24,480
Other FI	3,007	—	—	1,675	(17)	787	102	2,360	6,365	605	12,337	3,264	15,601	12,991	11,907
Corporate	12,549	2,029	671	8	—	183	75	116	1,838	24	14,527	23,202	37,729	2,838	406
Personal	220	1	—	—	—	—	—	—	—	—	220	132	352	—	—
	40,246	2,030	671	10,168	505	15,599	6,428	19,339	31,351	1,314	92,250	28,159	120,409	139,138	36,793
2011															
Government	602	—	—	9,838	639	14,742	9,397	15,183	1,648	—	17,433	543	17,976	4,558	791
Central bank	18,036	—	—	—	—	—	—	—	35	—	18,071	—	18,071	38	—
Other banks	2,382	—	—	1,748	(15)	761	1,118	1,391	23,808	466	28,047	588	28,635	140,028	26,775
Other FI	2,334	—	—	1,856	(72)	866	363	2,359	6,394	968	12,055	4,493	16,548	12,849	15,415
Corporate	15,100	1,485	456	52	2	290	59	283	2,383	3	17,769	15,367	33,136	4,342	713
Personal	217	—	—	—	—	—	—	—	—	—	217	128	345	—	—
	38,671	1,485	456	13,494	554	16,659	10,937	19,216	34,268	1,437	93,592	21,119	114,711	161,815	43,694
2010															
Government	1,651	—	—	8,883	107	18,423	9,584	17,722	1,311	—	20,684	41	20,725	4,363	18
Central bank	10,850	—	—	—	—	—	—	—	12	6,049	16,911	—	16,911	24	6,762
Other banks	2,446	—	—	1,590	4	1,272	1,006	1,856	18,549	293	23,144	974	24,118	112,235	20,728
Other FI	2,191	—	—	1,005	(58)	613	76	1,542	4,890	288	8,911	5,271	14,182	9,162	6,864
Corporate	17,050	1,304	241	41	—	433	238	236	2,288	—	19,574	16,986	36,560	3,936	391
Personal	243	—	—	—	—	—	—	—	—	—	243	128	371	—	—
	34,431	1,304	241	11,519	53	20,741	10,904	21,356	27,050	6,630	89,467	23,400	112,867	129,720	34,763

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	15,369	13,980	(45)	54	11,155	10,543	506	(447)	8,331	8,635	137	(138)
Other banks	7,174	6,969	31	(10)	10,293	10,059	635	(601)	8,480	8,140	145	(142)
Other FI	8,103	7,046	(1)	4	13,690	12,665	357	(321)	9,017	8,993	(18)	13
Corporate	33,774	30,710	(507)	512	65,670	60,712	1,225	(1,057)	55,975	53,386	(695)	775
	64,420	58,705	(522)	560	100,808	93,979	2,723	(2,426)	81,803	79,154	(431)	508

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	5,310	(27)	20,139	(184)	2,903	(9)	—	—	28,352	(220)
Other FI	18,137	(158)	14,049	(110)	3,215	(39)	667	5	36,068	(302)
Total	23,447	(185)	34,188	(294)	6,118	(48)	667	5	64,420	(522)
2011										
Banks	41,560	978	481	19	105	9	—	—	42,146	1,006
Other FI	57,067	1,586	80	1	1,368	116	147	14	58,662	1,717
Total	98,627	2,564	561	20	1,473	125	147	14	100,808	2,723

Country risk: Country risk exposure continued

Germany

				AFS and		HFT			Net			Off-		Gross	
				LAR debt	AFS	debt securities		Total debt			Balance	balance			
	Lending	REIL	Provisions	securities	reserves	Long	Short	securities	Derivatives	Repos	sheet	sheet	Total	Derivatives	Repos
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Government	—	—	—	6,626	456	5,070	1,592	10,104	533	—	10,637	735	11,372	1,656	—
Central bank	20,018	—	—	—	—	—	—	—	—	—	20,018	—	20,018	—	—
Other banks	619	—	—	197	1	280	332	145	5,492	183	6,439	110	6,549	50,914	4,927
Other FI	459	—	—	283	(18)	95	30	348	3,046	97	3,950	594	4,544	3,911	2,985
Corporate	3,620	434	141	—	—	11	2	9	295	24	3,948	5,394	9,342	592	406
Personal	83	1	—	—	—	—	—	—	—	—	83	25	108	—	—
	24,799	435	141	7,106	439	5,456	1,956	10,606	9,366	304	45,075	6,858	51,933	57,073	8,318
2011															
Government	—	—	—	8,071	534	4,136	2,084	10,123	423	—	10,546	—	10,546	1,284	164
Central bank	18,033	—	—	—	—	—	—	—	2	—	18,035	—	18,035	2	—
Other banks	517	—	—	371	—	282	761	(108)	5,819	88	6,316	228	6,544	62,496	4,227
Other FI	291	—	—	563	(29)	187	95	655	3,272	15	4,233	654	4,887	3,656	1,532
Corporate	5,982	191	80	13	1	14	7	20	490	—	6,492	3,955	10,447	861	42
Personal	84	—	—	—	—	—	—	—	—	—	84	22	106	—	—
	24,907	191	80	9,018	506	4,619	2,947	10,690	10,006	103	45,706	4,859	50,565	68,299	5,965
2010															
Government	—	—	—	4,889	24	5,911	4,124	6,676	160	—	6,836	—	6,836	805	18
Central bank	10,847	—	—	—	—	—	—	—	4	6,034	16,885	—	16,885	4	6,035
Other banks	912	—	—	241	2	526	481	286	5,357	138	6,693	188	6,881	52,253	2,746
Other FI	391	—	—	219	(40)	195	17	397	1,860	91	2,739	540	3,279	2,478	3,006
Corporate	6,751	146	28	14	—	28	53	(11)	488	—	7,228	4,603	11,831	1,225	—
Personal	84	—	—	—	—	—	—	—	—	—	84	22	106	—	—
	18,985	146	28	5,363	(14)	6,660	4,675	7,348	7,869	6,263	40,465	5,353	45,818	56,765	11,805

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	4,288	4,191	4	—	2,631	2,640	76	(67)	2,056	2,173	25	(19)
Other banks	2,847	2,693	13	(11)	4,754	4,688	306	(310)	3,795	3,907	74	(88)
Other FI	2,383	2,172	(16)	18	3,647	3,400	7	(2)	2,659	2,610	(16)	17
Corporate	10,519	9,644	(257)	261	20,304	18,292	147	(126)	19,487	18,927	(379)	369
	20,037	18,700	(256)	268	31,336	29,020	536	(505)	27,997	27,617	(296)	279

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
	Notional	Fair value	Notional	Fair value	Notional	Fair value	Notional	Fair value	Notional	Fair value
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Banks	1,967	(22)	6,264	(87)	940	(7)	—	—	9,171	(116)
Other FI	5,036	(69)	5,103	(56)	727	(15)	—	—	10,866	(140)
Total	7,003	(91)	11,367	(143)	1,667	(22)	—	—	20,037	(256)
2011										
Banks	14,641	171	163	4	8	—	—	—	14,812	175
Other FI	16,172	355	18	—	334	6	—	—	16,524	361
Total	30,813	526	181	4	342	6	—	—	31,336	536

Netherlands

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	7	—	—	466	60	1,248	993	721	—	—	728	1	729	1,626	—
Central bank	140	—	—	—	—	—	—	—	2	—	142	—	142	2	—
Other banks	303	—	—	447	2	281	86	642	6,645	309	7,899	60	7,959	16,507	3,074
Other FI	1,595	—	—	1,109	1	234	17	1,326	1,523	45	4,489	1,180	5,669	4,680	2,335
Corporate	3,544	456	144	6	—	29	28	7	443	—	3,994	6,542	10,536	615	—
Personal	26	—	—	—	—	—	—	—	—	—	26	12	38	—	—
	5,615	456	144	2,028	63	1,792	1,124	2,696	8,613	354	17,278	7,795	25,073	23,430	5,409
2011															
Government	—	—	—	823	68	848	591	1,080	—	—	1,080	—	1,080	1,480	—
Central bank	—	—	—	—	—	—	—	—	7	—	7	—	7	10	—
Other banks	313	—	—	574	(2)	302	212	664	7,322	143	8,442	4	8,446	17,312	2,571
Other FI	827	—	—	1,133	(34)	251	102	1,282	1,398	99	3,606	2,348	5,954	4,658	5,570
Corporate	2,885	408	85	17	1	113	5	125	689	3	3,702	1,980	5,682	1,749	416
Personal	20	—	—	—	—	—	—	—	—	—	20	11	31	—	—
	4,045	408	85	2,547	33	1,514	910	3,151	9,416	245	16,857	4,343	21,200	25,209	8,557
2010															
Government	914	—	—	425	2	1,425	607	1,243	—	—	2,157	—	2,157	1,637	—
Central bank	—	—	—	—	—	—	—	—	—	—	—	—	—	12	—
Other banks	275	—	—	669	2	195	275	589	4,610	3	5,477	28	5,505	12,900	833
Other FI	673	—	—	638	(14)	344	12	970	2,045	134	3,822	3,270	7,092	4,136	1,063
Corporate	3,046	203	—	15	—	117	57	75	729	—	3,850	2,566	6,416	1,020	—
Personal	22	—	—	—	—	—	—	—	—	—	22	11	33	—	—
	4,930	203	—	1,747	(10)	2,081	951	2,877	7,384	137	15,328	5,875	21,203	19,705	1,896

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	1,352	1,227	(12)	11	1,206	1,189	31	(31)	1,195	999	(2)	(4)
Other banks	658	695	(1)	2	962	995	41	(42)	779	784	12	(10)
Other FI	2,777	2,503	(8)	5	5,439	5,244	101	(94)	3,620	3,608	3	(2)
Corporate	7,930	6,852	(93)	87	15,302	14,212	250	(166)	11,750	10,907	(61)	171
	12,717	11,277	(114)	105	22,909	21,640	423	(333)	17,344	16,298	(48)	155

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
2012	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
Banks	763	(17)	3,112	(32)	539	(3)	—	—	4,414	(52)
Other FI	4,958	(34)	1,761	(20)	917	(13)	667	5	8,303	(62)
Total	5,721	(51)	4,873	(52)	1,456	(16)	667	5	12,717	(114)
2011										
Banks	7,590	107	88	1	6	—	—	—	7,684	108
Other FI	14,379	220	23	—	676	81	147	14	15,225	315
Total	21,969	327	111	1	682	81	147	14	22,909	423

Country risk: Country risk exposure continued

France

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	494	—	—	102	1	5,186	2,064	3,224	257	—	3,975	3	3,978	270	—
Central bank	9	—	—	—	—	—	—	—	—	—	9	—	9	—	—
Other banks	2,437	—	—	639	2	184	27	796	5,465	58	8,756	557	9,313	41,606	11,577
Other FI	122	—	—	232	—	252	51	433	833	392	1,780	741	2,521	1,721	2,743
Corporate	2,332	116	71	2	—	116	15	103	724	—	3,159	7,601	10,760	1,146	—
Personal	71	—	—	—	—	—	—	—	—	—	71	75	146	—	—
	5,465	116	71	975	3	5,738	2,157	4,556	7,279	450	17,750	8,977	26,727	44,743	14,320
2011															
Government	481	—	—	934	37	8,705	5,669	3,970	357	—	4,808	518	5,326	372	—
Central bank	3	—	—	—	—	—	—	—	—	—	3	—	3	—	—
Other banks	1,198	—	—	795	(13)	157	75	877	6,886	168	9,129	356	9,485	42,628	17,487
Other FI	253	—	—	111	(4)	325	126	310	590	83	1,236	720	1,956	1,758	4,541
Corporate	2,990	40	13	19	—	72	34	57	710	—	3,757	6,783	10,540	1,115	—
Personal	79	—	—	—	—	—	—	—	—	—	79	75	154	—	—
	5,004	40	13	1,859	20	9,259	5,904	5,214	8,543	251	19,012	8,452	27,464	45,873	22,028
2010															
Government	511	—	—	3,559	81	10,266	3,968	9,857	362	—	10,730	15	10,745	399	—
Central bank	3	—	—	—	—	—	—	—	—	15	18	—	18	—	727
Other banks	961	—	—	618	(1)	398	204	812	5,806	143	7,722	714	8,436	34,801	15,969
Other FI	451	—	—	54	(3)	42	23	73	291	11	826	823	1,649	720	1,255
Corporate	3,588	140	7	12	—	152	90	74	632	—	4,294	7,071	11,365	1,033	—
Personal	102	—	—	—	—	—	—	—	—	—	102	76	178	—	—
	5,616	140	7	4,243	77	10,858	4,285	10,816	7,091	169	23,692	8,699	32,391	36,953	17,951

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	4,989	4,095	76	(66)	3,425	2,859	225	(192)	2,225	2,287	87	(92)
Other banks	3,406	3,302	19	(1)	4,190	3,990	274	(235)	3,501	3,041	57	(43)
Other FI	1,777	1,362	(9)	10	2,544	2,051	133	(117)	1,567	1,597	(2)	(2)
Corporate	11,416	10,618	(106)	112	23,048	21,562	602	(578)	18,673	18,162	(172)	163
	21,588	19,377	(20)	55	33,207	30,462	1,234	(1,122)	25,966	25,087	(30)	26

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	1,779	14	7,102	(15)	921	6	—	—	9,802	5
Other FI	5,928	(17)	4,797	(5)	1,061	(3)	—	—	11,786	(25)
Total	7,707	(3)	11,899	(20)	1,982	3	—	—	21,588	(20)
2011										
Banks	13,321	452	162	13	79	8	—	—	13,562	473
Other FI	19,367	738	24	1	254	22	—	—	19,645	761
Total	32,688	1,190	186	14	333	30	—	—	33,207	1,234

Belgium

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	—	—	—	1	—	1,269	711	559	103	—	662	—	662	404	—
Other banks	186	—	—	—	—	2	2	—	2,472	50	2,708	7	2,715	3,886	1,256
Other FI	29	—	—	—	—	—	—	—	239	—	268	30	298	252	—
Corporate	408	50	15	—	—	6	—	6	180	—	594	1,207	1,801	270	—
Personal	22	—	—	—	—	—	—	—	—	—	22	8	30	—	—
	645	50	15	1	—	1,277	713	565	2,994	50	4,254	1,252	5,506	4,812	1,256
2011															
Government	—	—	—	7	—	608	722	(107)	89	—	(18)	—	(18)	492	—
Central bank	—	—	—	—	—	—	—	—	3	—	3	—	3	3	—
Other banks	239	—	—	—	—	—	—	—	2,241	51	2,531	—	2,531	7,666	1,694
Other FI	27	—	—	—	—	1	4	(3)	191	—	215	50	265	237	—
Corporate	306	—	—	3	—	20	—	23	271	—	600	660	1,260	369	255
Personal	20	—	—	—	—	—	—	—	—	—	20	8	28	—	—
	592	—	—	10	—	629	726	(87)	2,795	51	3,351	718	4,069	8,767	1,949
2010															
Government	102	—	—	7	—	529	602	(66)	92	—	128	—	128	745	—
Central bank	—	—	—	—	—	—	—	—	7	—	7	—	7	7	—
Other banks	154	—	—	34	1	66	2	98	1,787	—	2,039	—	2,039	5,915	961
Other FI	4	—	—	—	—	—	—	—	96	—	100	27	127	170	—
Corporate	512	—	—	—	—	5	2	3	187	—	702	611	1,313	383	391
Personal	21	—	—	—	—	—	—	—	—	—	21	8	29	—	—
	793	—	—	41	1	600	606	35	2,169	—	2,997	646	3,643	7,220	1,352

CDS by reference entity

	2012 Notional Bought £m	2012 Notional Sold £m	2012 Fair value Bought £m	2012 Fair value Sold £m	2011 Notional Bought £m	2011 Notional Sold £m	2011 Fair value Bought £m	2011 Fair value Sold £m	2010 Notional Bought £m	2010 Notional Sold £m	2010 Fair value Bought £m	2010 Fair value Sold £m
Government	1,890	1,674	(31)	29	1,612	1,505	120	(110)	880	986	53	(57)
Other banks	200	211	—	—	297	299	12	(13)	257	266	1	(1)
Corporate	300	276	(1)	1	562	569	12	(12)	627	588	(6)	6
	2,390	2,161	(32)	30	2,471	2,373	144	(135)	1,764	1,840	48	(52)

CDS bought protection: counterparty analysis by internal asset quality band

2012	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	244	(2)	1,156	(18)	281	(3)	—	—	1,681	(23)
Other FI	165	—	505	(9)	39	—	—	—	709	(9)
Total	409	(2)	1,661	(27)	320	(3)	—	—	2,390	(32)
2011										
Banks	1,597	97	2	—	12	1	—	—	1,611	98
Other FI	855	46	1	—	4	—	—	—	860	46
Total	2,452	143	3	—	16	1	—	—	2,471	144

Country risk: Country risk exposure continued

Luxembourg

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Central bank	13	—	—	—	—	—	—	—	—	—	13	—	13	—	—
Other banks	99	—	—	7	—	8	6	9	485	77	670	—	670	645	2,215
Other FI	712	—	—	51	—	198	4	245	722	68	1,747	695	2,442	2,243	2,951
Corporate	1,789	940	287	—	—	19	23	(4)	155	—	1,940	1,347	3,287	163	—
Personal	4	—	—	—	—	—	—	—	—	—	4	2	6	—	—
	2,617	940	287	58	—	225	33	250	1,362	145	4,374	2,044	6,418	3,051	5,166
2011															
Other banks	101	—	—	8	—	7	—	15	530	16	662	—	662	658	447
Other FI	862	—	—	49	(5)	77	34	92	907	771	2,632	607	3,239	2,409	3,495
Corporate	1,966	834	263	—	—	58	6	52	178	—	2,196	1,128	3,324	193	—
Personal	2	—	—	—	—	—	—	—	—	—	2	2	4	—	—
	2,931	834	263	57	(5)	142	40	159	1,615	787	5,492	1,737	7,229	3,260	3,942
2010															
Government	—	—	—	—	—	24	—	24	—	—	24	—	24	—	—
Other banks	21	—	—	28	—	35	—	63	488	7	579	—	579	595	7
Other FI	594	—	—	94	(1)	32	19	107	590	46	1,337	542	1,879	1,611	1,302
Corporate	2,051	751	184	—	—	104	21	83	215	—	2,349	1,215	3,564	226	—
Personal	3	—	—	—	—	—	—	—	—	—	3	2	5	—	—
	2,669	751	184	122	(1)	195	40	277	1,293	53	4,292	1,759	6,051	2,432	1,309

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Other FI	1,166	1,009	32	(29)	2,060	1,970	116	(108)	1,171	1,178	(3)	—
Corporate	1,388	1,238	(9)	10	2,414	2,136	145	(116)	2,245	1,871	(16)	15
	2,554	2,247	23	(19)	4,474	4,106	261	(224)	3,416	3,049	(19)	15

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
2012	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
Banks	96	4	611	23	63	—	—	—	770	27
Other FI	1,108	(13)	361	12	315	(3)	—	—	1,784	(4)
Total	1,204	(9)	972	35	378	(3)	—	—	2,554	23
2011										
Banks	1,534	93	16	—	—	—	—	—	1,550	93
Other FI	2,844	161	10	—	70	7	—	—	2,924	168
Total	4,378	254	26	—	70	7	—	—	4,474	261

Other eurozone

2012	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	Net Derivatives £m	Net Repos £m	Balance sheet £m	Off-balance sheet £m	Total £m	Gross Derivatives £m	Gross Repos £m
Government	126	—	—	—	—	971	411	560	734	—	1,420	—	1,420	954	—
Central bank	—	—	—	—	—	—	—	—	33	—	33	—	33	34	—
Other banks	19	—	—	—	—	130	27	103	927	8	1,057	88	1,145	4,805	1,431
Other FI	90	—	—	—	—	8	—	8	2	3	103	24	127	184	893
Corporate	856	33	13	—	—	2	7	(5)	41	—	892	1,111	2,003	52	—
Personal	14	—	—	—	—	—	—	—	—	—	14	10	24	—	—
	1,105	33	13	—	—	1,111	445	666	1,737	11	3,519	1,233	4,752	6,029	2,324
2011															
Government	121	—	—	3	—	445	331	117	779	—	1,017	25	1,042	930	627
Central bank	—	—	—	—	—	—	—	—	23	—	23	—	23	23	—
Other banks	14	—	—	—	—	13	70	(57)	1,010	—	967	—	967	9,268	349
Other FI	74	—	—	—	—	25	2	23	36	—	133	114	247	131	277
Corporate	971	12	15	—	—	13	7	6	45	—	1,022	861	1,883	55	—
Personal	12	—	—	—	—	—	—	—	—	—	12	10	22	—	—
	1,192	12	15	3	—	496	410	89	1,893	—	3,174	1,010	4,184	10,407	1,253
2010															
Government	124	—	—	3	—	268	283	(12)	697	—	809	26	835	777	—
Central bank	—	—	—	—	—	—	—	—	1	—	1	—	1	1	—
Other banks	123	—	—	—	—	52	44	8	501	2	634	44	678	5,771	212
Other FI	78	—	—	—	—	—	5	(5)	8	6	87	69	156	47	238
Corporate	1,102	64	22	—	—	27	15	12	37	—	1,151	920	2,071	49	—
Personal	11	—	—	—	—	—	—	—	—	—	11	9	20	—	—
	1,438	64	22	3	—	347	347	3	1,244	8	2,693	1,068	3,761	6,645	450

CDS by reference entity

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m	Bought £m	Sold £m
Government	2,850	2,793	(82)	80	2,281	2,350	54	(47)	1,975	2,190	(26)	34
Other banks	63	68	—	—	90	87	2	(1)	148	142	1	—
Corporate	2,221	2,082	(41)	41	4,040	3,941	69	(59)	3,193	2,931	(61)	51
	5,134	4,943	(123)	121	6,411	6,378	125	(107)	5,316	5,263	(86)	85

CDS bought protection: counterparty analysis by internal asset quality band

	AQ1		AQ2-AQ3		AQ4-AQ9		AQ10		Total	
2012	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m	Notional £m	Fair value £m
Banks	461	(4)	1,894	(55)	159	(2)	—	—	2,514	(61)
Other FI	942	(25)	1,522	(32)	156	(5)	—	—	2,620	(62)
Total	1,403	(29)	3,416	(87)	315	(7)	—	—	5,134	(123)
2011										
Banks	2,877	58	50	1	—	—	—	—	2,927	59
Other FI	3,450	66	4	—	30	—	—	—	3,484	66
Total	6,327	124	54	1	30	—	—	—	6,411	125

Country risk: Country risk exposure continued

Eurozone non-periphery

Key points*

- The Group holds a major and diversified portfolio in eurozone non-periphery countries with significant exposures to financial institutions and corporates, notably in Germany, the Netherlands and France, and a sizeable liquidity portfolio with the German central bank.

- Exposure increased owing to transfers from RBS N.V., offset by reductions owing to the cautious stance of RBS Group and the efforts of bank clients to reduce debt levels. On balance, contingent liabilities and commitments increased and derivatives exposure mostly decreased, whereas lending, repos and debt securities showed a mixed picture. Total exposure was up for Belgium and the Netherlands, and down for France, Luxembourg and Germany.

Government and central bank

- The Group holds significant short-term surplus liquidity with central banks for liquidity, credit risk and capital considerations as well as due to limited alternative investment opportunities. This exposure also fluctuates as part of the RBS Group's asset and liability management. In the third quarter of 2012 the RBS Group transferred part of its euro payment activity from the RBS N.V. account with the Dutch central bank to the Group's account with the German central bank, as part of the strategic plans to migrate most of the RBS N.V. balance sheet, activities and exposures to the Group.

- *Germany* - Net long HFT positions in German bonds in Markets increased during 2012, driven by market opportunities. Concurrently, German AFS bond positions in Group Treasury were reduced in the first half of the year, in line with internal liquidity management strategies.

- *France* - The Group reduced its long and short HFT positions in Markets throughout 2012 while reducing its net long HFT position in the first half of the year and increasing it again in the second half of the year, in anticipation of changes in credit spreads. AFS bond positions in Group Treasury were gradually reduced as part of general risk management and in line with internal liquidity management strategies of RBS Group.

- *Belgium* - Net HFT government debt exposure increased by £0.7 billion on balance over 2012, as part of regular fluctuations in the Markets business.

Financial institutions

- *France* - Lending exposure to banks increased as a result of a transfer of bank account services for Group Treasury secured funding transactions from in-house to an external bank, for £1.7 billion. Derivatives exposure to banks decreased by £1.4 billion, spread over a number of banks.

Corporate

- *Germany* - Lending to corporate clients fell by £2.4 billion, largely as a result of reductions in Non-Core exposure to the transport and commercial real estate sectors.

- *France* - Lending to corporate clients decreased by £0.7 billion, largely as a result of reductions in Non-Core exposure to commercial real estate and other sectors.

** unaudited*

Other risks

186	Operational risk
188	Regulatory risk
193	Conduct risk
194	Reputational risk
194	Business risk
195	Pension risk

Other risks

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 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.

In 2012, the Group continued to make good progress in enhancing its operational risk framework and risk management capabilities. Details of developments undertaken and planned are set out below along with the key processes through which the Group manages operational risk.

In 2013, through further embedding the enhanced operational risk framework and tools and improving framework linkages, operational risk will be managed on a more forward-looking basis.

Governance, structure and risk appetite

Governance and structure

Group Operational Risk is an independent function reporting to the Head of Restructuring & Risk. It is responsible for the design and maintenance of the operational risk policy standards.

The standards, which are incorporated in the Group Policy Framework (GPF), 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 Group.

The Operational Risk Executive Committee acts upon all operational risk matters, and reviews and monitors the operational risk profile across the Group, in line with risk appetite. It oversees, manages and monitors operational risk strategies and frameworks, and reviews operational risk policy. It escalates and reports necessary items to the Group Risk Committee.

Operational risk appetite, policy and frameworks are reviewed regularly at the Executive Risk Forum to satisfy oversight responsibilities and, as appropriate, other senior committees.

Risk appetite

The Group's operational risk appetite statement is agreed by the Group Board. It comprises a number of specific measures of risk, such as:

- The maximum operational risk losses the Group is prepared to accept. For 2012, this was expressed as a percentage of the Group's estimated gross income but will transition to a more forward-looking expected loss measure during 2013 following the development of the operational risk model; and
- Aggregate loss targets at specific confidence levels.

To confirm that the Group operates within the set risk appetite, the high-level statement is 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 Group to operate within the overall risk appetite and the specific tolerances.

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

Risk and control assessments are used to identify and assess material operational risks and key controls across all business areas. To provide a consistent categorisation of risks and controls across the Group and to support identification of risk concentrations, all risks and controls are mapped to the Group-wide risk taxonomy and the newly developed control catalogue.

The process is designed to confirm that risks are effectively managed in line with stated risk appetite, prioritised and documented. Controls are tested frequently to verify and validate that they remain fit for purpose and operate effectively.

Risk assessments are often conducted in a workshop environment, bringing together subject matter experts and key stakeholders from across the division and key functions. This approach has led to a more complete view of the risk profile and more informed decisions.

During 2013, the focus will be on the continued implementation and embedding of risk assessments across the Group. This includes the strengthening of links between risk assessments and other elements of the Group operational risk framework. In addition, risk assessments will increasingly be utilised to identify single points of failure.

New product risk assessment process

The Group's new product risk assessment process is designed to identify, assess and approve the risks associated with new products prior to launch.

Several process enhancements were made during 2012, which strengthened the interaction between business, risk and specialist areas. Reporting has been established and work has started to enhance the inventory of products provided by the Group.

** unaudited*

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 Group's risk appetite. The methodology provides a structured and consistent approach to scenario scoping and measurement. During 2012, the portfolio of scenarios was further enhanced to increase coverage of the material risks to which the Group is exposed.

Scenario analysis is an important component in the operational risk framework, providing senior management with valuable insight into systemic risk that could significantly impact the Group's financial performance or reputation 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, including consideration of single points of failure.

Scenarios are run in a workshop environment, bringing business, risk and control experts together, thereby ensuring that risk management is approached holistically. They include Group-wide themes, which are led by Group Operational Risk and allow the Group to assess the impacts of pan-divisional risks and macroeconomic stresses (e.g. eurozone distress).

Stress testing
The Group further refined its approach to assessing the impact of the economic cycle on its operational risk losses 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
- capital adequacy requirements for operational risk.

The impact of the FSA Anchor II scenario on the Group's operational risk capital, as calculated under the standardised approach, was also projected based on the outputs of the Group's stress-testing exercises.

Operational risk impacts are also assessed based on additional economic stress scenarios developed internally.

Capital model development
The Group has continued with the development of its statistical modelling capability for operational risk based on the requirements set out under the Basel II advanced measurement approach. The model considers internal and external loss data as well as scenarios and business environment and internal control factors. The primary use of the model will be to contribute to the economic capital calculation and to help test the Group's capital adequacy requirement. Embedding of the model outputs is continuing in 2013.

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 Group.

This element of the operational risk framework continues to be enhanced in areas such as analysis of common issues on an aggregated basis across the Group to identify emerging trends and improvements to the quality of data captured.

Event and loss data management
Event and loss data management covers the discovery, escalation, capture, investigation, approval and closure, and reporting and analysis of operational risk events and loss data. It also provides for clear, simple, quick and consistent communication of operational risk events that meet defined threshold criteria to those members of the Group's senior management and executives who need to know of these events.

The Group has continued to focus on the timely, accurate capture of operational risk losses; the use of a single Group-wide repository; and the escalation of material operational risk events. This has resulted in enhanced completeness and accuracy of the Group's internal loss data, and transparency of operational risk events, which allows the Group to manage its operational risk profile more effectively.

The event and loss data process will continue to evolve to keep apace with changing regulatory and industry standards regarding the collection of internal loss data.

Insurance
The Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements. Insurance is used to help manage the Group's exposures, providing protection against financial loss once a risk has crystallised.

Monitoring and reporting
Monitoring and reporting forms an integral part of all of the 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 during 2012 include single-source extraction and publication of operational risk data across the Group, such as operational risk events and losses. This has resulted in consistent and higher quality information for the purposes of oversight, challenge and operational risk management.

Other risks: Operational risk* continued

Control environment certification

Control Environment Certification (CEC) is used by the Group Executive management to review and assess its internal control framework. Senior management are required to provide a twice-yearly assessment of the robustness of the Group's internal control environment including:

- compliance with the Group Policy Framework and key divisional/functional policy standards;
- compliance with the requirements of the UK Corporate Governance Code;
- effectiveness of the risk frameworks, culture and governance structures of each division or function to help ensure the Group operates within risk appetite; and
- reporting on the material risks for the business against appetite.

The CEC outcomes are reported at both the divisional risk and audit committees and Group Audit Committee.

Capital

The Group calculates the capital requirement for operational risk using the standardised approach. The capital requirements are as follows:

	2012 £m	2011 £m
Operational risk minimum capital requirement	3,308	2,958

Regulatory risk*

Regulatory risk is the risk of material loss or liability, legal or regulatory sanctions, or reputational damage, arising from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards, in any location in which the Group operates. The Group believes that maintaining a strong regulatory risk framework is fundamental to protecting sustainable growth, rebuilding its reputation and maintaining stakeholder confidence.

The regulatory environment remained highly challenging during 2012, 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 European Union (EU) and national initiatives, constitutes the most sweeping set of changes seen in many decades. At 31 December 2012, the Group was managing some 105 major regulatory or legislative policy initiatives. During the year as a whole, it had also reviewed over 320 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 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 promote good business practice and to minimise enforcement risks.

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. Although policy initiation at the G20 level is drawing to an end, a substantial pipeline of policy development remains in train and the Group does not anticipate any easing of this for some time. During 2012, G20 countries continued to implement various elements of this action plan, and further endorsed it at the G20 leaders' summit held in Los Cabos, Mexico in June 2012 and the finance ministers' and central bank governors' meetings, most recently in Mexico City in November 2012.

** unaudited*

Key developments during 2012 included the following:

Basel III

Following publication by the Basel Committee on Banking Supervision in December 2010 of rules for the new Basel III capital and liquidity framework, work during 2012 focused on finalising the remaining elements of policy and preparing for implementation. Highlights were:

- Publication of results of the Basel III monitoring exercise at 30 June 2011 (published April 2012) and at 31 December 2011 (published September 2012). The latest results (which ignore the transitional provisions which apply) showed good progress, with an average Common Equity Tier 1 ratio of 7.7% across 102 banks with Tier 1 capital above €3 billion. This compares to an effective target of 7%. However, individual bank shortfalls, including surcharges for systemically important banks where applicable, still totalled €374 billion;

- The finalisation of rules for composition of capital disclosure requirements (June 2012);

- Proposals for monitoring indicators for intra-day liquidity management (July 2012);

- Interim rules for the capitalisation of bank exposures to central counterparties (July 2012);

- Final rules for the regulatory treatment of valuation adjustments to derivative liabilities (July 2012); and

- Final rules amending the liquidity coverage ratio (LCR), including revised definitions of high quality liquid assets and net cash outflows. The LCR will now be phased in from 2015 to 2019 and it was also re-confirmed that a stock of liquid assets would be available for use by banks in stress situations (January 2013).

The Basel Committee also turned its attention increasingly to developments beyond Basel III. In particular, it published an initial consultation paper to launch its fundamental review of the trading book (May 2012). Here, the Committee is seeking to improve the coherence of market risk capital requirements and to enhance the consistency of implementation across jurisdictions and convergence of requirements across the industry.

Systemic financial institutions

With the G20-mandated target of agreeing a framework for dealing with global systemically important financial institutions having been met in 2011, much work in 2012 was at the EU level, with discussions on incorporating a general approach into CRD IV.

Separately, and following consultation, the Basel Committee published a framework to address domestic systemically important banks in November 2012, which followed on from its methodology for identifying global systemically important banks developed in 2011. The framework focuses on the impact that the distress or failure of banks will have on the domestic economy. The correct calibration of linkages between the domestic and international frameworks is now critical.

Shadow banking

Work in this area, which 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, intensified during 2012.

Globally, Financial Stability Board (FSB) workstreams under relevant bodies including the International Organization of Securities Commissions and the Basel Committee continued in five key areas: 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. The FSB issued an update and a further series of consultation papers on certain workshops in November 2012 and revised recommendations are expected by the G20 St Petersburg leaders' summit in September 2013.

The European Commission began the first stage in its own regulatory process on shadow banking in March 2012, with the release of a Green Paper. A summary of responses published in September 2012 was broadly aligned with industry views.

Other

Other papers issued during the year covered subjects including risk data aggregation and reporting; margin requirements for uncleared derivatives; foreign exchange settlement risk; supervision; financial conglomerates; and revisions to the securitisation framework.

EU regulatory developments

The EU regulatory agenda in 2012 continued to focus mainly on prudential and market structure measures. Retail issues also came under increased focus. Key highlights were as follows:

The Liikanen Review

In November 2011, the EU Commissioner for Internal Market and Services, Michel Barnier, announced the establishment of a High-Level Expert Group to consider structural reform of EU banks and in early 2012 it was convened under the chairmanship of Erkki Liikanen, the Governor of the Bank of Finland. The group was mandated to consider measures to improve EU banks' stability and efficiency. In addition to any new measures, it was tasked to look at ongoing structural reforms, including the UK Independent Commission on Banking and the US 'Volcker Rule'.

The Expert Group's proposals in October 2012 contained five recommendations: a ring-fence of trading book activities where they form a significant part of a bank's activity; effective recovery and resolution plans (with authorities empowered to require further structural reform if that improves resolvability); specific 'bail-in' instruments (rather than a general bail-in power applied to existing liabilities); stricter capital treatment of trading book and real estate exposures; and a number of corporate governance, risk management and remuneration proposals.

Other risks: Regulatory risk* continued

The Commission is considering the Expert Group’s recommendations and has said that it will formally respond by September 2013. Member state views on the Expert Group's proposals, where expressed, have been mixed. The UK is meanwhile pushing ahead with implementation of its own ring-fencing reforms, as set out by the Independent Commission on Banking. These go further than the Expert Group's proposals. France and Germany have also published draft legislation of their own on ring-fencing, which focus mainly on separating out proprietary trading (but allowing market making activities to remain within the deposit-taking bank).

Crisis management and banking union proposals

In June 2012, the EU Commission published proposals for an EU-wide recovery and resolution regime, providing for banks and authorities to maintain plans for each firm, setting out measures to set right or resolve businesses should they face difficulties. Authorities would receive a number of powers to intervene in banks for these purposes, including early intervention powers ahead of problems coming to light, and a minimum set of tools to restructure or wind up a failed firm.

Among the new tools is the power to ‘bail in’ senior creditors when resolving a firm, to ensure losses are spread among shareholders and creditors, without recourse to tax-payer funding. Bailed-in creditors take a loss and become shareholders in the new entity created.

These proposals are likely to be agreed in 2013, with member states and banks in compliance from 2015, and bail-in provisions from 2018. Notwithstanding these developments, the euro-area crisis continued to develop and in July 2012, the President of the European Council, Herman Van Rompuy, set out a road-map for further euro-area financial integration. This aims to both resolve the current crisis and tackle longstanding structural problems in the single-currency zone. Fundamental to these proposals are banking and fiscal union and further economic integration. The President’s banking union proposal comprises: a Single Supervisory Mechanism; and mutualisation of bank losses through common deposit guarantee and resolution funding arrangements. The latter two elements are planned to follow agreement of the recovery and resolution regime in 2013.

In September, the Commission published its proposal for a Single Supervisory Mechanism, designating the European Central Bank (ECB) as primary prudential supervisor for all euro-area banks, with opt-ins available for EU member states outside the euro-area. The Council of the EU agreed to these proposals, with the proviso that the ECB would directly supervise only larger banks and those in receipt of state aid, while retaining some oversight of smaller banks that fall under the remit of national supervisors.

The European Parliament is now considering the proposals, with agreement expected in early 2013. The ECB will not acquire full supervisory authority until March 2014 and there is scope to delay this. Operational elements, such as how the ECB will be staffed, how it will interact with national supervisors and how it will implement its new macro-prudential responsibilities, remain to be seen. More detail should emerge during 2013.

Prudential and related reforms

A key focus during 2012 was work on agreeing the EU’s Capital Requirements Directive (CRD) following the publication of draft legislative text in 2011 for the CRD IV package to implement Basel III in the EU.

Progress of the legislation was slower than hoped and did not conclude before the Basel III start date of 1 January 2013. Nevertheless, the European Banking Authority did press ahead with proposals for a number of the technical standards mandated by CRD IV, including: reporting of own funds, liquidity, leverage and large exposures; gain on sale of associated with future margin income in a securitisation context; credit valuation adjustment; and prudent valuation.

Other prudential initiatives have included, notably: continued work on developing the Solvency II framework for insurers; capital requirements for central counterparties; corporate governance in financial institutions; and supervision of financial conglomerates.

Market and structural reforms

Key developments included:

- *European Markets Infrastructure Regulation -* the regulation came into force on 16 August 2012. In many areas, the European Securities and Markets Authority (ESMA) is yet to finalise draft technical standards. Full implementation is likely to be in the third quarter of 2013, when the final technical standards are due to be released by the ESMA.

- *Markets in Financial Instruments Directive -* the European Parliament voted on the proposal in September 2012 but the Council of the EU had not agreed its final position by the end of 2012. The new Irish Presidency of the Council plans to finalise the proposals before the end of its term in June 2013.

- *Financial Transaction Tax -* the EU Commission has previously published proposals, which would see trades in bonds and shares taxed at 0.1% and complex derivatives taxed at 0.01%. While the original EU-wide proposal was rejected due to opposition from several member states, including the UK, a subset of eleven EU member states has agreed to proceed via the Enhanced Cooperation Mechanism. The Commission set out detailed proposals for this in February 2013.

- *Other initiatives -* these have included proposals to revise the Data Protection Directive, further changes to the market abuse regime and prospectus requirements, further legislative developments impacting credit rating agencies and changes to depositor and investor protection.

* *unaudited*

EU retail market reforms
Notwithstanding the focus on prudential and market reforms in response to the financial crisis, the EU Commission during 2012 also continued to work on a wide range of retail agenda initiatives. These included:

- bank account transparency, switching and the potential for making basic bank accounts a legal right for EU citizens;
- the Insurance Mediation Directive II, which could have implications for packaged accounts with inbuilt insurance products;
- multilateral interchange fees; and
- the Mortgage Credit Directive, which is still progressing through the legislative process and which covers areas including responsible lending and pre-contract disclosure.

Regulatory architecture reforms
The Financial Services Act to introduce the “twin peaks” model of financial regulation received Royal Assent in December 2012 and so the formal split of the FSA into the Prudential Regulation Authority and the Financial Conduct Authority will take place on 1 April 2013 as expected. In the meantime, the FSA continued to alter its structure in anticipation of the split. The Group has been closely involved in work with trade associations to respond to a number of related consultations, notably to the ‘Journey to the FCA’ document.

UK regulatory developments
UK regulatory developments during 2012 continued to be extensively determined by global and EU developments, with UK regulators working to implement requirements coming into force and actively participating in policy development at the EU and global levels. There was less focus on prudential reviews issued by UK authorities in 2012 but nevertheless a number of papers were published, including consultations on macro-prudential tools and large exposures. In addition, there were a number of other developments specific to the UK.

The future of banking
The Group has actively engaged with, and contributed to, a number of inquiries regarding the future of banking. These included the Government’s White Paper on the implementation of the Independent Commission on Banking recommendations, a Parliamentary inquiry into banking standards and various inquiries (in Europe as well as the UK) looking more specifically at LIBOR and other benchmarks. The Group is represented on, and is working closely with, the British Bankers’ Association Taskforce on Banking Standards, and the Group have specifically welcomed the developing role of the Chartered Banker: Professional Standards Board. In addition, work continued on the finalisation of recovery and resolution planning frameworks.

Retail conduct issues
In addition to EU retail initiatives, the UK authorities continued to pursue additional issues during 2012. These included initiatives relating to Universal Credit, a review into the personal current account market and continuing work on the Retail Distribution Review ahead of its implementation on 31 December 2012. Work also continues on the Mortgage Market Review, Packaged Accounts and Simple Financial Products. Preparation for the new Financial Conduct Authority (FCA) stepped up, including papers on its powers, regulatory approach and the desire for transparency in areas such as product intervention and publication of Ombudsman decisions. The Group expects significant implementation and ongoing costs to arise from changes to documentation, structure and processes as well as increased regulatory fees.

Furthermore, the Government proposed a transfer of consumer credit regulation from the Office of Fair Trading to the FCA and it may also replace current Consumer Credit Act legislation with an FCA rulebook, changing rules in the process.

Supervisory developments
In line with other regulatory authorities, the FSA’s supervisory scrutiny has continued to intensify 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 2012 totalled £311.6 million, compared with £66.1 million in 2011, and £5.3 million as the financial crisis began in 2007.

In addition, the FSA moved to a “twin peaks” organisational structure in April 2012, with the creation of new conduct and prudential business units which form separate teams supervising systemically important firms from a conduct and prudential perspective. The FSA has continued to develop new supervisory approaches to align to the new regulatory structure. The prudential framework includes the 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. The conduct framework includes a greater focus on business models and strategic analysis.

US regulatory developments
In the US, activity continued to be dominated by rulemaking following the 2010 Dodd-Frank Act.

Key final rules were issued on a range of issues, including prudential standards for systemically important financial institutions, removal of certain references to credit rating agencies, Basel 2.5 market risk standards and final definitions of swap dealers, major swap participants and swaps. Requirements for the registration of entities as swap dealers took effect from 12 October 2012, with registration commencing from 31 December 2012 once firms reach certain activity thresholds. RBS plc was one of 65 global entities which registered with effect from 31 December 2012.

Other risks: Regulatory risk* continued
Proposed rules issued in December 2012 included important changes to the Federal Reserve Board's approach to supervisory and prudential requirements for foreign banking organizations (FBOs). These proposals would require the Group and other FBOs to establish a single US-incorporated intermediate holding company for all the Group's US subsidiaries (although not the US branches of RBS plc). Enhanced prudential standards would also be required, including for the US branches.

Other proposals included Basel III capital and leverage standards and disclosures and other rules relating to mortgages. The Volcker Rule, which restricts proprietary trading and investments in private equity/hedge funds, was not finalised by its effective date of 21 July 2012 but in April 2012 the Federal Reserve Board issued an interpretation which provided some guidance to the effect that banks should demonstrate their 'good faith' planning efforts in the two-year conformance period to July 2014.

Regulatory risk management
The Group manages its regulatory risk through a regulatory affairs framework covering over 120 different regulatory bodies and central banks, wherever the Group operates. This framework is managed by the Group's Regulatory Affairs function and includes: the tracking and management of regulatory developments and regulatory relationship management, together with ownership of the connected regulatory risk policies; assurance and monitoring; and training and awareness.

Against the backdrop of intensified regulatory pressure, 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.

Management of regulatory change
The early identification and effective management of changes in legislative, regulatory and other requirements that may impact the Group is critical to the successful mitigation of prudential and conduct risk.

Group Regulatory Affairs maintains a well-established policy and supporting processes for the identification and management of such changes across the Group. 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 augmented by more specialised groups which cover capital, liquidity, prudential and wholesale market and retail conduct issues. In addition, there is a divisional Heads of Regulatory Developments forum and an RBS Americas regional forum.

Reporting and internal communications activity expanded in 2012 in response to the growing regulatory change agenda. This included:

- monthly reporting of key developments to the Group Risk Committee;
- substantial enhancements to the suite of tools used to monitor and react to regulatory developments; and
- increased communications, such as staff seminars, publication of additional information such as house views on key issues on internal websites and the weekly Regulatory Affairs Flash Report, circulated widely across the Group, which captures key regulatory developments and relationship topics.

Regulatory relationship management
The Regulatory Relations Forum, chaired by 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.

Quarterly reporting to the 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.

Key regulatory policies - 'Group Relationships with Regulators' and 'Political, Legislative and Regulatory Environment', are kept under annual review. Each incorporates a new risk appetite statement, relevant benchmarking activity against the 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
As advocates of effective recovery and resolution planning, the Group continues to work towards the implementation of effective plans. In order to be able to deal effectively with any future severe stress events, the Group has developed a range of recovery options in the form of a detailed recovery plan.

Individual country regulators are developing and implementing their rules according to their own timescales. This emphasises the need for consistency of approach, both by the regulatory bodies and internally within the Group, to ensure effective management of financial stability across jurisdictions, and to avoid duplication and inefficiency for cross-border banks. The Group has worked with trade associations to provide feedback on the FSB's consultative document on operationalising recovery and resolution planning, published in November 2012.

The Group intends to continue its activities aimed at producing robust and effective plans and to proactively influence policy makers regarding the most practical approach to implementing the regulations. It will also be important to consider how individual regulations might be implemented in a manner that takes advantage of any potential synergies and avoids unnecessary re-work. The potential overlaps between recovery and resolution planning and the proposals arising from the Independent Commission on Banking, the US and the EU will provide an area of focus in this regard.

** unaudited*

Conduct risk*

Conduct risk is the risk that the conduct of the Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss by breaching regulatory rules or laws, or failing to meet customers' or regulators' expectations of the Group. Activities through which conduct risk may arise include: personal account dealing; privacy and data protection; conflicts of interest; money laundering; and bribery and corruption.

Effective conduct risk management is not only a commercial imperative for the Group. Customers, clients and counterparties demand it as a precursor to building trust. It also reflects the changing regulatory environment in the UK, with the establishment of the Financial Services Conduct Business Unit (forerunner to the Financial Conduct Authority), and the increasing focus of overseas regulators on conduct risk.

The Group's compliance functions are responsible for monitoring the management of conduct risk, including anti-money laundering (AML); sanctions and terrorist financing; and anti-bribery and corruption. In doing so, they design, implement and maintain an effective management framework to enable consistent identification, assessment, monitoring and reporting of conduct risk.

Policy design and implementation

Placing conduct risk at the centre of the Group's philosophy promotes a customer-oriented culture that informs and challenges business strategy, delivers fair outcomes and promotes behaviours consistent with regulatory and legal standards across its retail and wholesale markets.

The Group has established a defined and measurable appetite for conduct risk to ensure commercial decisions take into account any conduct risk implications. During 2012, the foundations of the Group's conduct risk framework were delivered. Key milestones were:

- Agreeing and establishing the Group's conduct risk policies under four pillars: employee conduct; corporate conduct; market conduct; and conduct towards the Group's customers. Each is designed to provide high-level direction to the Group and is supported by the Group's Code of Conduct;
- Launching a phased roll-out of these policies, in order of materiality and scheduled to complete in June 2013;
- Developing and delivering awareness initiatives and targeted conduct risk training for each policy, aligned to the phased roll-out, to assist businesses and executives in embedding the understanding of conduct risk and provide the necessary clarity for staff on their conduct risk requirements;
- Establishing effective leadership and a supporting governance framework, with the participation of all divisions, to oversee the Group's conduct agenda, notably the new Conduct Risk Committee; and
- Completion by the separate AML Change Programme of its Group-wide gap analysis and benchmarking against enhanced policies, including recording identified issues, establishing a new AML organisational reporting and accountability hierarchy, initiating comprehensive and continuing tailored staff training; and establishing a global AML assurance programme.

Training and awareness

Maintaining compliance with existing rules and regulations requires continued investment in professional training, as well as maintaining risk awareness. During 2012, the Group continued to focus on strengthening the capabilities of its compliance functions, at both Group and divisional level. In addition, it facilitated training on conduct risk through Executive education, including master classes and workshops, and computer-based Group Policy Learning modules. Each module addresses the specific regulatory content of relevant Group Policy Standards.

A comprehensive and progressive training programme supports the professional development of the Group's compliance teams. All members of these teams are engaged in compliance eLearning, including a mandatory 'essentials' course, and 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 regulatory familiarisation, designed to share knowledge and support both personal development and technical training across the Group's wider risk community.

Assurance and monitoring

Assurance and monitoring activities are essential to ensure that the Group can: demonstrate compliance with existing rules and regulations; assess whether it is managing its conduct risks appropriately; and determine whether key controls are fit for purpose and effective.

During 2012, as well as providing thematic process reviews and assurance over specific compliance topics, the Group Compliance assurance teams, working with its divisional counterparts, validated the closure of issues it identified during the 2011 programme of Group-wide assurance reviews, and identified common issues between divisions.

** unaudited*

Other risks continued

Reputational risk*

Reputational risk is the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group's conduct and performance.

Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business in a number of ways, including an inability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to funding sources.

One of the most fundamental stakeholder expectations is that a bank is financially prudent, safe and sound. The Group has made significant progress in meeting this expectation through the execution of its Strategic Plan in restructuring its balance sheet and improving its capital and funding position. Major reforms have also been made to strengthen its risk identification, evaluation and management processes. Further work remains, but the Group is now in a much stronger financial position to face challenges and uncertainties in its economic and operating environment.

Restoring the reputation of the Group and the wider banking sector is built upon the role of banks as good companies that perform well for their owners, regulators, employees and communities and, above all else, serve their customers well.

The Group has put the focus on serving customers well at the heart of its strategic objectives that, combined with a safe and sound bank, will build a culture and reputation in line with our stakeholder expectations. There are still legacy issues to work through, but dealing with them in an open and direct manner is a necessary part of the ability to move forward.

The Group's reputational risk management framework is aligned with its strategic objectives and its risk appetite goal of maintaining stakeholder confidence. It is designed to embed, at different points of decision-making processes, a series of reputational filters and controls that examine products, services and activities through the lenses of sustainability, transparency and fairness.

This approach recognises that reputational risk can arise across a range of actions taken (or not taken) by the Group, as well as its wider conduct, policies and practices. Therefore, it is aligned with the management of a range of risk types that have a high reputational sensitivity.

The Group Board risk report contains a 'top slice' view of key embedded risks, including a reputational risk impact assessment of each key risk. In addition, the divisions report to their own committees and Boards on relevant barometers of reputational risk and actions to manage reputational events according to the source.

For example, an Environmental, Social and Ethical (ESE) risk management function assesses the ESE risks associated with business engagements and business divisions, while the Group Policy Framework includes a range of policies relating to conduct and reputational matters. (For credit risk specific information on ESE risk policies, refer to Credit risk management framework on page 60).

The Group Board has ultimate responsibility for managing the Group's reputation, though all parts of the Group have responsibility for any reputational impact arising from their operations. The Board's oversight of reputational issues is supported by executive risk committees (including a new Conduct Risk Committee) and by the Group Sustainability Committee. Emerging reputational issues are pro-actively identified and assessed by a dedicated working group, and escalated through the appropriate governance channels where necessary.

Business risk*

Business risk is the risk that the Group suffers losses as a result of adverse variance in its revenues and/or costs relative to its business plan and strategy. Such variance may be caused by internal factors such as volatility in pricing, sales volumes and input costs and/or by external factors such as the Group's exposure to macroeconomic, regulatory and industry risks.

Business risk is impacted by other risks the Group faces that may contribute to the adverse changes in the Group's revenues and/or costs, were these risks to crystallise. Examples of such risks include funding risk (through volatility in cost of funding), interest rate risk in the banking book, operational risk, conduct risk and reputational risk.

The Group seeks to minimise its exposure to business risk, subject to its wider strategic objectives. Business risk is identified, measured and managed through the Group's planning cycles and performance management processes. Expected profiles for revenues and costs are determined, on a bottom-up basis, through plans reflecting expectations of the external environment and the Group's strategic priorities. 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 Group operates a rolling forecast process which identifies projected changes in, or risks to operating profit and ensures appropriate actions are taken.

The Group Board has ultimate responsibility for the impact of any volatility in revenues and costs on the Group's performance. Business risk is incorporated within the Group's risk appetite target for earnings volatility, with an assessment of volatility in revenues and costs a key component in determining whether the Group and its underlying businesses are within risk appetite.

The management of business risk lies primarily with divisions, with oversight at the Group level led by Finance. Divisions are responsible for delivery of their business plans and management of such factors as pricing, sales volumes, marketing spend and other factors that can introduce volatility into earnings.

** unaudited*

Pension risk*

The 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 in long-term interest rates and inflation in particular, as well as pensionable salaries, the longevity of scheme members and changes in legislation. The 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 Group could be obliged, or may choose, to make additional contributions to the schemes or be required to hold additional capital to mitigate such risk.

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 Trustee Limited, is a wholly owned subsidiary of The Royal Bank of Scotland plc. The trustee board comprises six directors selected by the 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 Group. Significant changes to asset strategy are discussed with the Group's Pension Risk Committee, which was established in 2011. The Group and the trustee must also agree on the Main scheme's funding plan.

In October 2006, the Main scheme was closed to new employees. In November 2009, the 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. In October 2012, the Group confirmed that it was increasing the charge made through its flexible benefits programme for membership of the Main scheme by 5% of salaries, with employees having the alternative of accepting an increase in their Normal Pension Age from 60 to 65 in respect of service from October 2012 at no additional cost.

Risk appetite and investment policy are agreed by the trustee with quantitative and qualitative input from the scheme actuaries and investment advisers. The Investment Executive, which acts on behalf of the trustee of the Group's largest pension schemes, also consults with the Group to obtain its view on the appropriate level of risk within the pension fund.

Risk management framework

The Group manages the risk it faces as a sponsor of its defined benefit pension schemes using a pension risk management framework that encompasses risk reporting and monitoring, stress testing, modelling and an associated governance structure that helps ensure the Group is able to fulfil its obligation to support the defined benefit pension schemes to which it has exposure.

Reporting and monitoring

The Group maintains an independent view of risk from a sponsor perspective within its pension funds. It achieves this through regular pension risk reporting and monitoring to the Group Board, Group Executive Committee and Group Board Risk Committee on the material pension schemes that the Group has an obligation to support.

Stress testing and modelling

Throughout 2012, various pension risk stress testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios to meet integrated 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 Pension Risk Committee. This committee also serves as a formal link between the Group and the Investment Executive, which acts on behalf of the trustee of the Group's largest pension schemes, on risk management, asset strategy and financing issues and has facilitated an agreement between the two on mechanisms for reducing risk within the RBS Group Pension Fund.

As part of the continuing development of the pension risk management framework within the Group, key achievements in 2012 focused on developing an improved pension risk reporting, monitoring, modelling and stress testing capability for the Group. The focus for 2013 will revolve around extending and embedding these improvements across the Group.

Main scheme

The most recent funding valuation, at 31 March 2010, was agreed during 2011. It showed that 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 Group 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 provided in Note 4 of the consolidated accounts. The next funding valuation is due at 31 March 2013.

The assets of the Main scheme, which represent 85% of Group pension plan assets at 31 December 2012, 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 investing 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.

** unaudited*

Other risks: Pension risk* continued

The table below shows the sensitivity 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 2012			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields	76	255	(179)
Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields	578	995	(417)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	71	1,261	(1,190)
Fall in equity values of 10%	(862)	—	(862)
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

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2012.

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.

At 31 December 2012, HMT's holding in the holding company's ordinary shares had reduced to 65.3% as a consequence of share issues during the year.

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

In 2007, RFS Holdings B.V., which was jointly owned by the RBS Group, the Dutch State (successor to Fortis) and Santander (together, the "Consortium Members") completed the acquisition of ABN AMRO Holding N.V.

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V."). Certain assets of RBS N.V. continue to be shared by the Consortium Members.

In October 2011, the RBS Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank pursuant to Part VII of the UK Financial Services and Markets Act 2000. Substantially all of the Netherlands and EMEA businesses were transferred in September 2012. Further transfers are expected to take place during 2013 but are subject to certain authorisations including regulatory approval where necessary. The RBS Group now anticipates that the transfers in China will be completed at a later date.

Results and dividends

The loss attributable to the ordinary shareholders of the Bank for the year ended 31 December 2012 amounted to £3,853 million compared with £1,645 million for the year ended 31 December 2011, as set out in the consolidated income statement on page 204.

The Bank did not pay a dividend on ordinary shares in 2011 or 2012.

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 4 to 6.

Asset Protection Scheme

On 22 December 2009, the Bank entered into an agreement, the Asset Protection Scheme (APS), with HM Treasury acting on behalf of the UK Government, under which it purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HM Treasury. The APS provided additional protection to the RBS Group's capital ratios and financial position.

The Bank entered into agreements with other RBS Group companies under which it sold credit protection over the exposures held that were subject to the APS.

On 18 October 2012, the Group exited 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 7. Fuller details of these and other risk factors are set out on pages 323 to 335.

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 210 to 220.

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 25 to 196.

Financial performance

A review of the Group's performance during the year ended 31 December 2012, including details of each division, and the Group's financial position as at that date is contained in the Financial review on pages 8 to 24.

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 2012, the Bank and its subsidiaries employed 111,000 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. Supporting the professionalisation of our front line staff, this year more than 6,000 of our customer facing employees participated in accredited development programmes. This helps our employees deliver the best service to our customers whilst working towards a recognised professional standard.

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 a European Employee Council that provides elected representatives with an opportunity to understand better the RBS Group's European operations.

Diversity and inclusion
During 2012, the RBS Group executive renewed its commitment to making workplace policies, processes and experiences inclusive for staff, customers and stakeholders. In support of this, RBS Group HR has set inclusion within its top priorities for 2013.

Inclusion is built into various policy areas and people management processes. For example the RBS Group continues to support disabled people ensuring they have equal opportunities in recruitment, employment, promotion and training.

The RBS Group also supports employee led networks such as Focused Women and Rainbow who provide personal and career development opportunities 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 continues to maintain 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 specialists supporting and guiding 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 remains supportive of the recommendations of Lord Davies' Report. There are currently three female directors on the Board out of a total of 12 directors, which meets Lord Davies' aspirational target of 25 per cent female Board representation. As at 31 December 2012, 19 per cent of executives and 55 per cent of employees were female.

Further details on the Board diversity policy can be found at www.rbs.com

This year the RBS Group has been recognised for its work on Equality, Diversity and Inclusion by retaining our Gold standard ranking from Opportunity Now (gender), achieving Silver for Race for Opportunity (race), attaining the Top Employers award for employee engagement from workingmums.co.uk as well as securing a position in the Working Families Top 10.

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 2012, 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. For example, in 2012 the RBS Group launched an online toolkit which provides easy access to a range of resources, provided through our Employee Assistance Programme, to help employees deal with stress, build resilience and manage personal finances.

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 the RBS Group of its expectations of their behaviour and practices.

Sustainability

The long term success of the RBS Group relies on being safe, strong and sustainable. This underpins everything that the RBS Group does and enables the RBS Group to play a central role within society that enables people to run their daily lives and businesses. This, in turn, supports economic growth and brings wider benefits to society. There are further opportunities for the RBS Group to build on this and explore ways in which we can create additional value for all stakeholder groups.

Sustainability is therefore not just about the many responsibilities and obligations that the RBS Group has in a legal sense, but is about broad issues that need to be addressed to ensure that the RBS Group is a healthy and respected business operating on a sustainable basis.

Sustainability is central to the way the RBS Group is managed. The RBS Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups and reports to the Board.

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 323 to 335. The Group's regulatory capital resources and significant developments in 2012 and anticipated future developments are detailed on pages 39 to 44. The liquidity and funding section on pages 45 to 56 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 2012.

The RBS Group assessed the effectiveness of its internal control over financial reporting as of 31 December 2012 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 2012, 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 as part of 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 at least 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 Performance and Remuneration Committee (formerly 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 comprises of independent non-executive directors and is chaired by the Senior Independent Director. It is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

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 as required to review strategy and business performance.

Share capital
Details of the ordinary and preference share capital at 31 December 2012 are shown in Note 26 on the accounts.

Directors
The current members of the Board of directors are shown on page 2.

All of the current directors served throughout the year and to the date of signing of the financial statements.

John McFarlane stepped down from the Board on 31 March 2012. Joe MacHale will step down from the Board on 14 May 2013.

All directors of the company, with the exception of Joe MacHale, will stand for re-election by shareholders at the Annual General Meeting in 2013.

Directors' interests
The interests of the directors in the shares of the holding company at 31 December 2012 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 2012 to 27 March 2013.

Directors' indemnities
In terms of section 236 of the Companies Act 2006, 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 2006, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the RBS Group's pension schemes.

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 2012 was £24.2 million (2011 - £33.9 million).

Political donations
During 2012, 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 2012, the Group's trade creditors represented 25 days (2011 - 27 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
27 March 2013

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
27 March 2013

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

Philip Hampton
Chairman

Stephen Hester
Group Chief Executive

Bruce Van Saun
Group Finance Director

27 March 2013

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
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 2012 which comprise the accounting policies, the balance sheets as at 31 December 2012, 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 2012, the related notes 1 to 42 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 of 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 2012 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 has prepared financial statements that comply with IFRS as adopted by the European Union and with 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
27 March 2013

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 2012

	Note	2012 £m	2011 £m	2010 £m
Interest receivable		17,556	19,110	19,417
Interest payable		(6,924)	(7,812)	(7,306)
Net interest income	1	10,632	11,298	12,111
Fees and commissions receivable	2	5,558	5,898	7,591
Fees and commissions payable	2	(963)	(1,047)	(2,060)
Income from trading activities	2	1,511	2,014	3,361
Gain on redemption of own debt	2	454	255	502
Other operating income	2	1,296	3,388	2,199
Non-interest income		7,856	10,508	11,593
Total income		18,488	21,806	23,704
Staff costs		(7,473)	(7,512)	(7,880)
Premises and equipment		(2,080)	(2,083)	(1,909)
Other administrative expenses		(5,468)	(4,229)	(2,996)
Depreciation and amortisation		(1,614)	(1,590)	(1,689)
Write-down of goodwill and other intangible assets		(51)	(80)	(1)
Operating expenses	3	(16,686)	(15,494)	(14,475)
Profit before impairment losses		1,802	6,312	9,229
Impairment losses	13	(5,214)	(7,176)	(9,400)
Operating loss before tax		(3,412)	(864)	(171)
Tax charge	6	(364)	(731)	(713)
Loss for the year		(3,776)	(1,595)	(884)
Loss attributable to:				
Non-controlling interests		19	(8)	29
Preference shareholders	7	58	58	60
Ordinary shareholders		(3,853)	(1,645)	(973)
		(3,776)	(1,595)	(884)

The accompanying notes on pages 222 to 319, the accounting policies on pages 210 to 220 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 25 to 196 form an integral part of these financial statements.

Consolidated statement of comprehensive income for the year ended 31 December 2012

	Note	2012 £m	2011 £m	2010 £m
Loss for the year		(3,776)	(1,595)	(884)
Other comprehensive (loss)/income				
Available-for-sale financial assets		(680)	1,729	1,506
Cash flow hedges		1,022	1,487	114
Currency translation		(787)	(226)	331
Actuarial (losses)/gains on defined benefit plans	4	(2,242)	(621)	176
Other comprehensive (loss)/income before tax		(2,687)	2,369	2,127
Tax credit/(charge)		381	(727)	(519)
Other comprehensive (loss)/income after tax		(2,306)	1,642	1,608
Total comprehensive (loss)/income for the year		(6,082)	47	724
Total comprehensive (loss)/income is attributable to:				
Non-controlling interests		15	(37)	96
Preference shareholders		58	58	60
Ordinary shareholders		(6,155)	26	568
		(6,082)	47	724

The accompanying notes on pages 222 to 319, the accounting policies on pages 210 to 220 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 25 to 196 form an integral part of these financial statements.

Balance sheet as at 31 December 2012

	Note	Group 2012 £m	Group 2011 £m	Group 2010 £m	Bank 2012 £m	Bank 2011 £m	Bank 2010 £m
Assets							
Cash and balances at central banks	10	74,524	68,487	49,838	70,374	64,261	44,921
Amounts due from subsidiaries	10	21,875	27,232	4,848	65,671	58,972	40,127
Other loans and advances to banks	10	60,192	69,908	82,657	43,900	50,068	60,838
Loans and advances to banks	10	82,067	97,140	87,505	109,571	109,040	100,965
Amounts due from holding company and subsidiaries	10	1,866	792	1,946	55,468	145,757	127,817
Other loans and advances to customers	10	492,971	488,607	516,375	216,081	205,366	221,362
Loans and advances to customers	10	494,837	489,399	518,321	271,549	351,123	349,179
Debt securities subject to repurchase agreements	28	87,159	72,652	79,558	55,320	37,166	41,203
Other debt securities		49,426	96,489	86,471	67,127	144,294	148,005
Debt securities	15	136,585	169,141	166,029	122,447	181,460	189,208
Equity shares	16	13,872	11,762	2,340	12,766	10,486	1,016
Investments in Group undertakings	17	—	—	—	40,262	32,164	27,504
Settlement balances		5,717	6,902	8,748	3,090	4,059	3,529
Amounts due from holding company and subsidiaries	14	7,200	10,380	17,469	14,953	18,457	24,085
Other derivatives	14	437,901	522,427	411,536	434,885	518,840	408,727
Derivatives	14	445,101	532,807	429,005	449,838	537,297	432,812
Intangible assets	18	12,403	12,365	11,832	1,033	876	443
Property, plant and equipment	19	9,694	11,478	16,143	2,430	2,244	2,301
Deferred tax	24	3,066	3,320	1,790	2,878	2,584	794
Prepayments, accrued income and other assets	20	6,104	5,892	6,237	4,433	5,338	4,760
Assets of disposal groups	21	304	24,088	9,542	—	18,715	4,765
Total assets		1,284,274	1,432,781	1,307,330	1,090,671	1,319,647	1,162,197
Liabilities							
Amounts due to subsidiaries	10	6,063	11,945	6,626	130,126	157,999	138,606
Other deposits by banks	10	96,197	97,152	78,594	79,457	76,298	59,367
Deposits by banks	10	102,260	109,097	85,220	209,583	234,297	197,973
Amounts due to holding company and subsidiaries	10	5,778	3,179	8,934	84,992	163,615	169,158
Other customers accounts	10	513,419	469,209	463,391	171,342	133,287	126,200
Customer accounts	10	519,197	472,388	472,325	256,334	296,902	295,358
Debt securities in issue	10	83,278	140,837	164,662	71,494	114,524	128,073
Settlement balances		5,832	6,778	8,501	2,878	3,517	3,343
Short positions	22	27,541	40,446	41,130	14,074	24,858	25,687
Amounts due to holding company and subsidiaries	14	5,580	11,377	14,255	9,321	15,505	18,355
Other derivatives	14	430,505	516,459	406,714	429,831	515,350	406,148
Derivatives	14	436,085	527,836	420,969	439,152	530,855	424,503
Accruals, deferred income and other liabilities	23	12,027	14,809	13,734	7,355	8,840	8,058
Retirement benefit liabilities	4	3,854	2,188	2,229	56	25	23
Deferred tax	24	789	1,384	1,422	—	—	—
Amounts due to holding company	10	18,184	15,772	15,028	18,184	15,772	15,028
Other subordinated liabilities	10	15,667	16,552	16,995	13,451	14,242	14,271
Subordinated liabilities	25	33,851	32,324	32,023	31,635	30,014	29,299
Liabilities of disposal groups	21	135	22,840	7,508	—	20,478	2,336
Total liabilities		1,224,849	1,370,927	1,249,723	1,032,561	1,264,310	1,114,653
Non-controlling interests		137	128	597	—	—	—
Owners' equity	26	59,288	61,726	57,010	58,110	55,337	47,544
Total equity		59,425	61,854	57,607	58,110	55,337	47,544
Total liabilities and equity		1,284,274	1,432,781	1,307,330	1,090,671	1,319,647	1,162,197

The accompanying notes on pages 222 to 319, the accounting policies on pages 210 to 220 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 25 to 196 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 27 March 2013 and signed on its behalf by:

Philip Hampton
Chairman

Stephen Hester
Group Chief Executive

Bruce Van Saun
Group Finance Director

The Royal Bank of Scotland plc
Registration No. SC90312

Statement of changes in equity for the year ended 31 December 2012

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Called-up share capital						
At 1 January and 31 December	6,609	6,609	6,609	6,609	6,609	6,609
Share premium account						
At 1 January	25,375	25,375	25,375	25,375	25,375	25,375
Ordinary share issued on cross-border merger (1)	706	—	—	706	—	—
At 31 December	26,081	25,375	25,375	26,081	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	2,220	917	(168)	1,925	735	(324)
Unrealised gains	1,200	2,489	1,765	1,088	2,294	1,488
Realised gains	(1,880)	(760)	(259)	(1,781)	(734)	(32)
Tax	210	(426)	(421)	211	(370)	(397)
At 31 December	1,750	2,220	917	1,443	1,925	735
Cash flow hedging reserve						
At 1 January	1,018	(81)	(129)	1,307	482	618
Amount recognised in equity	2,107	2,481	173	1,700	2,486	672
Amount transferred from equity to earnings	(1,085)	(994)	(59)	(1,146)	(1,403)	(867)
Tax	(225)	(388)	(66)	(94)	(258)	59
At 31 December	1,815	1,018	(81)	1,767	1,307	482
Foreign exchange reserve						
At 1 January	2,829	3,027	2,722	(302)	(317)	(305)
Retranslation of net assets	(930)	(176)	795	11	15	(12)
Foreign currency gains/(losses) on hedges of net assets	150	(21)	(531)	—	—	—
Tax	(5)	(1)	41	—	—	—
Recycled to profit or loss on disposal of business (nil tax)	(3)	—	—	—	—	—
At 31 December	2,041	2,829	3,027	(291)	(302)	(317)
Retained earnings						
At 1 January	12,794	10,282	9,761	20,423	14,660	13,545
(Loss)/profit attributable to ordinary and equity preference shareholders	(3,795)	(1,587)	(913)	(786)	1,112	(214)
Equity preference dividends paid	(58)	(58)	(60)	(58)	(58)	(60)
Actuarial (losses)/gains recognised in retirement benefit schemes						
- gross	(2,242)	(621)	176	(120)	(3)	—
- tax	401	88	(73)	25	—	—
Shares in holding company issued under employee share schemes	30	(39)	—	30	(27)	—
Capital contribution	2,870	4,539	1,000	2,870	4,539	1,000
Share-based payments						
- gross	117	200	385	117	200	385
- tax	(6)	(10)	6	—	—	4
At 31 December	10,111	12,794	10,282	22,501	20,423	14,660
Owners' equity at 31 December	59,288	61,726	57,010	58,110	55,337	47,544

Note:
(1) Detailed in Note 26.

Statement of changes in equity for the year ended 31 December 2012 continued

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Non-controlling interests						
At 1 January	128	597	1,146	—	—	—
Currency translation adjustments and other movements	(4)	(29)	67	—	—	—
Profit/(loss) attributable to non-controlling interests	19	(8)	29	—	—	—
Dividends paid	—	(40)	(154)	—	—	—
Equity raised	17	—	58	—	—	—
Equity withdrawn and disposals	(23)	(392)	(549)	—	—	—
At 31 December	137	128	597	—	—	—
Total equity at 31 December	59,425	61,854	57,607	58,110	55,337	47,544
Total comprehensive (loss)/income recognised in the statement of changes in equity is attributable to:						
Non-controlling interests	15	(37)	96	—	—	—
Preference shareholders	58	58	60	58	58	60
Ordinary shareholders	(6,155)	26	568	(950)	3,082	637
	(6,082)	47	724	(892)	3,140	697

The accompanying notes on pages 222 to 319, the accounting policies on pages 210 to 220 and the audited sections of the ‘Financial review: Risk and balance sheet management’ on pages 25 to 196 form an integral part of these financial statements.

Cash flow statement for the year ended 31 December 2012

		Group			Bank		
	Note	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Operating activities							
Operating (loss)/profit before tax		(3,412)	(864)	(171)	(824)	1,867	384
Adjustments for:							
Depreciation and amortisation		1,614	1,590	1,689	763	613	561
Write-down of goodwill and other intangible assets		51	80	1	21	—	—
Provisions for impairment losses		5,214	7,176	9,400	1,548	1,533	3,571
Loans and advances written-off net of recoveries		(3,555)	(3,675)	(4,015)	(1,823)	(1,477)	(2,392)
Interest on subordinated liabilities		1,207	1,034	816	1,134	947	647
Charge for defined benefit pension schemes		400	329	489	3	2	8
Pension scheme curtailment gains		(38)	—	(78)	—	—	—
Cash contribution to defined benefit pension schemes		(888)	(975)	(641)	(26)	(3)	(3)
Gain on redemption of own debt		(454)	(255)	(502)	(454)	—	(345)
Elimination of foreign exchange differences		6,111	1,743	(3,107)	4,933	2,331	(1,745)
Other non-cash items		(421)	(2)	(1,579)	1,343	(685)	(1,019)
Net cash inflow/(outflow) from trading activities		5,829	6,181	2,302	6,618	5,128	(333)
Changes in operating assets and liabilities		(36,173)	(3,645)	29,919	(56,567)	(2,701)	29,270
Net cash flows from operating activities before tax		(30,344)	2,536	32,221	(49,949)	2,427	28,937
Income taxes (paid)/received		(92)	(98)	771	(84)	(343)	507
Net cash flows from operating activities	32	(30,436)	2,438	32,992	(50,033)	2,084	29,444
Investing activities							
Sale and maturity of securities		35,388	64,506	35,032	64,031	63,905	50,043
Purchase of securities		(17,724)	(67,340)	(33,632)	(14,161)	(59,607)	(46,230)
Sale of property, plant and equipment		2,099	1,794	1,918	137	42	87
Purchase of property, plant and equipment		(1,356)	(3,362)	(1,954)	(531)	(474)	(294)
Net investment in business interests and intangible assets	33	8,245	6,516	2,607	(129)	2,067	2,040
Net cash flows from investing activities		26,652	2,114	3,971	49,347	5,933	5,646
Financing activities							
Issue of subordinated liabilities		2,968	940	—	2,754	940	—
Proceeds of non-controlling interests issued		17	—	58	—	—	—
Capital contribution		2,870	4,539	1,000	2,870	4,539	1,000
Redemption of non-controlling interests		(23)	(392)	(549)	—	—	—
Repayment of subordinated liabilities		(264)	(624)	(880)	—	(193)	(8)
Dividends paid		(58)	(98)	(214)	(58)	(58)	(60)
Interest on subordinated liabilities		(1,114)	(1,062)	(895)	(1,031)	(970)	(680)
Net cash flows from financing activities		4,396	3,303	(1,480)	4,535	4,258	252
Effects of exchange rate changes on cash and cash equivalents		(3,347)	(1,196)	756	(2,938)	(1,322)	321
Net (decrease)/increase in cash and cash equivalents		(2,735)	6,659	36,239	911	10,953	35,663
Cash and cash equivalents at 1 January		135,836	129,177	92,938	125,332	114,379	78,716
Cash and cash equivalents at 31 December	36	133,101	135,836	129,177	126,243	125,332	114,379

The accompanying notes on pages 222 to 319, the accounting policies on pages 210 to 220 and the audited sections of the ‘Financial review: Risk and balance sheet management’ on pages 25 to 196 form an integral part of these financial statements.

Accounting policies

1. Presentation of accounts
The accounts are prepared on a going concern basis (see the Report of the directors, page 199) 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: its financial statements are prepared in accordance with IFRS as issued by the IASB.

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 two amendments to IFRS that were effective for the Group from 1 January 2012. They have not had a material effect on the financial statements of the Group or the Bank:

'Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12 'Income Taxes')' clarifies that recognition of deferred tax should have regard to the expected manner of recovery or settlement of the asset or liability.

'Disclosures - Transfers of Financial Assets (Amendments to IFRS 7 'Financial Instruments: Disclosures')' replaces IFRS 7's existing derecognition disclosure requirements with disclosures about (a) transferred assets that have not been derecognised in their entirety and (b) transferred assets that have been derecognised in their entirety but where the reporting entity has continuing involvement in those assets.

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 is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances. Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary 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.

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. Employees may receive variable compensation satisfied by cash, by debt instruments issued by RBS Group or by RBSG shares. 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. These estimated useful economic lives are:

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. The estimated useful lives of the Group's property, plant and equipment are:

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 their functional currency - the currency of the primary economic environment in which they operate - 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 profit or loss, other comprehensive income or 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 (see Note 11 Financial instruments - valuation).

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 impairment assessments, 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 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, renegotiation and similar events.

Except for US retail portfolios, where write off of the irrecoverable amount takes place within 60 - 180 days, the typical time frames from initial impairment to write off for the Group’s collectively-assessed portfolios are:

- Retail mortgages: write off occurs within 5 years, and is accelerated where accounts are closed earlier.
- Credit cards: write off of the irrecoverable amount takes place at 12 months; the rest is expected to be recovered over a further 3 years following which any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: write offs occur within 6 years.
- Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed 5 years. Business loans are generally written off within 5 years.

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 principally comprise 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 - 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 (see Note 11 Financial instruments - valuation).

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 the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement; if the Group has not retained control of the asset, it is derecognised.

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 (see Note 11 Financial instruments - valuation).

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 is reclassified from equity to 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 is reclassified from equity to 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, the 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 'Conceptual Framework for Financial Reporting'. 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.

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 credit 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 £144 million and a liability of £3,854 million were recognised on the balance sheet at 31 December 2012 (2011 - asset £24 million, liability £2,188 million; 2010 - asset £39 million, liability £2,229 million).

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2012 was £10,423 million (2011 - £10,662 million; 2010 - £10,725 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions, such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

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. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash generating units 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 cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit 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 cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to changes in assumptions is discussed in Note 18 on pages 275 and 276.

Provisions for liabilities

As set out in Note 23, at 31 December 2012 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £895 million (2011 - £745 million; 2010 - nil), Interest Rate Hedging Products, £676 million (2011 and 2010 - nil), LIBOR investigations, £381 million (2011 and 2010 - nil) and other regulatory proceedings and litigation, £284 million (2011 - £195 million; 2010 - £57 million). Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

Payment Protection Insurance - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 23.

Interest Rate Hedging Products - the Group has agreed to a redress exercise and past business reviews in relation to the sale of Interest Rate Hedging Products to some small and medium sized businesses classified as retail clients. The ultimate cost of this exercise to the Group is uncertain. Estimating the liability depends on a number of assumptions. These assumptions and the sensitivity of the provision to changes in them are discussed in Note 23.

Provisions for litigation - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 31.

Tax contingencies - determining the Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and liabilities in the period when the matter is resolved.

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 £3,066 million were recognised as at 31 December 2012 (2011 - £3,320 million; 2010 - £1,790 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 UK taxable profits against which the losses can be utilised. Business projections indicate that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within six years (2011 - six years). The Group's cumulative losses are principally attributable to the comparatively recent unparalleled market conditions. Deferred tax assets of £1,295 million (2011 - £743 million; 2010 - £298 million) have not been recognised in respect of tax losses carried forward in jurisdictions where doubt exists over the availability of future taxable profits. Further details about the Group's deferred tax assets are given in Note 24.

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 renegotiation; 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 2012, loans and advances to customers classified as loans and receivables totalled £392,901 million (2011 - £402,324 million; 2010 - £444,561 million) and customer loan impairment provisions amounted to £20,693 million (2011 - £18,469 million; 2010 - £16,682 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 mortgages, credit card receivables and other personal lending. 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.

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), cash collateral.

Debt securities in issue (held-for-trading and designated as at fair value through 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 243 to 258.

Accounting developments

International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2012 that had effective dates of 1 January 2013 or later.

Effective for 2013

The following IFRSs and amendments to IFRS have an effective date of 1 January 2013:

IFRS 10 'Consolidated Financial Statements' replaces SIC-12 'Consolidation - Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. IFRS 10 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 so as to vary returns for the reporting entity. IFRS 10 requires retrospective application. The Group continues to assess aspects of IFRS 10. However implementation is not expected to have a material effect on the Group's 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. IFRS 11 requires retrospective application. Implementation of IFRS 11 will not have a material effect on the Group's financial statements.

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.

IAS 27 ‘Separate Financial Statements’ comprises those parts of the existing IAS 27 that deal with separate financial statements. 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. These two revised standards will have no material effect on the Group’s financial statements.

Although IFRS 10-12 (as amended) and revised IAS 27 and IAS 28 have an effective date of 1 January 2013, they have been endorsed by the EU for application from 1 January 2014. However, early adoption is permitted and the Group implemented these standards from 1 January 2013.

IFRS 13 ‘Fair Value Measurement’ sets out a single IFRS framework for defining and measuring fair value and requiring disclosures about fair value measurements. Implementation of IFRS 13 will not have a material effect on the Group’s financial statements.

‘Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)’ amended IFRS 7 to require disclosures about the effects and potential effects on an entity’s financial position of offsetting financial assets and financial liabilities and related arrangements.

IAS 19 ‘Employee Benefits’ (revised) requires: 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 long-term bond rate, an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. If the Group had adopted IAS 19 revised as at 31 December 2012, profit after tax for the period ended 31 December 2012 would have been lower by £84 million (2011 - £151 million; 2010 - £104 million) and other comprehensive income after tax higher by the same amounts.

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 items that are subject to subsequent reclassification.

‘Annual Improvements 2009-2011 Cycle’ makes a number of minor changes to IFRSs. These will not have a material effect on the Group’s financial statements.

Effective after 2013

In October 2012, the IASB issued ‘Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)’. The amendments apply to ‘investment entities’: entities whose business is to invest funds solely for returns from capital appreciation, investment income or both and which evaluate the performance of their investments on a fair value basis. The amendments provide an exception to IFRS 10 by requiring investment entities to measure their subsidiaries (other than those that provide services related to the entity’s investment activities) at fair value through profit or loss, rather than consolidate them. The amendments are effective from 1 January 2014.

In December 2011, the IASB issued ’Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)’. The amendments add application guidance to IAS 32 to address inconsistencies identified in applying some of the standard’s criteria for offsetting financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after 1 January 2014 and must be applied retrospectively.

The Group is reviewing these amendments to determine their effect on the Group’s financial reporting.

In November 2009, the IASB issued IFRS 9 ‘Financial Instruments’ 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 2011, 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. 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 results of IASB's reconsideration of IFRS 9’s classification and measurement requirements and the outcome of the other phases in the development of IFRS 9.

1 Net interest income

	Group		
	2012 £m	2011 £m	2010 £m
Loans and advances to customers	15,564	16,716	17,068
Loans and advances to banks	515	561	348
Debt securities	1,477	1,833	2,001
Interest receivable	17,556	19,110	19,417
Customer accounts: demand deposits	768	761	701
Customer accounts: savings deposits	1,608	1,343	1,410
Customer accounts: other time deposits	837	830	826
Deposits by banks	489	646	892
Debt securities in issue	1,780	3,036	2,758
Subordinated liabilities	1,207	1,034	816
Internal funding of trading business	235	162	(97)
Interest payable	6,924	7,812	7,306
Net interest income	10,632	11,298	12,111

2 Non-interest income

	Group		
	2012 £m	2011 £m	2010 £m
Fees and commissions receivable			
Payment services	1,301	1,388	1,610
Credit and debit card fees	1,078	1,088	2,408
Lending (credit facilities)	1,437	1,580	1,531
Brokerage	519	587	499
Trade finance	227	281	262
Investment management	421	434	490
Other	575	540	791
	5,558	5,898	7,591
Fees and commissions payable	(963)	(1,047)	(2,060)
Income from trading activities (1)			
Foreign exchange	632	944	907
Interest rate	1,777	797	2,169
Credit	797	(219)	(359)
Changes in the fair value of own debt and derivative liabilities attributable to own credit			
- debt securities in issue	(1,471)	225	(75)
- derivative liabilities	(302)	66	28
Equities	78	263	183
Commodities	(1)	3	387
Other	1	(65)	121
	1,511	2,014	3,361
Gain on redemption of own debt (2)	454	255	502
Other operating income			
Operating lease and other rental income	876	1,306	1,396
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	(1,998)	410	63
- subordinated liabilities	(133)	96	(19)
Changes in the fair value of securities and other financial assets and liabilities	69	187	17
Changes in the fair value of investment properties	(148)	(139)	(405)
Profit on sale of securities	1,803	867	253
Profit on sale of property, plant and equipment	21	11	50
Profit/(loss) on sale of subsidiaries and associates	150	(67)	675
Dividend income (4)	234	216	176
Share of (losses)/profits of associated entities	(5)	21	27
Other income (5)	427	480	(34)
	1,296	3,388	2,199

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.
(2) In March 2012 and September 2012, the Group redeemed certain notes resulting in net gains totalling £454 million being credited to profit or loss. 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 May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. Gains of £502 million were credited to profit or loss in 2010. 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 £179 million (2011 - £165 million; 2010 - £124 million) arising from investments in fellow subsidiaries of the RBS Group and consequently subject to the RBS Group's capital management policy (see Note 30).
(5) Includes income from activities other than banking.

3 Operating expenses

	Group		
	2012 £m	2011 £m	2010 £m
Wages, salaries and other staff costs	6,438	6,291	6,460
Bonus tax	—	78	50
Social security costs	531	548	537
Share-based compensation	126	197	397
Pension costs			
- defined benefit schemes (see Note 4)	400	329	489
- curtailment gains (see Note 4)	(38)	—	(78)
- defined contribution schemes	16	69	25
Staff costs	7,473	7,512	7,880
Premises and equipment	2,080	2,083	1,909
Other administrative expenses (1)	5,468	4,229	2,996
Property, plant and equipment (see Note 19)	1,064	1,197	1,335
Intangible assets (see Note 18)	550	393	354
Depreciation and amortisation	1,614	1,590	1,689
Write-down of goodwill and other intangible assets (see Note 18)	51	80	1
	16,686	15,494	14,475

Note:
(1) Includes Bank levy, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs and regulatory fines, which are discussed in more detail below.

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.

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 levy is not charged on the first £20 billion of chargeable liabilities.

The levy was charged at a rate of 0.088 per cent for 2012. Three different rates applied during 2011, these average to 0.075 per cent. The cost of the levy to the RBS Group for 2012 is £175 million (2011 - £300 million) (included in Other administrative expenses). As the RBS Group continues to target a reduction in wholesale funding, the cost should decline over time absent further rate increase. The levy for 2013 is currently 0.13 per cent.

Payment Protection Insurance (PPI)
To reflect current experience of PPI complaints received, the Group increased its provision for PPI by £1,110 million in 2012 (2011 - £850 million), bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion (59%) in redress had been paid by 31 December 2012. Of the £2.2 billion cumulative charge, £2 billion relates to redress and £0.2 billion to administrative expenses. The eventual cost is dependent upon complaint volumes, uphold rates and average redress costs. Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. The Group will continue to monitor the position closely and refresh its assumptions as more information becomes available.

Interest Rate Hedging Products redress and related costs
Following an industry-wide review conducted in conjunction with the Financial Services Authority, a charge of £700 million has been booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses, classified as retail clients under FSA rules. Of the £700 million charge, £575 million relates to redress and the cost of closing out hedging positions, and £125 million to administrative expenses.

Regulatory fines
On 6 February, 2013 the RBS Group reached agreement with the Financial Services Authority, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The RBS Group continues to co-operate with these and other bodies in this regard and expects it will incur some additional financial penalties related to these matters.

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		
	2012 £m	2011 £m	2010 £m
Staff costs	—	30	155
Premises and equipment	3	20	2
Other administrative expenses	2	45	78
Depreciation and amortisation	—	10	16
	5	105	251

Restructuring costs included in operating expenses comprise:

	2012 £m	2011 £m	2010 £m
Staff costs	575	297	296
Premises and equipment	119	136	101
Other administrative expenses	214	209	95
Depreciation and amortisation	142	—	—
	1,050	642	492

Divestment costs included in operating expenses comprise:

	2012 £m	2011 £m	2010 £m
Staff costs	111	84	51
Premises and equipment	(2)	11	6
Other administrative expenses	62	51	25
	171	146	82

The average number of persons employed, rounded to the nearest hundred, by the Group during the year, excluding temporary staff, was 108,600 (2011 - 111,500; 2010 - 114,600). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2012	2011	2010
UK Retail	27,500	29,200	30,300
UK Corporate	13,000	13,400	13,100
Wealth	5,000	5,400	5,200
International Banking	3,700	3,300	3,300
Ulster Bank	4,400	4,400	4,400
US Retail & Commercial	15,400	16,200	16,600
Markets	9,100	9,600	9,200
Central items	5,700	4,900	3,700
Core	83,800	86,400	85,800
Non-Core	1,500	1,700	2,300
Business Services	22,800	22,800	24,000
Total	108,100	110,900	112,100
UK	71,200	76,100	77,500
USA	21,900	22,900	23,700
Europe	8,100	5,300	5,500
Rest of the World	6,900	6,600	5,400
Total	108,100	110,900	112,100

3 Operating expenses continued

Share-based payments

As described in the Remuneration report in the RBS Group Annual Report and Accounts 2012, 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	2013 to 2019
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2013 to 2015
Restricted share awards	Senior employees	Awards of conditional shares	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2013 to 2015
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	2013 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.

The number of shares and exercise prices for all previous share awards have been adjusted for the sub-division and one-for-ten consolidation of RBS Group ordinary shares in June 2012.

Sharesave

	2012		2011 (1)		2010 (1)	
	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)
At 1 January	3.36	64	4.88	101	5.07	104
Granted	2.49	14	2.33	30	4.34	15
Exercised	2.37	—	3.80	(1)	3.80	(1)
Cancelled	3.76	(21)	4.11	(66)	4.47	(17)
At 31 December	2.86	57	3.36	64	4.88	101

Note:
(1) Adjusted for the sub-division and one-for-ten consolidation of RBS Group ordinary shares in June 2012.

Options are exercisable within six months of vesting; 0.2 million were exercisable at 31 December 2012 (2011 - 0.3 million; 2010 - 2.3 million). The weighted average share price at the date of exercise of options was £2.78 (2011 - £4.21; 2010 - £4.51). At 31 December 2012, exercise prices ranged from £2.33 to £39.27 and the average contractual life was 3.9 years (2011 - £2.33 to £39.27 and 3.7 years; 2010 - £3.80 to £39.27 and 3.3 years). The fair value of options granted in 2012 was £28 million (2011 - £43 million; 2010 - £48 million).

Deferred performance awards

	2012		2011		2010	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (1) (million)	Value at grant £m	Shares awarded (1) (million)
At 1 January	756	191	1,009	267	—	—
Granted	141	50	258	58	1,043	276
Forfeited	(98)	(25)	(47)	(13)	(34)	(9)
Vested	(538)	(143)	(464)	(121)	—	—
At 31 December	261	73	756	191	1,009	267

Note:
(1) Adjusted for the sub-division and one-for-ten consolidation of RBS Group ordinary shares in June 2012.

The awards granted in 2012 vest evenly over the following three anniversaries.

Restricted share awards

	2012		2011		2010	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (1) (million)	Value at grant £m	Shares awarded (1) (million)
At 1 January	100	30	110	34	117	33
Granted	—	—	—	—	26	6
Exercised	(49)	(17)	(6)	(3)	(6)	(2)
Lapsed	(35)	(10)	(4)	(1)	(27)	(3)
At 31 December	16	3	100	30	110	34

The market value of awards exercised in 2012 was £45 million (2011 - £11 million; 2010 - £6 million).

Long-term incentives

	2012			2011			2010		
	Value at grant £m	Shares awarded (million)	Options over shares (million)	Value at grant £m	Shares awarded (1) (million)	Options over shares (1) (million)	Value at grant £m	Shares awarded (1) (million)	Options over shares (1) (million)
At 1 January	345	58	37	219	25	38	122	1	41
Granted	157	59	—	154	37	1	115	24	—
Exercised	(15)	(4)	(1)	(6)	(1)	—	—	—	—
Lapsed	(112)	(15)	(16)	(22)	(3)	(2)	(18)	—	(3)
At 31 December	375	98	20	345	58	37	219	25	38

Note:
(1) Adjusted for the sub-division and one-for-ten consolidation of RBS Group ordinary shares in June 2012.

The market value of awards exercised in 2012 was £10 million (2011 - £5 million; 2010 - less than £1 million). There are vested options over 18 million shares exercisable up to 2019 (2011 - 4.8 million shares up to 2019; 2010 - 3.3 million shares up to 2020).

At 31 December 2012, a provision of £1 million had been made in respect of 0.1 million share awards and 0.3 million options over shares that may be cash-settled (2011 - £3 million in respect of 0.4 million share awards and 1.4 million options over shares; 2010 - £6 million in respect of 0.3 million share awards and 1.6 million options over shares).

The fair value of options granted in 2012 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 85% (2011 and 2010 - 88%) 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.

With effect from 1 October 2012, employees in the Main scheme and certain other UK schemes were offered a choice between accepting an increase in the charge made for membership of 5% of salary, or a retirement age of 65 for future benefits.

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)	2012 %	2011 %	2010 %
Discount rate	4.4	5.0	5.4
Expected return on plan assets	5.3	5.7	6.6
Rate of increase in salaries	1.7	1.8	1.8
Rate of increase in pensions in payment	2.6	2.8	3.1
Inflation assumption	2.8	2.9	3.2

Discount rate

The Group discounts its defined benefit pension obligations at discount rates determined by reference to the yield on 'high quality' corporate bonds.

The sterling yield curve (applied to 92% of the Group's defined benefit obligations) is constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The criteria include issuance size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed. In previous years, the discount rate was determined by reference to the upper quartile yield on the iBoxx over 15 year sterling corporate bond index, less a margin determined by reference to the shape of the yield curve and the spread of yields among the index's constituents.

Discount rates for other currencies are derived using a variety of methodologies. In the case of US dollar defined pension obligations, a matching portfolio of high-quality 'AA' corporate bonds is used for the first 30 years' cash flows; cash flows beyond 30 years are discounted using a yield curve determined in a similar way to the UK. For euro defined pension obligations, a similar approach to the UK has been used at 31 December 2012. However, at longer durations, rates are derived by extrapolating yields on 'A' and 'AAA' corporate bonds to derive equivalent 'AA' yields. Prior to 2012, extrapolation was not used at longer durations and different criteria were used to determine the reference pool of 'AA' bonds.

Major classes of plan assets as a percentage of total plan assets	2012 %	2011 %	2010 %
Quoted equities	25.0	23.1	28.1
Private equity	4.7	5.1	4.8
Index-linked bonds	28.7	24.0	23.9
Government fixed interest bonds	2.8	2.3	1.4
Corporate and other bonds	21.0	22.8	25.5
Hedge funds	2.5	2.6	3.7
Property	4.2	3.6	3.6
Derivatives	2.0	2.1	0.8
Cash and other assets	9.1	14.1	8.1
Equity exposure of equity futures	8.4	15.6	22.5
Cash exposure of equity futures	(8.4)	(15.3)	(22.4)
	100.0	100.0	100.0

The Main scheme, which represents 85% of plan assets at 31 December 2012 (2011 - 89%; 2010 - 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.

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2012			2011			2010		
	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	5,474	20	335	2,585	67	178	2,132	69	8
Interest rate swaps	19,304	3,424	2,811	15,149	2,232	1,864	10,727	270	110
Total return swaps	515	6	—	2,085	169	—	466	16	—
Currency swaps	2,539	326	259	2,861	116	117	(973)	—	1
Credit default swaps	709	11	12	238	6	—	—	—	—
Equity and bond futures	2,109	16	17	3,745	80	10	4,851	49	14
Currency forwards	8,551	41	—	2,078	8	—	4,883	35	91
Equity and bond call options	963	94	—	814	67	4	—	—	—
Equity and bond put options	963	13	31	665	11	—	—	—	—

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. The majority of swaps are with The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2012, the gross notional value of the swaps was £28,541 million (2011 - £22,918 million; 2010 - £12,352 million) and had a net positive fair value of £370 million (2011 - £431 million positive; 2010 - £236 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 £521 million of collateral at 31 December 2012 (2011 - £375 million; 2010 - £210 million).

Ordinary shares of the holding company with a fair value of £4 million (2011 - £3 million; 2010 - £9 million) are held by the Group's Main scheme which also holds other financial instruments issued by the Group with a value of £610 million (2011 - £424 million; 2010 - £264 million).

4 Pensions continued

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:

	2012 %	2011 %	2010 %
Quoted equities	7.8	7.8	7.9
Private equity	7.7	7.7	7.7
Index-linked bonds	3.2	3.1	4.2
Government fixed interest bonds	2.9	3.4	4.2
Corporate and other bonds	4.2	4.7	5.4
Hedge funds	6.0	6.0	5.3
Property	6.7	6.6	6.7
Cash and other assets	2.6	2.9	3.9
Equity exposure of equity futures	7.7	7.7	7.7
Cash exposure of equity futures	2.6	2.6	4.0
Total fund	5.3	5.7	6.6

Post-retirement mortality assumptions (Main scheme)	2012	2011	2010
Longevity at age 60 for current pensioners (years)			
Males	27.5	27.3	27.2
Females	29.8	29.6	29.6
Longevity at age 60 for future pensioners currently aged 40 (years)			
Males	29.5	29.3	29.3
Females	31.0	30.9	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 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 1 January 2012	23,830	25,994	2,164
Currency translation and other adjustments	(52)	(65)	(13)
Income statement			
Expected return	1,365		(1,365)
Interest cost		1,304	1,304
Current service cost		412	412
Less direct contributions from other scheme members		(31)	(31)
Past service cost		80	80
Gains on curtailments and settlements		(38)	(38)
	1,365	1,727	362
Statement of comprehensive income			
- Actuarial gains and losses	364	2,606	2,242
Transfers from fellow subsidiaries	1,009	852	(157)
Contributions by employer	888	—	(888)
Contributions by plan participants and other scheme members	42	42	—
Benefits paid	(897)	(897)	—
Assets and liabilities distributed on settlements	(123)	(123)	—
Expenses included in service cost	(67)	(67)	—
At 31 December 2012	26,359	30,069	3,710

Net pension deficit comprises	2012 £m	2011 £m	2010 £m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 20)	(144)	(24)	(39)
Net liabilities of schemes in deficit	3,854	2,188	2,229
	3,710	2,164	2,190

Curtailment gains of £9 million (2011 - nil; 2010 - £78 million) were recognised in 2010 arising from changes to pension benefits in a subsidiary's scheme. Settlement gains of £29 million were recognised in 2012 (2011 and 2010 - nil) in respect of subsidiary schemes.

RBS Group and the Trustees of the Main scheme agreed the funding valuation as at 31 March 2010 in 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, 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 £250 million for future accrual benefits.

The Group expects to contribute a total of £766 million to its defined benefit pension schemes in 2013. Of the net liabilities of schemes in deficit, £160 million (2011 - £159 million; 2010 - £155 million) relates to unfunded schemes.

Cumulative net actuarial losses of £6,543 million (2011 - £4,301 million; 2010 - £3,680 million) have been recognised in the statement of comprehensive income, of which £5,367 million losses (2011 - £3,589 million; 2010 - £3,252 million) relate to the Main scheme.

4 Pensions continued

History of defined benefit schemes	Group 2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of plan assets	26,359	23,830	21,687	18,805	16,651
Present value of defined benefit obligations	30,069	25,994	23,877	21,399	18,093
Net deficit	3,710	2,164	2,190	2,594	1,442
Experience (losses)/gains on plan liabilities	(202)	(224)	(851)	139	(91)
Experience gains/(losses) on plan assets	364	610	1,789	1,157	(5,318)
Actual return/(loss) on pension schemes assets	1,729	2,031	3,055	2,310	(3,917)
Actual return/(loss) on pension schemes assets - %	7.1%	9.3%	16.3%	13.9%	(19.2%)

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		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
0.25% increase in the discount rate	(75)	(18)	(23)	(1,337)	(1,137)	(1,037)
0.25% increase in inflation	66	68	67	1,096	997	886
0.25% additional rate of increase in pensions in payment	44	44	42	755	671	580
0.25% additional rate of increase in deferred pensions	19	22	22	316	304	286
0.25% additional rate of increase in salaries	12	9	9	122	76	77
Longevity increase of 1 year	38	40	38	705	653	573

5 Auditor's remuneration

Amounts paid to the Group's auditor for statutory audit and other services are set out below:

	Group 2012 £m	2011 £m
Fees payable for the audit of the Group's annual accounts	5.5	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	7.9	7.8
Total audit and audit-related assurance services fees	13.4	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 2012 £m	2011 £m	2010 £m
Current tax			
(Charge)/credit for the year	(306)	47	(269)
Over provision in respect of prior years	49	173	13
	(257)	220	(256)
Deferred tax			
Charge for the year	(56)	(953)	(389)
(Under)/over provision in respect of prior years	(51)	2	(68)
Tax charge for the year	(364)	(731)	(713)

The actual tax charge differs from the expected tax credit computed by applying the standard rate of UK corporation tax of 24.5% (2011 - 26.5%; 2010 - 28%) as follows:

	2012 £m	2011 £m	2010 £m
Expected tax credit	836	229	48
Losses in year where no deferred tax asset recognised	(253)	(334)	(292)
Foreign profits taxed at other rates	(381)	(373)	(496)
UK tax rate change impact (1)	(152)	(141)	31
Unrecognised timing differences	59	(20)	11
Non-deductible goodwill impairment	(10)	(21)	—
Items not allowed for tax			
- losses on disposals and write-downs	(36)	(31)	(95)
- non-deductible UK bank levy	(43)	(80)	—
- regulatory fines	(93)	—	—
- employee share schemes	(9)	(113)	(32)
- other disallowable items	(209)	(287)	(268)
Non-taxable items			
- gain on sale of RBS Aviation Capital	26	—	—
- gain on sale of Global Merchant Services	—	12	221
- gain on redemption of own debt	—	—	1
- other non-taxable items	75	249	218
Taxable foreign exchange movements	31	4	(5)
Reduction in carrying value of deferred tax asset in respect of losses in Ireland	(203)	—	—
Adjustments in respect of prior years (2)	(2)	175	(55)
Actual tax charge	(364)	(731)	(713)

Notes:
(1) In recent years the UK Government has steadily reduced the rate of UK corporation tax, with the latest enacted rate standing at 23% with effect from 1 April 2013. Further reductions of the rate to 21% with effect from 1 April 2014 and 20% from 1 April 2015 were announced on 5 December 2012 and 20 March 2013 respectively, but not substantively enacted at the balance sheet date. Accordingly the closing deferred tax assets and liabilities have been calculated at 23%.
(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		
	2012 £m	2011 £m	2010 £m
Non-cumulative preference shares of US$0.01	41	40	42
Non-cumulative preference shares of €0.01	17	18	18
Total	58	58	60

Note:
(1) Between 1 January 2013 and the date of approval of these accounts, dividends amounting to US$29 million have been declared in respect of equity preference shares for payment on 28 March 2013.

8 Ordinary dividends

The Bank did not pay an ordinary dividend in 2012, 2011 or 2010.

9 (Loss)/profit 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, £844 million (2011 - £1,054 million profit; 2010 - £274 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 with assets and liabilities outside the scope of IAS 39 shown separately.

	Group								
2012	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	—	—		—	74,524				74,524
Loans and advances to banks									
- amounts due from fellow subsidiaries	4,401	1		—	17,473				21,875
- reverse repos	33,388	—		—	1,056				34,444
- other (1)	12,022	—		—	13,726				25,748
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	31	—			1,835				1,866
- reverse repos	70,010	—		—	33				70,043
- other	24,474	189		—	391,033		7,232		422,928
Debt securities (2)	77,030	697		54,561	4,297				136,585
Equity shares	12,311	484		1,077	—				13,872
Settlement balances	—	—		—	5,717				5,717
Derivatives									
- amounts due from holding company and fellow subsidiaries	7,200		—						7,200
- other	429,688		8,213						437,901
Intangible assets								12,403	12,403
Property, plant and equipment								9,694	9,694
Deferred tax								3,066	3,066
Prepayments, accrued income and other assets	—	—		—	—			6,104	6,104
Assets of disposal groups								304	304
	670,555	1,371	8,213	55,638	509,694		7,232	31,571	1,284,274
Liabilities									
Deposits by banks									
- amounts due to fellow subsidiaries	2,188	—				3,875			6,063
- repos	36,361	—				7,962			44,323
- other (3)	29,505	—				22,369			51,874
Customer accounts									
- amounts due to holding company and fellow subsidiaries	123	—				5,655			5,778
- repos	82,213	—				5,784			87,997
- other (4)	11,314	6,323				407,785			425,422
Debt securities in issue (5)	10,820	22,183				50,275			83,278
Settlement balances	—	—				5,832			5,832
Short positions	27,541	—							27,541
Derivatives									
- amounts due to holding company and fellow subsidiaries	5,580		—						5,580
- other	426,863		3,642						430,505
Accruals, deferred income and other liabilities	—	—				1,684	12	10,331	12,027
Retirement benefit liabilities								3,854	3,854
Deferred tax								789	789
Subordinated liabilities									
- amounts due to holding company	—	—				18,184			18,184
- other	—	538				15,129			15,667
Liabilities of disposal groups								135	135
	632,508	29,044	3,642			544,534	12	15,109	1,224,849
Equity									59,425
									1,284,274

For the notes relating to this table refer to page 237.

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
	Group								
Assets									
Cash and balances at central banks	—	—		—	68,487				68,487
Loans and advances to banks									
- amounts due from fellow subsidiaries	13,796	199		—	13,237				27,232
- reverse repos	34,659	—		—	3,101				37,760
- other (1)	18,595	—		—	13,553				32,148
Loans and advances to customers									
- amounts due from holding company and fellow subsidiaries	83	—		—	709				792
- reverse repos	53,583	—		—	7,674				61,257
- other	24,514	476		—	393,941		8,419		427,350
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									
- amounts due from holding company and fellow subsidiaries	10,380		—						10,380
- other	515,375		7,052						522,427
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									
- amounts due to fellow subsidiaries	5,879	—				6,066			11,945
- repos	23,342	—				15,558			38,900
- other (3)	33,128	—				25,124			58,252
Customer accounts									
- amounts due to holding company and fellow subsidiaries	234	—				2,945			3,179
- repos	65,526	—				22,651			88,177
- other (4)	13,435	5,627				361,970			381,032
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									
- amounts due to holding company and fellow subsidiaries	11,377		—						11,377
- other	512,660		3,799						516,459
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									
- amounts due to holding company	—	—				15,772			15,772
- other	—	465				16,087			16,552
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 237.

10 Financial instruments - classification continued

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
	Group								
Assets									
Cash and balances at central banks	—	—		—	49,838				49,838
Loans and advances to banks									
- amounts due from fellow subsidiaries	2,725	186		—	1,937				4,848
- reverse repos	38,215	—		—	2,315				40,530
- other (1)	25,825	—		—	16,302				42,127
Loans and advances to customers									
- amounts due from fellow subsidiaries	1,464	—		—	482				1,946
- reverse repos	41,110	—		—	8,050				49,160
- other	19,657	1,092		—	436,029		10,437		467,215
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									
- amounts due from holding company and fellow subsidiaries	17,469		—						17,469
- other	406,911		4,625						411,536
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									
- amounts due to fellow subsidiaries	4,621	—				2,005			6,626
- repos	20,555	—				8,039			28,594
- other (3)	28,167	—				21,833			50,000
Customer accounts									
- amounts due to holding company and fellow subsidiaries	935	—				7,999			8,934
- repos	52,952	—				24,814			77,766
- other (4)	12,529	4,824				368,272			385,625
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									
- amounts due to holding company and fellow subsidiaries	14,255		—						14,255
- other	404,294		2,420						406,714
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									
- amounts due to holding company	—	—				15,028			15,028
- other	—	468				16,527			16,995
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 related to this table refer to page 237.

The above includes amounts due from/to:

	Group					
	2012		2011		2010	
	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m	Holding company £m	Fellow subsidiaries £m
Assets						
Loans and advances to customers	1,455	411	322	470	—	1,946
Derivatives	7	7,193	79	10,301	231	17,238
Liabilities						
Customer accounts	5,777	1	2,596	583	4,507	4,427
Derivatives	511	5,069	1,502	9,875	1,475	12,780

Notes:
(1) Includes items in the course of collection from other banks of £1,531 million (2011 - £1,470 million; 2010 - £1,958 million).
(2) Debt securities balances with Group companies are shown on pages 117 to 119.
(3) Includes items in the course of transmission to other banks of £521 million (2011 - £506 million; 2010 - £577 million).
(4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £305 million (2011 - £166 million; 2010 - £233 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 £79,565 million (2011 - £112,220 million; 2010 - £109,528 million) and certificates of deposit and other commercial paper of £3,713 million (2011 - £28,617 million; 2010 - £55,134 million).

Amounts included in the consolidated income statement:

	Group		
	2012 £m	2011 £m	2010 £m
(Losses)/gains on financial assets/liabilities designated as at fair value through profit or loss	(1,973)	795	169
(Losses)/gains on disposal or settlement of loans and receivables	(76)	13	78

10 Financial instruments - classification continued

The following tables show the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39 with assets and liabilities outside the scope of IAS 39 shown separately.

2012	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	—	—		—	70,374			70,374
Loans and advances to banks								
- amounts due from subsidiaries	7,111	1		—	58,559			65,671
- reverse repos	25,594	—		—	—			25,594
- other (1)	12,015	—		—	6,291			18,306
Loans and advances to customers								
- amounts due from holding company and subsidiaries	19,254	—		12	36,202			55,468
- reverse repos	42,972	—		—	23			42,995
- other	23,555	134		—	149,397			173,086
Debt securities (2)	42,899	1,242		43,059	35,247			122,447
Equity shares	12,278	274		214	—			12,766
Investment in Group undertakings							40,262	40,262
Settlement balances	—	—		—	3,090			3,090
Derivatives								
- amounts due from holding company and subsidiaries	14,953		—					14,953
- other	428,261		6,624					434,885
Intangible assets							1,033	1,033
Property, plant and equipment							2,430	2,430
Deferred tax							2,878	2,878
Prepayments, accrued income and other assets	—	—		—	—		4,433	4,433
	628,892	1,651	6,624	43,285	359,183		51,036	1,090,671
Liabilities								
Deposits by banks								
- amounts due to subsidiaries	6,897	84				123,145		130,126
- repos	27,499	—				6,078		33,577
- other (3)	29,087	—				16,793		45,880
Customer accounts								
- amounts due to holding company and subsidiaries	18,900	567				65,525		84,992
- repos	37,460	—				4,727		42,187
- other (4)	11,299	1,024				116,832		129,155
Debt securities in issue (5)	10,820	21,220				39,454		71,494
Settlement balances	—	—				2,878		2,878
Short positions	14,074	—						14,074
Derivatives								
- amounts due to holding company and subsidiaries	9,321		—					9,321
- other	428,082	—	1,749					429,831
Accruals, deferred income and other liabilities	—	—				1,106	6,249	7,355
Retirement benefit liabilities							56	56
Subordinated liabilities								
- amounts due to holding company	—	—				18,184		18,184
- other	—	538				12,913		13,451
	593,439	23,433	1,749			407,635	6,305	1,032,561
Equity								58,110
								1,090,671

For the notes relating to this table refer to page 241.

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	Non-financial assets/ liabilities £m	Total £m
	Bank							
Assets								
Cash and balances at central banks	—	—		—	64,261			64,261
Loans and advances to banks								
- amounts due from subsidiaries	14,886	199		—	43,887			58,972
- reverse repos	25,396	—		—	14			25,410
- other (1)	18,589	—		—	6,069			24,658
Loans and advances to customers								
- amounts due from holding company and subsidiaries	13,181	—		—	132,576			145,757
- reverse repos	40,797	—		—	1,251			42,048
- other	23,785	386		—	139,147			163,318
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								
- amounts due from holding company and subsidiaries	18,457		—					18,457
- other	513,041		5,799					518,840
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								
- amounts due to subsidiaries	10,257	—				147,742		157,999
- repos	21,406	—				7,311		28,717
- other (3)	32,389	—				15,192		47,581
Customer accounts								
- amounts due to holding company and subsidiaries	23,061	756				139,798		163,615
- repos	32,458	—				4,670		37,128
- other (4)	13,310	832				82,017		96,159
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								
- amounts due to holding company and subsidiaries	15,505		—					15,505
- other	513,599		1,751					515,350
Accruals, deferred income and other liabilities	—	—				1,130	7,710	8,840
Retirement benefit liabilities							25	25
Subordinated liabilities								
- amounts due to holding company	—	—				15,772		15,772
- other	—	465				13,777		14,242
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 241.

10 Financial instruments - classification continued

	Bank							
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	Non-financial assets/ liabilities £m	Total £m
Assets								
Cash and balances at central banks	—	—		—	44,921			44,921
Loans and advances to banks								
- amounts due from subsidiaries	3,445	186		—	36,496			40,127
- reverse repos	27,359	—		—	44			27,403
- other (1)	25,783	—		—	7,652			33,435
Loans and advances to customers								
- amounts due from subsidiaries	9,671	—		—	118,146			127,817
- reverse repos	29,900	—		—	1,324			31,224
- other	18,566	561		—	171,011			190,138
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								
- amounts due from holding company and subsidiaries	24,085		—					24,085
- other	404,738		3,989					408,727
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								
- amounts due to subsidiaries	9,487	—				129,119		138,606
- repos	17,551	—				2,224		19,775
- other (3)	27,294	—				12,298		39,592
Customer accounts								
- amounts due to holding company and subsidiaries	23,375	652				145,131		169,158
- repos	20,384	—				98		20,482
- other (4)	12,442	976				92,300		105,718
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								
- amounts due to holding company and subsidiaries	18,355		—					18,355
- other	405,139		1,009					406,148
Accruals, deferred income and other liabilities	—	—				1,094	6,964	8,058
Retirement benefit liabilities							23	23
Subordinated liabilities								
- amounts due to holding company	—	—				15,028		15,028
- other	—	468				13,803		14,271
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 241.

The above includes amounts due from/to:

	Bank 2012			2011			2010		
	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	—	21,875	43,796	—	118	58,854	—	169	39,958
Loans and advances to customers	1,455	290	53,723	322	27,131	118,304	—	5,159	122,658
Derivatives	7	7,186	7,760	79	10,297	8,081	231	17,224	6,630
Liabilities									
Deposits by banks	—	5,015	125,111	—	672	157,327	—	311	138,295
Customer accounts	5,777	1	79,214	2,596	10,339	150,680	4,507	6,090	158,561
Derivatives	511	5,069	3,741	1,502	9,870	4,133	1,475	12,770	4,110

Notes:

(1) Includes items in the course of collection from other banks of £303 million (2011 - £316 million; 2010 - £463 million).

(2) Debt securities balances with Group companies are shown on page 120.

(3) Includes items in the course of transmission to other banks of £63 million (2011 - £138 million; 2010 - £266 million).

(4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £43 million higher (2011 - £46 million higher; 2010 - £57 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 £68,530 million (2011 - £97,838 million; 2010 - £89,492 million) and certificates of deposit and other commercial paper of £2,964 million (2011 - £16,686 million; 2010 - £38,576 million).

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, 2011 or 2012.

	Group					
			Amount recognised in income statement			
2012	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 result of reclassification £m
Reclassified from HFT to LAR						
Loans	2,892	2,546	42	15	517	460
Debt securities	1,548	1,232	(107)	(2)	184	293
	4,440	3,778	(65)	13	701	753
Reclassified from HFT to AFS (1)						
Debt securities	891	891	38	8	13	(33)
Reclassified from AFS to LAR (2)						
Debt securities	167	90	7	—	7	—
	5,498	4,759	(20)	21	721	720

For the notes to this table refer to the following page.

10 Financial instruments - classification continued

2011	Group Carrying value £m	Fair value £m	Amount recognised in income statement: Income £m	Impairment releases/(losses) £m	Amount that would have been recognised had reclassification not occurred £m	Reduction/(increase) in profit or loss as 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)
2010						
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

Notes:
(1) The amount taken to AFS reserves was £77 million (2011 - £17 million; 2010 - £137 million).
(2) The amount that would have been taken to AFS reserves if reclassification had not occurred is £1 million (2011 - £24 million; 2010 - £98 million).

The table below shows the carrying value and fair value of reclassifications undertaken by the Bank in 2008 and 2009.

	Bank 2012 Carrying value £m	2012 Fair value £m	2011 Carrying value £m	2011 Fair value £m	2010 Carrying value £m	2010 Fair value £m
Reclassified from HFT to LAR						
Loans	2,555	2,215	3,838	3,036	6,182	5,330
Debt securities	1,548	1,232	2,268	1,656	3,008	2,678
	4,103	3,447	6,106	4,692	9,190	8,008
Reclassified from HFT to AFS (1)						
Debt securities	891	891	2,601	2,601	4,395	4,395
Reclassified from AFS to LAR (2)						
Debt securities	167	90	248	229	422	380
	5,161	4,428	8,955	7,522	14,007	12,783

Notes:
(1) The amount taken to AFS reserves was £77 million (2011 - £17 million; 2010 - £137 million).
(2) The amount that would have been taken to AFS reserves if reclassification had not occurred is £1 million (2011 - £24 million; 2010 - £98 million).

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 Markets and Non-Core.

During 2012, the Group has 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 in the RBS Group 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 Markets 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, Markets 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 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, Markets Chief Financial Officer, the Non-Core Chief Financial Officer, the Head of QuaRC, the Head of GPU and representation from Front Office Trading and Finance.

Valuation issues, adjustments and reserves are reported to Markets, Non-Core and Group Audit Committees. Key judgmental issues are described in reports submitted to these Audit Committees.

Market risk metrics such as value-at-risk (VaR) and stressed value-at-risk (SVaR) cover financial instruments in Markets and Non-Core. The Group has a framework for quantify those market risks not adequately captured by standard market risk framework such as VaR and SVaR - Risks not in VaR. Refer to page 150 for details.

New products

The RBS Group has formal review procedures owned by RBS 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 248) 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), Overnight Index Swaps rate (OIS) and other 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. Markets 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 credit valuation adjustments and other reserves.

Credit valuation adjustments

Credit valuation adjustments (CVA) 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. Certain credit derivative product company exposures were restructured during the first half of the year and the CVA methodology applied to these exposures was updated to reflect the revised risk mitigation strategy that is now in place. There were no other changes to valuation methodologies.

	2012 £m	2011 £m	2010 £m
Credit valuation adjustments			
- monoline insurers	181	1,012	800
- credit derivative product companies	314	1,034	490
- other counterparties	2,186	2,069	1,609
	2,681	4,115	2,899
Bid-offer, liquidity, funding, valuation and other reserves (1)	1,980	2,652	2,607
Valuation reserves	4,661	6,767	5,506

Note:
(1) Includes bid-offer reserves of £621 million (2011 - £787 million), funding valuation adjustment of £475 million (2011 - £552 million), product and deal specific reserves of £758 million (2011 - £1,023 million), valuation basis reserves of £96 million (2011 - £241 million) and other reserves of £30 million (2011 - £49 million).

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 16% and 49% respectively (2011 - 13% and 47%; 2010 - 13% and 49%), 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. Trade restructurings during the second half of 2012 provided market evidence of the fair value of certain CDPC exposures resulting in valuation adjustments of £279 million at 31 December 2012. These adjustments are also included in the table above. For trades facing other CDPCs, 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 these CDPC exposures is estimated with reference to risk mitigation strategies.

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.

Where exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, 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 together with exposures to counterparties which are considered to be close to default. 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 credit derivative trades where the default risk of the referenced entity is correlated with the counterparty risk. The risk also 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.

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.

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS rates at an individual trade level. Uncollateralised derivatives are discounted with reference to funding levels by applying a funding spread over benchmark interest rates on a portfolio basis (funding valuation adjustment).

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 2012, net gains of £150 million (2011 and 2010 - £156 million) were carried forward on the balance sheet. During the year, net gains of £38 million (2011 - £87 million; 2010 - £96 million) were deferred and £44 million (2011 - £87 million; 2010 - £99 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 to 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). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of the Group's derivative financial liabilities has also been adjusted to reflect the 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, is 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, provided the liability is not repaid at a premium or a discount.

The following table shows the cumulative own credit adjustment recorded on securities held-for-trading (HFT), classified as fair value through profit or loss (DFV) and derivative liabilities.

Cumulative own credit adjustment (1)	Debt securities in issue (2) HFT £m	DFV £m	Total £m	Subordinated liabilities DFV £m	Total £m	Derivatives £m	Total (3) £m
2012	(648)	41	(607)	104	(503)	240	(263)
2011	882	1,995	2,877	241	3,118	540	3,658
2010	517	510	1,027	138	1,165	444	1,609

Carrying values of underlying liabilities	£bn	£bn	£bn	£bn	£bn
2012	10.8	22.2	33.0	0.5	33.5
2011	11.4	26.8	38.2	0.5	38.7
2010	7.7	11.0	18.7	0.5	19.2

Notes:
(1) The own credit adjustment does not alter cash flows and is not used for performance management. It is disregarded for regulatory capital reporting purposes and will reverse over time as the liabilities mature.
(2) Consists of wholesale and retail note issuances.
(3) 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.

11 Financial instruments - valuation continued

Valuation hierarchy

The following tables show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy - level 1, level 2 and level 3.

	2012				2011				2010			
	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	—	49.4	0.4	49.8	—	66.8	0.4	67.2	—	66.6	0.4	67.0
Loans and advances to customers	—	94.2	0.5	94.7	—	78.2	0.4	78.6	—	63.1	0.2	63.3
Debt securities	79.9	47.5	4.9	132.3	101.2	55.0	7.5	163.7	92.7	59.3	7.3	159.3
Of which ABS												
- RMBS	—	27.9	0.9	28.8	—	35.0	0.6	35.6	—	32.1	0.4	32.5
- CMBS	—	3.8	—	3.8	—	2.1	0.1	2.2	—	3.5	0.2	3.7
- CDO	—	—	0.6	0.6	—	—	1.7	1.7	—	0.8	2.4	3.2
- CLO	—	0.5	2.4	2.9	—	1.2	3.7	4.9	—	3.5	2.1	5.6
- other	—	1.6	0.4	2.0	—	2.0	0.8	2.8	—	2.0	1.4	3.4
Equity shares	12.3	1.1	0.5	13.9	10.2	1.0	0.6	11.8	0.7	1.0	0.6	2.3
Derivatives	0.4	440.8	3.9	445.1	0.2	525.8	6.8	532.8	1.7	421.8	5.5	429.0
	92.6	633.0	10.2	735.8	111.6	726.8	15.7	854.1	95.1	611.8	14.0	720.9
Proportion	12.6%	86.0%	1.4%	100%	13.1%	85.1%	1.8%	100%	13.2%	84.9%	1.9%	100%
Of which is classified as AFS (2)												
Debt securities	31.2	20.4	3.0	54.6	40.6	25.1	5.7	71.4	35.6	27.5	4.3	67.4
Of which AFS ABS												
- RMBS	—	12.8	0.2	13.0	—	17.9	0.2	18.1	—	15.9	0.2	16.1
- CMBS	—	2.3	—	2.3	—	0.7	—	0.7	—	1.2	0.1	1.3
- CDO	—	—	0.5	0.5	—	—	1.4	1.4	—	0.5	1.4	1.9
- CLO	—	0.3	1.9	2.2	—	0.7	3.3	4.0	—	3.4	1.5	4.9
- other	—	0.8	0.2	1.0	—	1.1	0.7	1.8	—	1.0	1.1	2.1
Equity shares	0.2	0.7	0.1	1.0	0.3	0.8	0.2	1.3	0.3	0.9	0.2	1.4
Total AFS assets (2)	31.4	21.1	3.1	55.6	40.9	25.9	5.9	72.7	35.9	28.4	4.5	68.8
Liabilities												
Deposits by banks and customers	—	168.0	—	168.0	—	147.2	—	147.2	—	124.4	0.2	124.6
Debt securities in issue	—	31.7	1.3	33.0	—	36.4	1.8	38.2	—	18.5	0.2	18.7
Short positions	23.6	4.0	—	27.6	34.1	6.1	0.2	40.4	33.5	6.8	0.8	41.1
Derivatives	0.8	431.8	3.5	436.1	0.4	523.4	4.0	527.8	0.2	419.4	1.4	421.0
Subordinated liabilities	—	0.5	—	0.5	—	0.5	—	0.5	—	0.5	—	0.5
	24.4	636.0	4.8	665.2	34.5	713.6	6.0	754.1	33.7	569.6	2.6	605.9
Proportion	3.7%	95.6%	0.7%	100%	4.6%	94.6%	0.8%	100%	5.6%	94.0%	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 loans, 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, certain emerging markets instruments, 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.

	2012			2011			2010		
		Sensitivity			Sensitivity			Sensitivity	
	Balance £bn	Favourable £m	Unfavourable £m	Balance £bn	Favourable £m	Unfavourable £m	Balance £bn	Favourable £m	Unfavourable £m
Assets									
Loans and advances to banks	0.4	50	(30)	0.4	40	(50)	0.4	40	(20)
Loans and advances to customers	0.5	90	(40)	0.4	80	(20)	0.2	30	(40)
Debt securities									
Corporate	0.1	10	(10)	0.5	30	(30)	0.7	190	(140)
Financial institutions	4.8	350	(190)	7.0	510	(140)	6.6	510	(160)
	4.9	360	(200)	7.5	540	(170)	7.3	700	(300)
Of which ABS									
- RMBS	0.9	40	(50)	0.6	60	(40)	0.4	70	(50)
- CMBS	—	—	—	0.1	10	—	0.2	50	(30)
- CDO	0.5	80	(10)	1.7	210	(20)	2.4	180	(20)
- CLO	2.4	120	(50)	3.7	90	(40)	2.1	180	(50)
- other	0.4	50	(10)	0.9	110	(20)	1.4	150	(90)
Equity shares	0.5	70	(80)	0.6	80	(90)	0.6	110	(120)
Derivatives									
Credit	1.6	230	(230)	3.8	670	(390)	3.6	1,160	(1,080)
Other	2.3	420	(300)	3.0	180	(190)	1.9	150	(140)
	3.9	650	(530)	6.8	850	(580)	5.5	1,310	(1,220)
	10.2	1,220	(880)	15.7	1,590	(910)	14.0	2,190	(1,700)
Liabilities									
Deposits	—	30	(30)	—	20	(20)	0.2	60	(80)
Debt securities in issue	1.3	50	(60)	1.8	50	(30)	0.2	30	(40)
Short positions	—	—	—	0.2	10	(30)	0.8	20	(50)
Derivatives									
Credit	0.8	40	(90)	1.7	370	(170)	0.3	40	(80)
Other	2.7	110	(70)	2.3	140	(140)	1.1	60	(100)
	3.5	150	(160)	4.0	510	(310)	1.4	100	(180)
	4.8	230	(250)	6.0	590	(390)	2.6	210	(350)

11 Financial instruments - valuation continued

Level 3 valuation assumptions

Assets	Valuation basis/technique	Main assumptions (2)
Loans and advances	Proprietary model	credit spreads, indices
Debt securities		
RMBS	Industry standard model	prepayment rates, probability of default, loss severity and yield, recovery rates
CMBS	Proprietary model	prepayment rates, probability of default, loss severity and yield, recovery rates
CDO	Proprietary model	credit spreads, default rates, housing prices, implied collateral valuation
CLO	Industry standard simulation model	credit spreads, default rates, loss severity and yield, recovery rates
Other ABS	Proprietary model	credit spreads
Other debt securities	Proprietary model	credit spreads
Equity securities	Fund valuation statements, fundamentals valuation	performance of funds and issuers
Derivatives		
Foreign exchange	Proprietary model	correlation, volatility
Interest rate	Proprietary model	correlation, volatility
Equities and commodities	Proprietary model	correlation, long dated volatility, dividends
Credit	Proprietary CVA model, industry option and correlation model	correlation, counterparty credit risk, volatility

Liabilities		
Customer accounts	Proprietary model	correlation, credit spreads
Debt securities in issue	Proprietary model	correlation, volatility, model uncertainty risk
Short positions	Proprietary model	correlation, credit spreads
Derivatives		
Foreign exchange	Proprietary model	correlation, volatility
Interest rate	Proprietary model	correlation, volatility
Equities and commodities	Proprietary model	correlation, long dated volatility, dividends
Credit	Proprietary CVA model, industry option and correlation model	correlation, counterparty credit risk, volatility

Notes:
(1) Sensitivity represents the favourable and unfavourable effect 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) Includes model uncertainty risk.

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. 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.

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 depth 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.

11 Financial instruments - valuation continued

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.

Overview of sensitivity methodologies

Reasonably possible alternative assumptions of unobservable inputs are determined based on a 95% confidence interval. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market bias (e.g. one-way inventory); day 1 P&L arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

Loans and advances to customers

Loans in level 3 primarily comprise loans to emerging market counterparties, structured loans and legacy commercial mortgages.

Loans to emerging market counterparties

The trades in each loan structure are valued using curves using a proxy methodology. Each curve consists of the independent proxy value and various basis adjustments, such as those relating to loan-CDS basis, credit basis, tenor and liquidity. For the low and high valuation scenarios for the structures, these different bases are flexed up and down within the range that each one is deemed to span. The resultant maximum and minimum scenario curves are used to value the assets and liabilities in the structure separately. The low valuation scenario is the one that minimises the assets and maximises the liabilities. The high valuation scenario is the converse.

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 and credit enhancement. 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.

Residential mortgages

These pools of residential mortgages were mostly acquired for securitisation before the 2008 financial crisis. Factors that affect the value, or liquidation level, of these loans are geographic location, current loan-to-value, condition of the home, and availability of eligible buyers. The loans are serviced by various mortgage servicers. Operations and the Front Office monitor the performance of these loans and the valuations are tested against an estimated recovery level as part of the IPV process. The market for non-agency securitisation remains extremely weak and is restricted to new issue prime loans.

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.

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

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.

11 Financial instruments - valuation continued

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 valuation adjustment applied to these exposures 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.

Valuation adjustments

CVA applied to derivative exposures to other counterparties and own credit adjustments applied to derivative liabilities (DVA) are calculated on a portfolio basis. Whilst the methodology used to calculate each of these adjustments references certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the net valuation of the related portfolios. The classification of the derivative portfolios which the valuation adjustments are applied to is not determined by the observability of the valuation adjustments, and any related sensitivity does not form part of the level 3 sensitivities presented.

Other considerations

CVA is calculated by applying expected losses to potential future exposures whilst DVA is calculated by applying expected gains to potential future liabilities. Expected losses and gains are determined from market implied probability of defaults and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities. A weighting is applied to arrive at the expected loss or gain. The weighting reflects portfolio churn and varies according to counterparty credit quality and hedging considerations.

The unobservable inputs include certain inputs used in the calculation of potential future exposures and liabilities, probabilities of default, and recovery levels together with the weightings applied.

Funding valuation adjustments

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS rates whilst uncollateralised derivatives are discounted with reference to funding levels. Whilst the discount rates applied reference certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of the individual trades. The classification of derivatives is not determined by the observability of the discount rates applied, and any related sensitivity does not form part of the level 3 sensitivities presented.

Own credit - issued debt

For issued debt and structured notes the own credit adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Whilst certain debt issuance spreads are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of individual trades. The classification of issued debt and structured notes is not determined by the observability of the debt issuance spreads applied, and any related sensitivity does not form part of the level 3 sensitivities presented.

Level 3 movement table

		Amounts recorded in the		Level 3 transfers								Amounts recorded in the income statement relating to instruments held at year end	
2012	At 1 January £m	Income statement (1) £m	SOCI (2) £m	In £m	Out £m	Issuances £m	Purchases £m	Settlements £m	Sales £m	Foreign exchange £m	At 31 December £m	Changes in fair value £m	Other £m
Assets													
FVTPL (3)													
Loans and advances to banks	443	5	—	28	(1)	—	—	(64)	(30)	2	383	5	—
Loans and advances to customers	316	3	—	20	(16)	—	589	(324)	(15)	(14)	559	(12)	3
Debt securities	1,911	127	—	617	(81)	—	1,451	(188)	(1,885)	(21)	1,931	(54)	72
Equity shares	350	(17)	—	32	(4)	—	149	(73)	(106)	(4)	327	(18)	4
Derivatives	6,850	(2,085)	—	472	(695)	—	621	(1,014)	(191)	(57)	3,901	(1,744)	36
FVTPL assets	9,870	(1,967)	—	1,169	(797)	—	2,810	(1,663)	(2,227)	(94)	7,101	(1,823)	115
AFS													
Debt securities	5,663	77	10	391	(472)	—	78	(1,000)	(1,808)	(6)	2,933	(145)	39
Equity shares	210	29	27	17	—	—	14	(1)	(118)	(8)	170	1	12
AFS assets	5,873	106	37	408	(472)	—	92	(1,001)	(1,926)	(14)	3,103	(144)	51
	15,743	(1,861)	37	1,577	(1,269)	—	2,902	(2,664)	(4,153)	(108)	10,204	(1,967)	166
Of which ABS													
- FVTP	1,304	163	—	576	(32)	—	1,050	(188)	(1,515)	(7)	1,351	15	61
- AFS	5,601	86	(12)	317	(457)	—	76	(992)	(1,778)	(4)	2,837	(97)	34
Liabilities													
Deposits	22	9	—	1	—	—	—	—	—	—	32	8	—
Debt securities in issue	1,793	175	—	9	—	530	—	(1,174)	—	(1)	1,332	184	—
Short positions	235	(213)	—	—	—	—	3	—	(23)	(1)	1	—	—
Derivatives	3,991	(413)	—	848	(420)	12	369	(894)	35	(44)	3,484	(619)	2
	6,041	(442)	—	858	(420)	542	372	(2,068)	12	(46)	4,849	(427)	2
Net (losses)/gains		(1,419)	37									(1,540)	164

For the notes relating to this table refer to page 257.

11 Financial instruments - valuation continued

Level 3 movement table continued

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 to banks	407	5	—	60	—	—	49	(36)	(40)	(2)	443	2
Loans and advances to customers	251	(3)	—	85	—	—	649	(622)	(45)	1	316	(13)
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 257.

2010	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	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 to banks	1	—	—	32	—	374	—	—	—	407	—
Loans and advances to customers	548	(1)	—	(56)	—	145	(229)	(165)	9	251	(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)

Notes:
(1) Net losses on held-for-trading instruments of £1,481 million (2011 - £650 million; 2010 - £1,018 million) were recorded in income from trading activities. Net gains on other instruments of £62 million (2011 - £4 million losses; 2010 - £70 million gains) 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 2010, 2011 and 2012.

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					
	2012 Carrying value £bn	2012 Fair value £bn	2011 Carrying value £bn	2011 Fair value £bn	2010 Carrying value £bn	2010 Fair value £bn	2012 Carrying value £bn	2012 Fair value £bn	2011 Carrying value £bn	2011 Fair value £bn	2010 Carrying value £bn	2010 Fair value £bn
Financial assets												
Cash and balances at central banks	74.5	74.5	68.5	68.5	49.8	49.8	70.4	70.4	64.3	64.3	44.9	44.9
Loans and advances to banks	32.3	32.2	29.9	29.8	20.6	20.5	64.9	65.5	50.0	50.2	44.2	43.8
Loans and advances to customers	400.1	380.9	410.7	381.8	455.0	431.0	185.6	178.7	273.0	258.1	290.5	281.2
Debt securities	4.3	3.9	5.5	4.9	6.7	6.0	35.2	35.3	71.2	70.8	78.7	77.4
Settlement balances	5.7	5.7	6.9	6.9	8.7	8.7	3.1	3.1	4.1	4.1	3.5	3.5
Financial liabilities												
Deposits by banks	34.2	34.2	46.7	46.1	31.9	31.8	146.0	146.1	170.2	170.1	143.6	143.6
Customer accounts	419.2	419.6	387.6	387.7	401.1	401.1	187.1	183.8	226.5	223.5	237.5	234.6
Debt securities in issue	50.3	50.1	102.6	100.5	145.9	142.8	39.5	40.3	76.3	75.7	109.3	108.4
Settlement balances	5.8	5.8	6.8	6.8	8.5	8.5	2.9	2.9	3.5	3.5	3.3	3.3
Notes in circulation	1.7	1.7	1.7	1.7	1.8	1.8	1.1	1.1	1.1	1.1	1.1	1.1
Subordinated liabilities	33.3	37.3	31.9	28.7	31.6	30.4	31.1	35.4	29.5	27.0	28.8	27.8

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. Furthermore there is a wide range of potential valuation techniques. 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.

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:

For certain short-term financial instruments, fair value approximates to carrying value: 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 portfolios where counterparties have external ratings: large corporate loans in UK Corporate and institutional and corporate lending in International Banking and Markets.

(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, Ulster Bank, US Retail & Commercial and Wealth and SME loans in UK Corporate reflecting the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank’s commercial real estate portfolio, and high loan to value mortgages, a bespoke approach is used based on available market data.

The discount to amortised cost predominantly reflects stressed markets for commercial real estate loans, in both Non-Core and Core as well as high loan to value tracker mortgages.

Debt securities

Fair values are determined using discounted cashflow valuation techniques.

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								
	2012			2011			2010		
	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	74,524	—	74,524	68,487	—	68,487	49,830	8	49,838
Loans and advances to banks	80,625	1,442	82,067	93,304	3,836	97,140	84,281	3,224	87,505
Loans and advances to customers	194,968	299,869	494,837	181,880	307,519	489,399	180,573	337,748	518,321
Debt securities	24,088	112,497	136,585	37,178	131,963	169,141	30,031	135,998	166,029
Equity shares	—	13,872	13,872	—	11,762	11,762	—	2,340	2,340
Settlement balances	5,717	—	5,717	6,902	—	6,902	8,748	—	8,748
Derivatives	51,248	393,853	445,101	60,216	472,591	532,807	62,662	366,343	429,005
Liabilities									
Deposits by banks	93,742	8,518	102,260	95,725	13,372	109,097	80,850	4,370	85,220
Customer accounts	493,432	25,765	519,197	458,230	14,158	472,388	457,106	15,219	472,325
Debt securities in issue	14,547	68,731	83,278	60,642	80,195	140,837	80,233	84,429	164,662
Settlement balances and short positions	8,499	24,874	33,373	14,037	33,187	47,224	13,229	36,402	49,631
Derivatives	51,958	384,127	436,085	62,487	465,349	527,836	66,808	354,161	420,969
Subordinated liabilities	2,385	31,466	33,851	684	31,640	32,324	1,076	30,947	32,023

	Bank								
	2012			2011			2010		
	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	70,374	—	70,374	64,261	—	64,261	44,921	—	44,921
Loans and advances to banks	89,433	20,138	109,571	96,531	12,509	109,040	91,901	9,064	100,965
Loans and advances to customers	142,109	129,440	271,549	182,666	168,457	351,123	155,713	193,466	349,179
Debt securities	38,277	84,170	122,447	53,676	127,784	181,460	47,383	141,825	189,208
Equity shares	—	12,766	12,766	—	10,486	10,486	—	1,016	1,016
Settlement balances	3,090	—	3,090	4,059	—	4,059	3,529	—	3,529
Derivatives	51,288	398,550	449,838	60,230	477,067	537,297	62,905	369,907	432,812
Liabilities									
Deposits by banks	179,390	30,193	209,583	210,057	24,240	234,297	185,766	12,207	197,973
Customer accounts	214,970	41,364	256,334	189,210	107,692	296,902	178,670	116,688	295,358
Debt securities in issue	13,285	58,209	71,494	48,718	65,806	114,524	61,878	66,195	128,073
Settlement balances and short positions	4,606	12,346	16,952	9,957	18,418	28,375	5,918	23,112	29,030
Derivatives	52,048	387,104	439,152	62,467	468,388	530,855	67,015	357,488	424,503
Subordinated liabilities	2,353	29,282	31,635	372	29,642	30,014	585	28,714	29,299

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					
2012	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	26,107	1,075	5,489	383	1,022	395
Customer accounts	382,714	26,838	11,494	2,148	1,208	64
Debt securities in issue	13,194	10,539	20,833	12,019	18,833	4,282
Derivatives held for hedging	176	498	1,096	785	848	360
Subordinated liabilities	448	2,601	6,268	4,546	16,195	4,919
Settlement balances and other liabilities	7,500	4	8	1	—	1
	430,139	41,555	45,188	19,882	38,106	10,021
Guarantees and commitments - notional amount						
Guarantees (1, 2)	12,373	—	—	—	—	—
Commitments (3)	212,149	—	—	—	—	—
	224,522	—	—	—	—	—
2011						
Deposits by banks	35,596	4,487	5,256	400	1,008	364
Customer 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
Guarantees 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
Guarantees and commitments - notional amount						
Guarantees (1, 2)	10,393	—	—	—	—	—
Commitments (3)	234,203	—	—	—	—	—
	244,596	—	—	—	—	—

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 £2,901 million (2011 - £5,753 million; 2010 - £12,479 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.

2012	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	122,785	7,501	11,689	4,307	542	146
Customers accounts	171,495	8,984	3,114	1,212	3,155	1,050
Debt securities in issue	5,038	10,496	20,827	12,018	18,831	4,276
Derivatives held for hedging	64	217	515	397	422	199
Subordinated liabilities	433	2,513	5,714	4,400	15,307	4,473
Settlement balances and other liabilities	3,982	—	—	—	—	—
	303,797	29,711	41,859	22,334	38,257	10,144
Guarantees and commitments - notional amount						
Guarantees (1, 2)	8,436	—	—	—	—	—
Commitments (3)	135,542	—	—	—	—	—
	143,978	—	—	—	—	—
2011						
Deposits by banks	147,543	6,828	9,692	3,992	926	85
Customer 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
Guarantees 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
Guarantees and commitments - notional amount						
Guarantees (1, 2)	4,716	—	—	—	—	—
Commitments (3)	144,276	—	—	—	—	—
	148,992	—	—	—	—	—

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 £2,901 million (2011 - £5,753 million; 2010 - £12,479 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 liabilities - held-for-trading liabilities of £632.5 billion (2011 - £717.5 billion; 2010 - £587.2 billion) for the Group and £593.4 billion (2011 - £698.3 billion; 2010 - £567.4 billion) 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	2012 £m	2011 £m	2010 £m
At 1 January	11,632	5,037	1,885	18,554	16,770	12,020
Transfers from/(to) disposal groups	153	548	63	764	(773)	(72)
Currency translation and other adjustments	(388)	226	(13)	(175)	(261)	(5)
Transfers from fellow subsidiaries	413	2	—	415	3	—
Disposals	—	—	(1)	(1)	—	(13)
Amounts written-off	(2,289)	(1,598)	—	(3,887)	(4,183)	(4,375)
Recoveries of amounts previously written-off	115	217	—	332	508	360
Charge to the income statement	3,111	2,183	(13)	5,281	6,969	9,299
Unwind of discount (recognised in interest income)	(336)	(140)	—	(476)	(479)	(444)
At 31 December (1)	12,411	6,475	1,921	20,807	18,554	16,770

Note:
(1) Includes £114 million relating to loans and advances to banks (2011 - £85 million; 2010 - £88 million).

	Bank					
	Individually assessed £m	Collectively assessed £m	Latent £m	2012 £m	2011 £m	2010 £m
At 1 January	3,501	651	471	4,623	5,581	4,650
Transfers from/(to) to disposal groups	149	532	61	742	(746)	(72)
Currency translation and other adjustments	150	(13)	15	152	(28)	(6)
Transfers from fellow subsidiaries	413	2	—	415	3	—
Amounts written-off	(1,667)	(261)	—	(1,928)	(1,764)	(2,537)
Recoveries of amounts previously written-off	54	51	—	105	287	145
Charge to the income statement	1,432	249	(36)	1,645	1,425	3,514
Unwind of discount (recognised in interest income)	(87)	(41)	—	(128)	(135)	(113)
At 31 December (1)	3,945	1,170	511	5,626	4,623	5,581

Note:
(1) Includes £108 million relating to loans and advances to banks (2011 - £76 million; 2010 - £79 million).

	Group		
Impairment losses charged to the income statement	2012 £m	2011 £m	2010 £m
Loans and advances to customers	5,270	6,969	9,299
Loans and advances to banks	11	—	—
	5,281	6,969	9,299
Debt securities	(97)	172	71
Equity shares	30	35	30
	(67)	207	101
	5,214	7,176	9,400

	Group		
	2012 £m	2011 £m	2010 £m
Gross income not recognised but which would have been recognised under the original terms of the impaired loans			
Domestic	660	634	568
Foreign	899	905	530
	1,559	1,539	1,098
Interest on impaired loans included in net interest income			
Domestic	232	217	214
Foreign	244	261	230
	476	478	444

The following tables analyse impaired financial assets.

	Group								
	2012			2011			2010		
	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)	134	114	20	94	85	9	98	88	10
Loans and advances to customers (2)	37,754	18,772	18,982	37,020	16,584	20,436	33,693	14,183	19,510
	37,888	18,886	19,002	37,114	16,669	20,445	33,791	14,271	19,520

	Group		
	Carrying value 2012 £m	Carrying value 2011 £m	Carrying value 2010 £m
Available-for-sale securities			
Debt securities	222	546	566
Equity shares	31	57	43
Loans and receivables			
Debt securities	902	114	107
	1,155	717	716

	Bank								
	2012			2011			2010		
	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)	127	108	19	85	76	9	89	79	10
Loans and advances to customers (3)	12,320	5,007	7,313	12,215	4,076	8,139	12,584	4,779	7,805
	12,447	5,115	7,332	12,300	4,152	8,148	12,673	4,858	7,815

	Bank		
	Carrying value 2012 £m	Carrying value 2011 £m	Carrying value 2010 £m
Available-for-sale securities			
Debt securities	222	537	560
Equity shares	9	9	16
Loans and receivables			
Debt securities	902	114	107
	1,133	660	683

Notes:
(1) Impairment provisions individually assessed.
(2) Impairment provisions individually assessed on balances of £26,292 million (2011 - £27,614 million; 2010 - £23,679 million).
(3) Impairment provisions individually assessed on balances of £10,235 million (2011 - £10,889 million; 2010 - £10,205 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		
	2012 £m	2011 £m	2010 £m
Residential property	67	60	47
Other property	46	73	139
Cash	49	56	127
Other assets	1	2	28
	163	191	341

	Bank		
	2012 £m	2011 £m	2010 £m
Cash	15	23	19

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
2012	5,599	1,117	1,177	2,637	10,530	665	120	532	962	2,279
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

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 2012, variable rate financial assets of £60 billion (2011 - £49 billion) for the Group and £48 billion (2011 - £37 billion) for the Bank, and variable rate financial liabilities of £8 billion (2011 - £12 billion) for the Group and £4 billion (2011 - £4 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 2012, fixed rate financial assets of £16 billion (2011 - £17 billion) for the Group and £9 billion (2011 - £10 billion) for the Bank, and fixed rate financial liabilities of £34 billion (2011 - £36 billion) for the Group and £31 billion (2011 - £35 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								
	2012			2011			2010		
	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	2,243	23,083	22,700	2,097	30,316	28,917	2,758	40,830	42,307
Currency swaps	1,051	21,785	29,993	1,044	24,482	34,499	963	28,344	35,584
Options purchased	682	17,558	—	640	19,098	—	505	14,938	—
Options written	684	—	17,487	641	—	18,597	546	—	13,763
Interest rate contracts									
Interest rate swaps	25,465	303,697	287,515	29,965	348,986	334,118	29,704	250,108	242,288
Options purchased	1,934	61,794	—	2,398	74,590	—	2,622	57,475	—
Options written	1,884	—	58,336	2,593	—	72,058	2,738	—	54,280
Futures and forwards	4,191	748	653	3,757	876	744	4,619	3,061	1,262
Credit derivatives	552	10,995	10,363	1,063	27,017	26,750	1,341	28,201	24,446
Equity and commodity contracts	116	5,441	9,038	127	7,442	12,153	81	6,048	7,039
		445,101	436,085		532,807	527,836		429,005	420,969

14 Derivatives continued

	Group					
	2012		2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Amounts above include:						
Due from/to holding company	7	511	79	1,502	231	1,475
Due from/to fellow subsidiaries	7,193	5,069	10,301	9,875	17,238	12,780

Included in the table on the previous page are derivatives held for hedging purposes as follows:

	Group					
	2012		2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging						
Interest rate swaps	3,398	2,554	2,968	2,524	1,722	1,412
Cash flow hedging						
Interest rate swaps	4,814	1,074	3,964	1,270	2,903	995
Net investment hedging						
Exchange rate contracts	1	14	120	5	—	13

	Group		
Hedge ineffectiveness recognised in other operating income comprised	2012 £m	2011 £m	2010 £m
Fair value hedging			
(Losses)/gains on the hedged items attributable to the hedged risk	(141)	212	(120)
Gains/(losses) on the hedging instruments	188	(193)	62
Fair value hedging ineffectiveness	47	19	(58)
Cash flow hedging ineffectiveness	25	20	(37)
	72	39	(95)

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								
2012	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	282	256	229	174	135	186	—	—	1,262
Forecast payable cash flows	(32)	(21)	(13)	(11)	(11)	(58)	(103)	(29)	(278)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	274	254	222	169	130	176	—	—	1,225
Forecast payable cash flows	(31)	(20)	(12)	(11)	(11)	(59)	(103)	(29)	(276)
2011									
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	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	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)

	Bank 2012			2011			2010		
	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	2,248	23,125	22,737	2,110	30,432	29,168	2,776	41,097	42,530
Currency swaps	1,067	22,733	29,990	1,059	24,802	35,097	982	28,984	37,355
Options purchased	683	17,571	—	641	19,121	—	505	14,960	—
Options written	684	—	17,500	642	—	18,620	547	—	13,784
Interest rate contracts									
Interest rate swaps	25,512	307,523	290,431	29,988	353,177	336,267	29,840	252,931	243,498
Options purchased	1,918	61,659	—	2,405	74,487	—	2,628	57,320	—
Options written	1,888	—	58,385	2,592	—	72,091	2,751	—	54,315
Futures and forwards	4,156	721	644	3,703	862	735	4,533	3,051	1,265
Credit derivatives	552	11,062	10,363	1,063	27,017	26,682	1,343	28,268	24,455
Equity and commodity contracts	116	5,444	9,102	124	7,399	12,195	80	6,201	7,301
		449,838	439,152		537,297	530,855		432,812	424,503

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.

	Bank 2012		2011		2010	
Amounts above include:	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Due from/to holding company	7	511	79	1,502	231	1,475
Due from/to fellow subsidiaries	7,186	5,069	10,297	9,870	17,224	12,770
Due from/to subsidiaries	7,760	3,741	8,081	4,133	6,630	4,110

Included in the above are derivatives held for hedging purposes as follows:

	Bank 2012		2011		2010	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedging						
Exchange rate contracts	1	5	—	—	—	1
Interest rate contracts	2,945	1,189	2,711	1,248	1,559	702
Cash flow hedging						
Interest rate contracts	3,678	554	3,088	503	2,430	306
Net investment hedging						
Exchange rate contracts	—	1	—	—	—	—

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								
2012	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	226	202	180	135	106	148	—	—	997
Forecast payable cash flows	(21)	(12)	(8)	(7)	(7)	(39)	(72)	(15)	(181)
Hedged forecast cash flows affect on profit or loss									
Forecast receivable cash flows	219	200	174	131	101	141	—	—	996
Forecast payable cash flows	(20)	(11)	(8)	(7)	(7)	(40)	(72)	(15)	(180)
2011									
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)

15 Debt securities

	Group							
	Central and local government				Other financial			Of which
	UK	US	Other	Banks	institutions	Corporate	Total	ABS (1)
2012	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	7,692	17,303	26,344	2,036	21,722	1,933	77,030	18,619
Designated as at fair value through profit or loss	—	—	—	86	610	1	697	516
Available-for-sale	7,950	17,514	10,083	2,933	15,967	114	54,561	18,953
Loans and receivables	5	—	—	327	3,683	282	4,297	3,663
	15,647	34,817	36,427	5,382	41,982	2,330	136,585	41,751
Available-for-sale								
Gross unrealised gains	944	861	579	17	582	8	2,991	647
Gross unrealised losses	—	(1)	—	(1)	(122)	—	(124)	(124)
2011								
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)

Note:
(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Gross gains of £1,696 million (2011 - £786 million; 2010 - £341 million) and gross losses of £30 million (2011 - £58 million; 2010 - £81 million) were realised on the sale of available-for-sale securities.

15 Debt securities continued

	Bank							
	Central and local government							
2012	UK £m	US £m	Other £m	Banks £m	Other financial institutions £m	Corporate £m	Total £m	Of which ABS (1) £m
Held-for-trading	7,692	4,174	23,458	1,615	4,974	986	42,899	2,446
Designated as at fair value through profit or loss	—	—	—	86	1,156	—	1,242	1,062
Available-for-sale	7,950	13,989	9,477	2,829	8,725	89	43,059	7,555
Loans and receivables	—	—	—	327	34,638	282	35,247	34,618
	15,642	18,163	32,935	4,857	49,493	1,357	122,447	45,681
Available-for-sale								
Gross unrealised gains	944	775	577	17	326	6	2,645	307
Gross unrealised losses	—	—	—	(1)	(122)	—	(123)	(123)
2011								
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)

Note:
(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

16 Equity shares

	Group								
	2012			2011			2010		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	12,255	56	12,311	9,779	65	9,844	416	66	482
Designated as at fair value through profit or loss	243	241	484	336	239	575	201	295	496
Available-for-sale	182	895	1,077	215	1,128	1,343	223	1,139	1,362
	12,680	1,192	13,872	10,330	1,432	11,762	840	1,500	2,340
Available-for-sale									
Gross unrealised gains	56	86	142	50	185	235	46	144	190
Gross unrealised losses	(53)	(13)	(66)	(18)	(21)	(39)	(11)	(34)	(45)

Gross gains of £138 million (2011 - £139 million; 2010 - £48 million) and gross losses of £1 million (2011 - nil; 2010 - £55 million) were realised on the sale of available-for-sale equity shares.

Dividend income from available-for-sale equity shares was £234 million (2011 - £216 million; 2010 - £176 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 (2011 - £0.7 billion; 2010 - £0.8 billion), together with a number of individually small shareholdings. Disposals in the year generated gains of £2 million (2011 - £2 million gains; 2010 - £2 million losses).

	Bank								
	2012			2011			2010		
	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m	Listed £m	Unlisted £m	Total £m
Held-for-trading	12,230	48	12,278	9,736	57	9,793	401	65	466
Designated as at fair value through profit or loss	214	60	274	300	29	329	162	35	197
Available-for-sale	140	74	214	190	174	364	186	167	353
	12,584	182	12,766	10,226	260	10,486	749	267	1,016
Available-for-sale									
Gross unrealised gains	30	21	51	40	76	116	28	54	82
Gross unrealised losses	(51)	(1)	(52)	(15)	(1)	(16)	(11)	—	(11)

17 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	Bank		
	2012 £m	2011 £m	2010 £m
At 1 January	32,164	27,504	29,385
Currency translation and other adjustments	(103)	21	364
Additional investments in Group undertakings	8,287	5,238	3,015
Additions	—	59	—
Redemption of investments in Group undertakings	(123)	(618)	(4,994)
Disposals	(83)	—	(78)
Write-back/(impairment) of investments	120	(40)	(188)
At 31 December	40,262	32,164	27,504

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
RBS 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				
2012	Goodwill £m	Core deposit intangibles £m	Other purchased intangibles £m	Internally generated software £m	Total £m
Cost					
At 1 January	18,224	365	420	4,900	23,909
Transfers from/(to) fellow subsidiaries	5	—	(7)	242	240
Transfers from disposal groups	80	—	—	—	80
Currency translation and other adjustments	(294)	(9)	(16)	(21)	(340)
Additions	—	—	39	797	836
Disposals and write-off of fully amortised assets	(105)	(307)	(73)	(1,126)	(1,611)
At 31 December	17,910	49	363	4,792	23,114
Accumulated amortisation and impairment					
At 1 January	7,562	341	317	3,324	11,544
Transfers (to)/from fellow subsidiaries	—	—	(5)	215	210
Transfers from disposal groups	80	—	—	—	80
Currency translation and other adjustments	(119)	(9)	(11)	(10)	(149)
Disposals and write-off of fully amortised assets	(72)	(307)	(73)	(1,123)	(1,575)
Charge for the year	—	2	39	509	550
Write down of goodwill and other intangible assets	36	—	8	7	51
At 31 December	7,487	27	275	2,922	10,711
Net book value at 31 December	10,423	22	88	1,870	12,403

2011	Group 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
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
Disposal 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
Disposals 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

18 Intangible assets continued

2012	Bank Goodwill £m	Bank Internally generated software £m	Bank Total £m
Cost			
At 1 January	126	1,988	2,114
Transfers from subsidiaries	5	160	165
Additions	—	627	627
Disposals and write-off of fully amortised assets	—	(1,123)	(1,123)
At 31 December	131	1,652	1,783
Accumulated amortisation and impairment			
At 1 January	12	1,226	1,238
Transfers from fellow subsidiaries	—	229	229
Disposals and write-off of fully amortised assets	—	(1,123)	(1,123)
Charge for the year	—	385	385
Write down of goodwill and other intangible assets	18	3	21
At 31 December	30	720	750
Net book value at 31 December	101	932	1,033
2011			
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	—	(35)	(35)
Disposals and write-off of fully amortised assets	—	(18)	(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

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 2012 £m
UK Retail	Value in use	2,770
UK Corporate	Value in use	2,821
Wealth	Value in use	611
International Banking	Value in use	153
US Retail & Commercial	Value in use	3,827

	Recoverable amount based on	Goodwill at 30 September 2011 £m	Goodwill at 30 September 2010 £m
UK Retail	Value in use	2,697	2,697
UK Corporate	Value in use	2,693	2,693
Wealth	Value in use	611	611
Global Transaction Services	Value in use	1,473	1,464
US Retail & Commercial	Value in use	2,826	2,811

The analysis of goodwill by operating segment is shown in Note 37. The change in reportable segments in 2012 disclosed in Note 37 did not impact the impairment tests performed in 2011.

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 2012 were based on the value in use test, using management's latest five-year forecasts. The carrying amount of each CGU is assumed to be its capital contribution as a proxy for equity, where a divisional balance sheet is not available. The long-term growth rates have been based on respective country nominal GDP growth rates. 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.

2012

The results of the annual impairment test for 2012 and comparative periods are presented separately as a result of the changes to the Group’s structure implemented during 2012.

The recoverable amount of UK Retail, based on a 4.7% terminal growth rate and a 13.5% pre tax discount rate, exceeded its carrying value by £13.8 billion. A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £2.5 billion and £2.4 billion respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £1.3 billion.

The recoverable amount of UK Corporate, based on a 4.7% terminal growth rate and a 13.5% pre tax discount rate, exceeded its carrying value by £6.3 billion. A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £2.3 billion and £1.8 billion respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £1.4 billion.

The recoverable amount of Wealth, based on a 4.7% terminal growth rate and a 14.8% pre tax discount rate, exceeded its carrying value by £1.9 billion. A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £0.5 billion and £0.4 billion respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.3 billion.

18 Intangible assets continued

The recoverable amount of International Banking, based on a 4.7% terminal growth rate and a 12.2% pre tax discount rate, exceeded its carrying value by £0.3 billion. A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £1.1 billion and £1.2 billion respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.6 billion.

The recoverable amount of US Retail & Commercial, based on a 5.3% terminal growth rate and a 16.9% pre tax discount rate, exceeded its carrying value by £2.0 billion. A 1% change in the discount rate or terminal growth rate would change the recoverable amount by approximately £1.2 billion and £0.8 billion respectively. In addition, a 5% change in forecast pre tax earnings would change the recoverable amount by approximately £0.7 billion.

The RBS Group has been considering various strategies for its investment in RBS Citizens Financial Group (CFG). The RBS Group has announced plans for a partial IPO of CFG over the medium term, likely two years. Notwithstanding this planned course of action, the recoverable amount of the US Retail & Commercial CGU remains its value in use.

2011 and 2010

The recoverable amount of UK Retail, based on a 3% (2010 - 3%) terminal growth rate and a 14% (2010 - 15.7%) pre tax discount rate, exceeded the carrying amount by £5.5 billion (2010 - £6.9 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) and £0.6 billion (2010 - £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 - £0.9 billion).

The recoverable amount of UK Corporate, based on a 3% (2010 - 3%) terminal growth rate and a 14.1% (2010 - 15.6%) pre tax discount rate, exceeded its carrying value by £2.1 billion (2010 - £5.3 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) and £0.5 billion (2010 - £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).

The recoverable amount of Wealth, based on a 3% (2010 - 3%) terminal growth rate and an 11.0% (2010 - 12.0%) 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 - 3%) terminal growth rate and an 11.4% (2010 - 12.8%) pre tax discount rate, exceeded its carrying value by more than 100% (2010 - 100%) and was insensitive to a reasonably possible change in key assumptions.

The recoverable amount of US Retail & Commercial, based on a 5% (2010 - 5%) terminal growth rate and a 14.4% (2010 - 14.9%) pre tax discount rate, exceeded its carrying value by £0.2 billion (2010 - £1.6 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) and £0.5 billion (2010 - £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 - £0.7 billion).

19 Property, plant and equipment

2012	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Group Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
Cost or valuation							
At 1 January	4,413	2,690	192	1,708	4,114	3,892	17,009
Transfers from disposal groups	—	107	12	93	41	—	253
Transfers from fellow subsidiaries	48	12	35	39	58	—	192
Currency translation and other adjustments	(49)	(29)	(2)	(21)	(57)	(54)	(212)
Reclassifications	24	(22)	(4)	(6)	8	—	—
Additions	238	226	8	111	453	402	1,438
Expenditure on investment properties	10	—	—	—	—	—	10
Change in fair value of investment properties	(148)	—	—	—	—	—	(148)
Disposals and write-off of fully depreciated assets	(1,425)	(32)	(1)	(254)	(276)	(916)	(2,904)
At 31 December	3,111	2,952	240	1,670	4,341	3,324	15,638
Accumulated impairment, depreciation and amortisation							
At 1 January	—	697	93	775	2,779	1,187	5,531
Transfers from disposal groups	—	43	6	66	26	—	141
Transfers from fellow subsidiaries	—	1	16	15	85	—	117
Currency translation and other adjustments	—	(4)	—	(11)	(50)	(21)	(86)
Disposals and write-off of fully depreciated assets	—	(12)	—	(96)	(263)	(462)	(833)
Charge for the year	—	94	10	131	412	417	1,064
Write down of property, plant and equipment	—	9	1	—	—	—	10
At 31 December	—	828	126	880	2,989	1,121	5,944
Net book value at 31 December	3,111	2,124	114	790	1,352	2,203	9,694

2011	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

19 Property, plant and equipment continued

2010	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	4,883	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)	—	—
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
Write down of property, plant and equipment	—	32	4	—	—	—	36
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

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 2012 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 £186 million of depreciation since purchase (2011 - £146 million; 2010 - £248 million).

Rental income from investment properties was £267 million (2011 - £270 million; 2010 - £279 million). Direct operating expenses of investment properties were £125 million (2011 - £110 million; 2010 - £64 million).

Property, plant and equipment, excluding investment properties, include £35 million (2011 - £186 million; 2010 - £298 million) assets in the course of construction.

2012	Bank Freehold premises £m	Long leasehold premises £m	Short leasehold premises £m	Computers and other equipment £m	Total £m
Cost or valuation					
At 1 January	1,018	48	708	2,409	4,183
Transfers from disposal groups	80	9	90	40	219
Transfer from fellow subsidiaries	7	35	35	52	129
Currency translation and other adjustments	(1)	—	(2)	—	(3)
Reclassifications	2	(4)	(2)	4	—
Additions	195	3	53	329	580
Disposals and write-off of fully depreciated assets	(4)	—	(195)	(122)	(321)
At 31 December	1,297	91	687	2,712	4,787
Accumulated impairment, depreciation and amortisation					
At 1 January	232	24	232	1,451	1,939
Transfers from disposal groups	33	4	63	23	123
Transfer from fellow subsidiaries	—	16	13	81	110
Currency translation and other adjustments	—	—	—	(3)	(3)
Disposals and write-off of fully depreciated assets	(2)	—	(64)	(124)	(190)
Charge for the year	40	5	52	281	378
At 31 December	303	49	296	1,709	2,357
Net book value at 31 December	994	42	391	1,003	2,430
2011					
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

19 Property, plant and equipment continued

2010	Bank 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	1,077	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

20 Prepayments, accrued income and other assets

	Group 2012 £m	Group 2011 £m	Group 2010 £m	Bank 2012 £m	Bank 2011 £m	Bank 2010 £m
Prepayments	862	939	1,054	2,093	2,087	2,107
Accrued income	463	567	963	242	325	694
Deferred expenses	66	77	277	20	430	176
Pension schemes in net surplus (see Note 4)	144	24	39	99	8	7
Other assets	4,569	4,285	3,904	1,979	2,488	1,776
	6,104	5,892	6,237	4,433	5,338	4,760

21 Assets and liabilities of disposal groups

	Group 2012 £m	Group 2011 £m	Group 2010 £m	Bank 2012 £m	Bank 2011 £m	Bank 2010 £m
Assets of disposal groups						
Cash and balances at central banks	—	100	—	—	94	—
Loans and advances to banks	20	25	629	—	1	273
Loans and advances to customers	263	18,723	2,884	—	18,110	2,329
Debt securities and equity shares	5	5	17	—	—	2
Derivatives	3	439	5,148	—	414	1,757
Intangible assets	—	15	—	—	—	—
Settlement balances	—	14	555	—	—	295
Property, plant and equipment	—	4,749	18	—	96	—
Other assets	13	18	291	—	—	109
	304	24,088	9,542	—	18,715	4,765
Liabilities of disposal groups						
Deposits by banks	—	—	266	—	—	140
Customer accounts	18	21,820	900	—	20,390	144
Derivatives	3	126	5,042	—	88	1,610
Settlement balances	—	8	907	—	—	391
Other liabilities	114	886	393	—	—	51
	135	22,840	7,508	—	20,478	2,336

At 31 December 2011, disposal groups comprised the RBS Aviation Capital business which was sold in the second half of 2012 and the RBS England and Wales and NatWest Scotland branch-based businesses, along with certain SME and corporate activities across the UK ('UK branch-based businesses'). In October 2012 Santander announced its withdrawal from the sale agreed in August 2010. Although the RBS Group continues to explore disposal options, sale within 12 months is no longer highly probable; accordingly at 31 December 2012 the assets and liabilities of this UK branch-based business ceased to be classified as a disposal group. No adjustment was required to the carrying value of these assets and liabilities on reclassification. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', comparatives have not been restated.

In 2011, £80 million of allocated goodwill was written off against operating expenses in respect of the UK branch-based businesses. No adjustment was 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		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Debt securities						
- Government	23,529	32,812	34,437	11,984	19,910	21,268
- Other issuers	3,411	5,972	6,412	1,489	3,288	4,120
Equity shares	601	1,662	281	601	1,660	299
	27,541	40,446	41,130	14,074	24,858	25,687

Note:
(1) All short positions are classified as held-for-trading.

23 Accruals, deferred income and other liabilities

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Notes in circulation	1,684	1,683	1,793	1,106	1,130	1,094
Current tax	323	209	561	526	525	755
Accruals	3,276	4,040	5,415	2,019	2,484	3,392
Deferred income	718	872	1,457	505	537	861
Provisions for liabilities and charges	3,061	1,310	584	1,895	652	457
Other liabilities (1)	2,965	6,695	3,924	1,304	3,512	1,499
	12,027	14,809	13,734	7,355	8,840	8,058

Note:
(1) Other liabilities include £24 million (2011 - £15 million; 2010 - £18 million) in respect of share-based compensation.

	Group									
Provisions for liabilities and charges	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Other customer redress (3) £m	LIBOR (4) £m	Other regulatory provisions (5) £m	Litigation (6) £m	Technology incident redress (7) £m	Property (8) £m	Other £m	Total £m
At 1 January 2012	745	—	—	—	—	5	—	368	192	1,310
Transfer from accruals and other liabilities	—	—	119	—	125	65	—	—	88	397
	745	—	119	—	125	70	—	368	280	1,707
Currency translation and other movements	—	—	—	—	—	(3)	1	(2)	1	(3)
Charge to income statement	1,110	700	140	381	75	140	175	153	27	2,901
Releases to income statement	—	—	(2)	—	—	(8)	—	(38)	—	(48)
Provisions utilised	(960)	(24)	(96)	—	—	(115)	(148)	(90)	(63)	(1,496)
At 31 December 2012	895	676	161	381	200	84	28	391	245	3,061

For the notes to these tables refer to pages 282 and 283.

23 Accruals, deferred income and other liabilities continued

	Bank									
Provisions for liabilities and charges	Payment Protection Insurance (1) £m	Interest Rate Hedging Products (2) £m	Other customer redress (3) £m	LIBOR (4) £m	Other regulatory provisions (5) £m	Litigation (6) £m	Technology incident redress (7) £m	Property (8) £m	Other £m	Total £m
At 1 January 2012	254	—	—	—	—	—	—	214	184	652
Transfer from accruals and other liabilities	—	—	82	—	125	23	—	—	88	318
	254	—	82	—	125	23	—	214	272	970
Charge to income statement	541	275	122	381	75	13	54	140	26	1,627
Releases to income statement	—	—	(1)	—	—	(1)	—	(35)	—	(37)
Provisions utilised	(405)	(10)	(68)	—	—	(7)	(45)	(67)	(63)	(665)
At 31 December 2012	390	265	135	381	200	28	9	252	235	1,895

Notes:

(1) In April 2011, following dismissal by the High Court of a Judicial Review application by the British Bankers' Association, the RBS Group reached agreement with the FSA and the Financial Ombudsman Service on the handling of Payment Protection Insurance (PPI) complaints in accordance with FSA Policy Statement PS 10/12. The statement sets out the framework for reviewing individual complaints. It also requires firms to undertake root cause analysis; proactive contact exercises are required for certain categories of customer if systemic issues are identified.

The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio 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 (the uphold rate) have been established based on recent experience, guidance in the FSA policy statements and expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and the calculation rules in the FSA statement.

The table below shows the sensitivity of the Group's provision to changes in the principal assumptions (all other assumptions remaining the same).

	Sensitivity	
Assumption	Change in assumption %	Consequential change in provision £m
Take up rate	+/-5	+/-300
Uphold rate	+/-5	+/-35
Average redress	+/-5	+/-35

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, take up and uphold rates and average redress costs.

(2) In June 2012, following an industry wide review, the FSA announced that the RBS Group and other UK banks had agreed to:
- provide automatically fair and reasonable redress to non-sophisticated customers who were sold structured collars;
- review the sales of interest rate hedging products (other than caps or structured collars) to non-sophisticated customers to determine whether redress is due; and
- review the sale of caps to non-sophisticated customers to determine whether redress is due if a complaint is made by the customer during the review.

On 31 January 2013, the FSA announced the results of pilot studies by the RBS Group and other UK banks. The FSA announcement also clarified the tests to be applied to determine whether a customer qualifies as 'sophisticated' and created a set of redress principles.

The Group has estimated £700 million for its liability based on the FSA's guidance, an analysis of its portfolio of interest rate hedging products and the results of the pilot exercise. The provision includes redress that will be paid to customers, interest payable on customer redress: the cost to the Group of exiting the hedging positions; and the cost of undertaking the review.

The principal assumptions that underlie the estimate are: the number of transactions that meet the criteria for redress; the nature of the redress; in particular whether a product is terminated or replaced with an alternative product and/or a different profile; and the cost of the review.

23 Accruals, deferred income and other liabilities continued

The table below shows the sensitivity of the Group's provision to changes in the principal assumptions (all other assumptions remaining the same).

Assumption	Sensitivity: Change in assumption %	Sensitivity: Consequential change in provision £m
Number of customer transactions qualifying for redress (i)	+/-5	+/-29
Proportion of customer transactions qualifying for full redress (i)	+/-5	+/-42

(i) Customers qualifying for an alternative product reduced/increased pro rata.

As the redress and review exercise progresses it is likely that the level of the provision will change. There remain significant uncertainties over the number of transactions that will qualify for redress and the nature and cost of that redress.

(3) The Group has provided for customer redress in relation to certain other retail products. None of these provisions is individually material.

(4) On 6 February 2013, the Group reached agreement with the FSA, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The Group continues to cooperate with other governmental and regulatory authorities and the probable outcome of these investigations is that the Group will incur additional financial penalties. However, at this early stage, the Group is unable reliably to estimate their quantum.

(5) The Group is subject to a number of investigations by regulatory and other authorities. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 31.

(6) Arising out of its normal business operations, the Group is party to legal proceedings in the United Kingdom, the United States and other jurisdictions. Litigation provisions at 31 December 2012 related to numerous proceedings; no individual provision is material. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 31.

(7) In June 2012, the RBS Group experienced a technology incident that affected its transaction batch processing. Provisions of £175 million were charged during 2012 to meet the waiver of fees and interest; redress for customers of the Group; and other costs principally staff costs. These costs have been substantially settled and there is minimal uncertainty as to the final cost.

(8) The property provisions principally comprise provisions for onerous lease contracts. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

24 Deferred tax

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Deferred tax liability	789	1,384	1,422	—	—	—
Deferred tax asset	(3,066)	(3,320)	(1,790)	(2,878)	(2,584)	(794)
Net deferred tax asset	(2,277)	(1,936)	(368)	(2,878)	(2,584)	(794)

24 Deferred tax continued

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	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2011	(517)	2,652	(1,383)	88	(294)	2	76	91	(32)	(31)	(914)	(106)	(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)	(3)	369	132	951
(Credit)/charge to other comprehensive income	(88)	—	—	1	—	—	66	—	271	14	415	—	679
Disposals of subsidiaries	—	(35)	—	—	—	—	—	—	(1)	—	—	—	(36)
Currency translations and other adjustments	(4)	6	(6)	2	—	(4)	2	3	3	3	9	(5)	9
At 1 January 2012	(476)	2,363	(1,285)	70	(218)	75	119	177	235	(17)	(3,000)	21	(1,936)
Charge/(credit) to income statement	34	(505)	219	(12)	77	(98)	(28)	17	188	(1)	283	(67)	107
(Credit)/charge to other comprehensive income	(401)	—	—	(10)	—	—	36	—	152	5	(170)	—	(388)
(Disposals)/acquisitions of subsidiaries	—	(38)	—	—	—	(6)	—	—	—	—	—	52	8
Transfer to disposal groups	—	—	(85)	—	—	—	—	—	—	—	—	—	(85)
Currency translations and other adjustments	20	(37)	34	8	(7)	7	9	(8)	—	—	8	(17)	17
At 31 December 2012	(823)	1,783	(1,117)	56	(148)	(22)	136	186	575	(13)	(2,879)	(11)	(2,277)

	Bank									
	Pension £m	Accelerated capital allowances £m	Provisions £m	Deferred gains £m	IFRS transition £m	Cash flow hedging £m	Share schemes £m	Tax losses carried forward £m	Other £m	Total £m
At 1 January 2011	(7)	(193)	(520)	44	(125)	177	(26)	(144)	—	(794)
Transfer from fellow subsidiary	—	—	—	—	—	—	—	(3,038)	—	(3,038)
Charge/(credit) to income statement	3	130	267	(7)	33	4	(3)	143	(1)	569
Charge to other comprehensive income	—	—	—	—	—	259	4	416	—	679
At 1 January 2012	(4)	(63)	(253)	37	(92)	440	(25)	(2,623)	(1)	(2,584)
Charge/(credit) to income statement	5	(331)	(46)	(6)	35	4	—	139	2	(198)
(Credit)/charge to other comprehensive income	(25)	—	—	(6)	—	93	(1)	(170)	—	(109)
Currency translation and other adjustments	21	—	(5)	6	(7)	—	—	—	(2)	13
At 31 December 2012	(3)	(394)	(304)	31	(64)	537	(26)	(2,654)	(1)	(2,878)

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed below.

	2012 £m	2011 £m	2010 £m
UK tax losses carried forward			
- The Royal Bank of Scotland plc	2,654	2,623	144
- National Westminster Bank Plc	66	93	349
	2,720	2,716	493
Overseas tax losses carried forward			
- Ulster Bank Ireland	72	284	260
- RBS Citizens Financial Group, Inc	87	—	—
- RBS Aerospace	—	—	161
	159	284	421
	2,879	3,000	914

UK tax losses

Under UK tax rules, tax losses do not expire and can be carried forward indefinitely.

The Royal Bank of Scotland plc - the deferred tax asset in respect of tax losses brought forward at 1 January 2012 relates wholly to trading losses that arose in the UK branch of RBS N.V. These were transferred on 1 January 2011 following the transfer of the majority of the activities of the UK Branch of RBS N.V. to The Royal Bank of Scotland plc. The UK Branch tax losses attributable to credit market write-downs during the financial crisis were principally incurred between 2007 and 2009.

The Royal Bank of Scotland plc reported a taxable profit in 2011 and a tax loss in 2012. The tax loss in 2012 reflects the reversal of previous own credit gains offset by core banking profitability. Based on the RBS Group's strategic plan, the carried forward losses will be substantially utilised against future taxable profits of The Royal Bank of Scotland plc by the end of 2018. A 20% reduction in forecast profits would extend the recovery period by one year to 2019.

National Westminster Bank Plc - the deferred tax asset in respect of tax losses at 31 December 2012 relates to residual unrelieved trading losses that arose between 2009 and 2012. 95% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Based on the RBS Group's strategic plan, the residual carried forward losses will be fully utilised against future taxable profits of the company by the end of 2015. A 20% reduction in forecast profits would extend the recovery period by one year to 2016.

Overseas tax losses

Ulster Bank Ireland - a deferred tax asset has been recognised in respect of £575 million of total tax losses of £7,627 million carried forward at 31 December 2012. These losses arose principally as a result of significant impairment charges reflecting deteriorating economic conditions in the Republic of Ireland. Impairment charges are expected to reduce in the future. Based on the RBS Group's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits of the company by the end of 2019. A 20% reduction in forecast profits would extend the recovery period by one year to 2020.

RBS Citizens Financial Group - a deferred tax asset of £87 million has been recognised in respect of total tax losses of £239 million carried forward at 31 December 2012. The losses on which a deferred tax asset has been recognised will be utilised against future taxable profits in 2013. A 20% reduction in forecast profits would not extend the recovery period beyond 2013.

Unrecognised deferred tax

Deferred tax assets of £1,295 million (2011 - £743 million, 2010 - £298 million) have not been recognised in respect of tax losses carried forward of £10,230 million (2011 - £6,525 million, 2010 - £2,422 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses, £2,300 million will expire after five years. The balance of tax losses carried forward has no time limit.

Deferred tax liabilities of £214 million (2011 - £249 million; 2010 - £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 taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

25 Subordinated liabilities

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Dated loan capital	21,442	20,931	21,645	20,383	19,815	20,115
Undated loan capital	9,118	7,959	7,039	8,267	7,079	6,157
Preference shares	3,291	3,434	3,339	2,985	3,120	3,027
	33,851	32,324	32,023	31,635	30,014	29,299

In a series of exchange and tender offers in May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. In March 2012, the Group exchanged certain subordinated debt securities for new subordinated debt securities. 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 undertook that, unless otherwise agreed with the European Commission, neither the company nor any of its direct or indirect subsidiaries (excluding companies in the RBS Holdings N.V. Group, which are subject to different restrictions) would 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 was a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 were generally not subject to the restriction on dividend or coupon payments or call options. On 30 April 2012, the deferral period for RBS Group instruments ended and in May 2012, the RBS Group determined that it was in a position to recommence payments on these instruments. Future coupons and dividends will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Certain preference shares issued by the company 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 the final redemption date; and by the next call date.

2012 - final redemption	Group 2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	244	—	629	5,471	—	4,587	10,931
US dollar	625	664	1,497	3,254	—	5,898	11,938
Euro	1,474	—	1,713	3,607	219	1,507	8,520
Other	42	425	751	909	—	335	2,462
	2,385	1,089	4,590	13,241	219	12,327	33,851

2012 - call date	Group Currently £m	2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	—	464	60	826	7,221	135	2,225	10,931
US dollar	1,469	3,300	664	3,128	1,939	1,345	93	11,938
Euro	—	2,914	289	2,833	2,220	219	45	8,520
Other	9	715	—	1,174	564	—	—	2,462
	1,478	7,393	1,013	7,961	11,944	1,699	2,363	33,851

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

25 Subordinated liabilities continued

2012 - final redemption	Bank 2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	217	—	276	5,007	—	4,078	9,578
US dollar	620	664	1,497	3,040	—	5,462	11,283
Euro	1,474	—	1,713	3,607	219	1,308	8,321
Other	42	425	751	909	—	326	2,453
	2,353	1,089	4,237	12,563	219	11,174	31,635

2012 - call date	Bank Currently £m	2013 £m	2014 £m	2015-2017 £m	2018-2022 £m	Thereafter £m	Perpetual £m	Total £m
Sterling	—	217	60	386	6,725	135	2,055	9,578
US dollar	1,469	2,859	664	3,127	1,726	1,345	93	11,283
Euro	—	2,760	289	2,833	2,220	219	—	8,321
Other	—	715	—	1,174	564	—	—	2,453
	1,469	6,551	1,013	7,520	11,235	1,699	2,148	31,635

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

Dated loan capital	Capital treatment	2012 £m	2011 £m	2010 £m
The Bank				
€1,000 million 6% subordinated notes 2013	Lower Tier 2	869	921	989
US$50 million floating rate subordinated notes 2013	Lower Tier 2	36	37	38
€500 million 6% subordinated notes 2013	Lower Tier 2	415	426	439
£150 million 10.5% subordinated bonds 2013 (1)	Lower Tier 2	164	171	177
AUD397 million (2011 and 2010 - AUD590 million) 6% subordinated notes 2014 (callable quarterly from October 2009) (2)	Lower Tier 2	257	392	391
AUD265 million (2011 and 2010 - AUD410 million) floating rate subordinated notes 2014 (callable quarterly from October 2009) (2)	Lower Tier 2	171	272	272
CAD217 million (2011 and 2010 - CAD700 million) 4.25% subordinated notes 2015 (callable quarterly from March 2010) (2)	Lower Tier 2	135	444	452
£250 million 9.625% subordinated bonds 2015	Lower Tier 2	289	297	303
US$322 million (2011 and 2010 - US$750 million) floating rate Bermudian callable subordinated notes 2015 (callable quarterly from September 2010) (2)	Lower Tier 2	199	485	483
€750 million floating rate subordinated notes 2015	Lower Tier 2	688	709	725
CHF400 million 2.375% subordinated notes 2015	Lower Tier 2	287	295	287
CHF100 million 2.375% subordinated notes 2015	Lower Tier 2	84	88	83
CHF200 million 2.375% subordinated notes 2015	Lower Tier 2	134	136	136
US$229 million (2011 and 2010 - US$500 million) floating rate subordinated notes 2016 (callable quarterly from October 2011) (2)	Lower Tier 2	142	324	322
US$686 million (2011 and 2010 - US$1,500 million) floating rate subordinated notes 2016 (callable quarterly from April 2011) (2)	Lower Tier 2	425	971	967
€227 million (2011 and 2010 - €500 million) 4.5% subordinated notes 2016 (callable quarterly from January 2011) (2)	Lower Tier 2	185	420	450
CHF34 million (2011 and 2010 - CHF200 million) 2.75% subordinated notes 2017 (callable quarterly from December 2012) (2)	Lower Tier 2	23	138	138
€100 million floating rate subordinated notes 2017	Lower Tier 2	82	84	86
€102 million (2011 and 2010 - €500 million) floating rate subordinated notes 2017 (callable quarterly from January 2012) (2)	Lower Tier 2	84	419	432
€750 million 4.35% subordinated notes 2017	Lower Tier 2	721	723	721
AUD50 (2011 and 2010 - AUD450 million) 6.5% subordinated notes 2017 (callable quarterly from February 2012) (2)	Lower Tier 2	32	303	302
AUD90 million (2011 and 2010 - AUD450 million) floating rate subordinated notes 2017 (callable quarterly from February 2012) (2)	Lower Tier 2	58	298	295
US$450 million (2011 and 2010 - US$1,500 million) floating rate subordinated callable step-up notes 2017 (callable quarterly from August 2012) (2)	Lower Tier 2	279	970	966
€2,000 million 6.93% subordinated notes 2018	Lower Tier 2	2,033	2,023	1,999
US$125.6 million floating rate subordinated notes 2020	Lower Tier 2	78	81	81
€1,000 million 4.625% subordinated notes 2021 (callable quarterly from September 2016)	Lower Tier 2	938	948	949
€300 million CMS linked floating rate subordinated notes 2022	Lower Tier 2	272	271	280
€144.4 million floating rate subordinated notes 2023	Lower Tier 2	224	157	153
AUD883 million 13.125% subordinated notes 2022 (issued March 2012) callable March 2017	Lower Tier 2	585	—	—
CAD420 million 10.5% subordinated notes 2022 (issued March 2012) callable March 2017	Lower Tier 2	269	—	—
CHF124 million 9.375% subordinated notes 2022 (issued March 2012) callable March 2017	Lower Tier 2	90	—	—
€564 million 10.5% subordinated notes 2022 (issued March 2012) callable March 2017	Lower Tier 2	497	—	—
US$2,132 million 9.5% subordinated notes 2022 (issued March 2012) callable March 2017	Lower Tier 2	1,350	—	—
Due to the holding company				
US$300 million 6.375% subordinated notes 2011 (3)		—	—	199
US$750 million 5% subordinated notes 2013 (3)	Lower Tier 2	485	523	533
US$750 million 5% subordinated notes 2014 (3)	Lower Tier 2	520	562	562
US$250 million 5% subordinated notes 2014 (3)	Lower Tier 2	152	159	158
US$675 million 5.05% subordinated notes 2015 (3)	Lower Tier 2	463	495	493
US$350 million 4.7% subordinated notes 2018 (3)	Lower Tier 2	262	271	252
£5,000 million floating subordinated notes 2019 (3)	Lower Tier 2	5,008	5,002	5,002
US$2,250 million 6.125% subordinated notes 2022 (issued December 2012) (3)	Lower Tier 2	1,398	—	—
		20,383	19,815	20,115

25 Subordinated liabilities continued

Dated loan capital continued

	Capital treatment	2012 £m	2011 £m	2010 £m
National Westminster Bank Plc				
€500 million 5.125% subordinated notes 2011		—	—	442
£300 million 7.875% subordinated notes 2015	Lower Tier 2	360	371	370
£300 million 6.5% subordinated notes 2021	Lower Tier 2	410	400	367
Charter One Financial, Inc.				
US$400 million 6.375% subordinated notes 2012 (redeemed January 2012)		—	261	265
US$350 million 4.150% subordinated notes 2022 (issued September 2012)	Ineligible	217	—	—
First Active plc				
£60 million 6.375% subordinated bonds 2018 (callable quarterly from April 2013)	Lower Tier 2	63	64	66
Non-controlling interests subordinated issues		9	20	20
		21,442	20,931	21,645

Notes:
(1) Unconditionally guaranteed by The Royal Bank of Scotland Group plc.
(2) Partially repurchased following completion of an exchange offer in March 2012.
(3) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
(4) 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.
(5) 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.
(6) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Undated loan capital	Capital treatment	2012 £m	2011 £m	2010 £m
The Bank				
£31 million 7.375% undated subordinated notes	Upper Tier 2	31	31	31
£51 million 6.25% undated subordinated notes (callable every five years from December 2012) (1)	Upper Tier 2	51	53	55
£56 million 6% undated subordinated notes (callable every five years from September 2014) (1)	Upper Tier 2	61	62	61
€176 million 5.125% undated subordinated notes (callable quarterly from July 2014) (1)	Upper Tier 2	155	161	166
€170 million floating rate undated subordinated notes (callable quarterly from July 2014) (1)	Upper Tier 2	138	141	145
£54 million 5.125% undated subordinated notes (callable every five years from March 2016) (1)	Upper Tier 2	61	61	58
£35 million 5.5% undated subordinated notes (callable every five years from December 2019) (1)	Upper Tier 2	39	37	35
£21 million 6.2% undated subordinated notes (callable every five years from March 2022) (1)	Upper Tier 2	46	45	43
£103 million 9.5% undated subordinated bonds (callable every five years from August 2018) (1,2)	Upper Tier 2	137	137	130
£16 million (2011 and 2010 - £22 million) 5.625% undated subordinated notes (callable every five years from September 2026) (1)	Upper Tier 2	24	23	21
£19 million 5.625% undated subordinated notes (callable every five years from June 2032) (1)	Upper Tier 2	13	13	20
£1 million floating rate undated subordinated notes (callable semi-annually from March 2011) (1)	Upper Tier 2	1	1	2
CAD474 million 5.37% fixed rate undated subordinated notes (callable quarterly from May 2016) (1)	Upper Tier 2	328	347	340
Due to the holding company				
US$350 million floating rate primary capital notes (callable semi-annually from December 1990) (3)	Upper Tier 2	217	226	225
€1,250 million 6.467% perpetual regulatory tier one securities (callable quarterly from June 2012) (3)	Tier 1	1,019	1,083	1,125
US$1,200 million 7.648% perpetual regulatory securities (callable quarterly from September 2031) (3,4)	Tier 1	752	785	783
£1,500 million floating rate perpetual subordinated notes (3)	Upper Tier 2	1,516	1,510	1,500
US$600 million floating rate perpetual subordinated notes (callable quarterly from October 2017) (3)	Upper Tier 2	371	388	386
US$1,600 million floating rate perpetual subordinated notes (callable quarterly from October 2017) (3)	Upper Tier 2	990	1,034	1,031
£940 million floating rate perpetual subordinated notes (3)	Lower Tier 2	950	941	—
US$150 million 8.000% perpetual subordinated notes (issued April 2012) (3)	Lower Tier 2	95	—	—
US$136 million 7.750% perpetual subordinated notes (issued April 2012) (3)	Lower Tier 2	84	—	—
£200 million perpetual subordinated notes (issued June 2012) (3)	Lower Tier 2	202	—	—
£885 million perpetual subordinated notes (issued September 2012) (3)	Lower Tier 2	885	—	—
£100 million perpetual subordinated notes (issued September 2012) (3)	Lower Tier 2	101	—	—
		8,267	7,079	6,157

	Capital treatment	2012 £m	2011 £m	2010 £m
National Westminster Bank Plc				
US$193 million floating rate primary capital, Series A (callable semi-annually from July 1990) (1)	Upper Tier 2	119	124	124
US$229 million primary capital floating rate primary capital, Series B (callable semi-annually from August 1990) (1)	Upper Tier 2	142	148	148
US$285 million primary capital floating rate primary capital, Series C (callable semi-annually from November 1990 (1)	Upper Tier 2	177	184	184
€178 million 6.625% fixed/floating rate undated subordinated notes (callable quarterly from October 2009) (1)	Upper Tier 2	146	150	154
€10 million floating rate step-up notes (callable quarterly from October 2009) (1)	Upper Tier 2	9	9	9
£87 million floating rate subordinated step-up notes (callable every five years from January 2010) (1)	Upper Tier 2	92	91	89
£53 million 7.125% subordinated step-up notes (callable every five years from October 2022) (1)	Upper Tier 2	55	56	54
£35 million 11.5% subordinated notes (callable any time from December 2022) (1,5)	Upper Tier 2	38	42	42
First Active plc				
£20 million 11.75% perpetual; subordinated notes	Lower Tier 2	25	26	26
€38 million 11.375% perpetual; subordinated notes	Lower Tier 2	46	48	50
£1.3 million floating rate perpetual; subordinated notes	Lower Tier 2	2	2	2
		9,118	7,959	7,039

Notes:
(1) Partially repurchased following completion of the exchange and tender offers in May 2010.
(2) Guaranteed by the company.
(3) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
(4) 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.
(5) 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.
(6) 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.
(7) 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.
(8) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Preference shares	Capital treatment	2012 £m	2011 £m	2010 £m
The Bank				
Non-cumulative preference shares of US$0.01 (1)				
Series F US$200 million 7.65% (callable any time from March 2007)	Tier 1	123	129	129
Series H US$300 million 7.25% (callable any time from March 2004)	Tier 1	186	194	193
Series L US$751 million 6.800% callable any time from October 2009)	Tier 1	465	485	483
Series M US$850 million 4.709% (callable July 2013)	Tier 1	528	554	542
Series N US$650 million 6.425% (callable January 2034)	Tier 1	524	548	472
Series R US$850 million 5.75% (callable quarterly from October 2009)	Tier 1	526	549	548
Series 1 US$1,000 million 9.118% (callable any time from March 2010)	Tier 1	633	661	660
		2,985	3,120	3,027
National Westminster Bank Plc				
Non-cumulative preference shares of £1 £140 million 9% (not callable)	Tier 1	145	145	144
Non-cumulative preference shares of US$25, US$246 million 7.7628% (callable quarterly from April 2002) (2,3)	Tier 1	161	169	168
		3,291	3,434	3,339

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		
	2012 £m	2011 £m	2010 £m
Ordinary shares of £1	6,609	6,609	6,609
Non-cumulative preference shares of US$0.01	—	—	—
Non-cumulative preference shares of €0.01	—	—	—

	Allotted, called up and fully paid		
Number of shares - millions	2012	2011	2010
Ordinary shares of £1	6,609	6,609	6,609
Non-cumulative preference shares of US$0.01	59	59	59
Non-cumulative preference shares of €0.01	1	1	1

Ordinary and preference shares

One ordinary share was issued at a premium of £706 million on the cross-border merger with RBS II B.V. in connection with the transfer of substantially all of RBS N.V.'s Netherlands and EMEA businesses to the company. No other shares were issued during either 2012 or 2011.

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.

During the year, the Group received a contribution of capital of £2,870 million (2011 - £4,539 million; 2010 - £1,000 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				Operating lease assets: future minimum lease rentals £m
	Gross amount £m	Present value adjustments £m	Other movements £m	Present value £m	
2012					
Within 1 year	3,605	(330)	(40)	3,235	293
After 1 year but within 5 years	5,963	(600)	(197)	5,166	512
After 5 years	4,984	(1,709)	(315)	2,960	291
Total	14,552	(2,639)	(552)	11,361	1,096
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

	Group		
	2012 £m	2011 £m	2010 £m
Nature of operating lease assets on the balance sheet			
Transportation	1,432	1,549	6,162
Cars and light commercial vehicles	606	995	1,016
Other	165	161	208
	2,203	2,705	7,386
Amounts recognised as income and expense			
Finance leases - contingent rental income	(110)	(133)	(160)
Operating leases - minimum rentals payable	392	409	411
Finance lease contracts and hire purchase agreements			
Accumulated allowance for uncollectable minimum receivables	278	347	401

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 234 to 237) and operating lease assets (see pages 277 and 278).

	Year in which residual value will be recovered				
2012	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	284	182	207	333	1,006
- cars and light commercial vehicles	317	44	49	1	411
- other	30	19	39	3	91
Finance lease contracts	38	47	148	318	551
Hire purchase agreements	1	–	1	—	2
	670	292	444	655	2,061
2011					
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

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, asset transfers and other collateral given

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											
	2012				2011				2010			
		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)	16,448	6,462	11,963	18,425	49,269	10,732	47,324	58,056	52,767	12,713	50,028	62,741
- UK (covered bonds)	15,990	10,139	—	10,139	15,441	9,107	—	9,107	8,046	4,100	—	4,100
- Irish	10,587	3,217	7,634	10,851	12,660	3,472	8,670	12,142	15,034	5,101	11,152	16,253
UK credit cards	3,019	1,243	1,736	2,979	4,037	500	110	610	3,993	34	1,500	1,534
UK personal loans	4,658	—	4,283	4,283	5,168	—	4,706	4,706	5,795	—	5,383	5,383
Other loans (4)	17,215	352	18,064	18,416	19,778	4	20,577	20,581	25,193	974	23,186	24,160
	67,917	21,413	43,680	65,093	106,353	23,815	81,387	105,202	110,828	22,922	91,249	114,171
Cash deposits (5)	5,823				11,998				13,068			
	73,740				118,351				123,896			

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 2012, cash deposits comprised £4.7 billion from mortgage repayments and £1.1 billion from other loan repayments held in the SPEs, to repay debt securities issued by the own-asset securitisation vehicles (2011 - £11.2 billion and £0.8 billion; 2010 - £12.3 billion and £0.8 billion respectively).

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	2012 (2) £m	2011 £m	2010 £m
Mortgages			
- UK (RMBS)	8,829	22,140	26,829
- UK (covered bonds)	3,030	3,127	2,466
UK credit cards	1,128	1,560	1,819
UK personal loans	1,238	1,374	1,540
Other loans (1)	9,226	12,463	15,868
	23,451	40,664	48,522

Notes:
(1) Comprises corporate, social housing and student loans.
(2) The fair value of the transferred assets is £22,273 million. Holders of securities issued by the SPEs have recourse to these assets only.

28 Securitisations, asset transfers and other collateral given continued

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 of the assets and continues to recognise the assets to the extent of its continuing involvement, as defined by IAS 39, which takes the form of retaining certain subordinated bonds issued by the securitisation SPEs.

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.

At 31 December 2012, securitised assets were £0.4 billion (2011 - £0.6 billion; 2010 - £2.3 billion); retained interest at fair value £61 million (2011 - £72 million; 2010 - £286 million); subordinated assets £1 million (2011 - £3 million; 2010 - £4 million); and related liabilities £1 million (2011 - £3 million; 2010 - £4 million).

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 subject to securities repurchase agreements or lending transactions	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Debt securities	87,159	72,652	79,558	55,320	37,166	41,203
Equity shares	6,772	5,256	77	6,772	5,245	77

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	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Loans and advances to banks	11,553	18,030	25,148	11,545	18,021	25,107
Loans and advances to customers	24,814	51,447	44,781	23,040	21,694	15,115
Securities	16,371	3,690	4,318	12,365	694	—
	52,738	73,167	74,247	46,950	40,409	40,222
Liabilities secured by assets						
Deposits by banks	9,409	6,346	7,684	7,433	3	—
Customer accounts	3,000	2,663	3,599	—	—	—
Derivatives	56,738	75,513	78,989	56,089	74,481	78,512
	69,147	84,522	90,272	63,522	74,484	78,512

The Group transferred certain assets resulting in their derecognition, but the Group has continuing involvement as defined in IFRS 7 in these assets through holdings of debt securities with a carrying value of £398 million (fair value - £339 million) at 31 December 2012. Income for the year was £13 million.

29 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 295 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.

29 Special purpose entities continued

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 ways the Group may be involved with conduits and other special purpose entities are described above.

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.

	2012			2011			2010		
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
Total assets held by the conduits	2,839	765	3,604	11,208	1,893	13,101	14,142	3,624	17,766
Commercial paper issued (1)	717	—	717	10,590	859	11,449	13,277	2,540	15,817
Liquidity and credit enhancements									
Deal specific liquidity									
- drawn	2,122	781	2,903	321	1,051	1,372	868	1,109	1,977
- undrawn	1,521	17	1,538	15,324	1,144	16,468	19,642	2,980	22,622
PWCE (2)	60	—	60	795	193	988	1,025	257	1,282
	3,703	798	4,501	16,440	2,388	18,828	21,535	4,346	25,881
Maximum exposure to loss (3)	3,643	798	4,441	15,646	2,194	17,840	20,510	4,089	24,599

Notes:
(1) Includes £0.7 billion of ABCP issued to RBS plc at 31 December 2012 (2011 - £0.3 billion; 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.

30 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)	2012 £m	2011 £m	2010 £m
Shareholders' equity per balance sheet	59,288	61,726	57,010
Other equity instruments	(1,421)	(1,421)	(1,421)
	57,867	60,305	55,589
Non-controlling interests per balance sheet	137	128	597
Regulatory adjustments and deductions			
Own credit	1,563	(1,157)	(622)
Defined pension benefit adjustment	913	—	—
Unrealised gains on AFS debt securities	(1,710)	(2,114)	(843)
Unrealised gains on AFS equity shares	(40)	(106)	(74)
Cash flow hedging reserve	(1,815)	(1,018)	81
Other adjustments for regulatory purposes	10	(230)	(277)
Goodwill and other intangible assets	(12,403)	(12,365)	(11,832)
50% excess of expected losses over impairment provisions (net of tax)	(1,954)	(2,553)	(1,998)
50% of securitisation positions	(1,001)	(1,605)	(1,916)
50% of APS first loss	—	(2,763)	(4,225)
	(16,437)	(23,911)	(21,706)
Core Tier 1 capital	41,567	36,522	34,480
Other Tier 1 capital			
Preference shares - debt	2,759	2,857	2,890
Innovative/hybrid Tier 1 securities	3,551	3,645	3,638
	6,310	6,502	6,528
Tier 1 deductions			
50% of material holdings	(239)	(235)	(242)
Tax on excess of expected losses over impairment provisions	634	920	797
	395	685	555
Total Tier 1 capital	48,272	43,709	41,563

30 Capital resources continued

Qualifying Tier 2 capital	2012 £m	2011 £m	2010 £m
Undated subordinated debt	4,814	4,916	4,925
Dated subordinated debt, net of amortisation	18,121	17,272	18,067
Unrealised gains on AFS equity shares	40	106	74
Collectively assessed impairment provisions	379	584	672
Non-controlling Tier 2 capital	—	11	11
	23,354	22,889	23,749
Tier 2 deductions			
50% of securitisation positions	(1,001)	(1,605)	(1,916)
50% excess of expected losses over impairment provisions	(2,588)	(3,473)	(2,795)
50% of material holdings	(239)	(235)	(242)
50% of APS first loss	—	(2,763)	(4,225)
	(3,828)	(8,076)	(9,178)
Total Tier 2 capital	19,526	14,813	14,571
Supervisory deductions			
Unconsolidated investments	(37)	(111)	(116)
Other deductions	(193)	(184)	(267)
	(230)	(295)	(383)
Total regulatory capital	67,568	58,227	55,751

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.

31 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 2012. 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		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Contingent liabilities						
Guarantees and assets pledged as collateral security	15,413	15,142	22,946	11,412	9,965	17,195
Other contingent liabilities	9,760	8,999	10,033	7,959	7,304	7,976
	25,173	24,141	32,979	19,371	17,269	25,171
Commitments						
Undrawn formal standby facilities, credit lines and other commitments to lend						
- less than one year	82,753	97,501	114,112	28,488	43,893	46,751
- one year and over	129,396	123,644	120,091	107,054	101,579	97,525
Other commitments	1,589	2,830	4,053	1,382	59	1,124
	213,738	223,975	238,256	136,924	145,531	145,400

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.

31 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		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Operating leases						
Minimum rentals payable under non-cancellable leases (1)						
Within 1 year	375	394	409	161	164	171
After 1 year but within 5 years	1,213	1,321	1,327	547	585	595
After 5 years	2,261	2,489	2,651	1,419	1,523	1,621
	3,849	4,204	4,387	2,127	2,272	2,387
Property, plant and equipment						
Contracts to buy assets to be leased under operating leases (2,3)	—	2,607	2,590	—	—	—
Other capital expenditure	37	35	150	17	19	23
	37	2,642	2,740	17	19	23
Contracts to purchase goods or services (4)	959	1,130	938	895	1,044	871
	4,845	7,976	8,065	3,039	3,335	3,281
Included above are obligations to fellow subsidiaries						
Within 1 year	—	7	7	—	7	7
After 1 year but within 5 years	—	28	27	—	27	27
After 5 years	—	28	35	—	28	35
	—	63	69	—	62	69

Notes:
(1) Predominantly property leases.
(2) Of which due within 1 year - nil (2011 - £486 million; 2010 - £263 million).
(3) At 31 December 2011, £2,607 million related to the RBS Aviation Capital business which was sold in 2012.
(4) Of which due within 1 year: Group - £444 million (2011 - £483 million; 2010 - £435 million); Bank - £386 million (2011 - £405 million; 2010 - £374 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 £414 million (2011 - £416 million; 2010 - £407 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 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 compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The interest rate on these borrowings increased from 12 month LIBOR plus 30 basis points to 12 month LIBOR plus 100 basis points from April 2012. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS expects to levy the deposit taking sector for the balance of the principal on the non-Bradford & Bingley loans over three scheme years to repay the principal by March 2016 with a first instalment of £363 million in the 2013/14 scheme year.

The Group has accrued £119 million for its share of estimated FSCS levy for the 2012/13 and 2013/14 scheme years.

Litigation, investigations and reviews

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 is 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 2012.

The material legal proceedings, investigations and reviews involving the RBS Group are described below. If 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

Shareholder litigation

RBSG and certain of its subsidiaries, together with certain current and former individual officers and directors were 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 alleged 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 asserted claims under Sections 11, 12 and 15 of the US Securities Act of 1933, as amended (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 (SEC) registration statement. Plaintiffs sought unquantified damages on behalf of the putative class. The defendants moved to dismiss the complaint and briefing on the motions was completed in September 2011. On 4 September 2012, the Court dismissed the Preferred Shares litigation with prejudice. The plaintiffs have appealed the dismissal to the United States Court of Appeals for the Second Circuit.

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 (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 on the motions was completed in April 2012. The Court heard oral argument on the motions on 19 July 2012. On 27 September 2012, the Court dismissed the ADR claims with prejudice. The plaintiffs have filed motions for reconsideration and for leave to re-plead their case.

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. In October 2011, the RBS Group submitted a detailed response to a letter before action from one purported plaintiff group in the United Kingdom.

Other securitisation and securities related litigation in the United States

There continues to be a high level of litigation activity in the financial services industry focused on residential mortgage and credit crisis related matters. As a result, the RBS Group has become the subject of claims for damages and other relief regarding mortgages and related securities and expects that it may become the subject of additional such claims in the future.

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 pending individual and class action cases involve the issuance of more than US$85 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 45 lawsuits brought by purchasers of MBS, including the purported class actions identified below.

31 Memorandum items continued

Among these MBS 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 is pending in the federal court in Connecticut, and it relates to approximately US$32 billion of MBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. The defendants' motion to dismiss FHFA's amended complaint in this case is pending, but the court has permitted discovery to commence. The other five FHFA lawsuits (against Ally Financial Group, Countrywide Financial Corporation, JP Morgan, Morgan Stanley, and Nomura) name RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. Four of these cases are part of a coordinated proceeding in federal court in New York in which discovery is underway. The fifth case (the Countrywide matter) is pending in federal court in California, and is currently the subject of a motion to dismiss.

Other MBS 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. (the Thornburg Litigation); and Luther v. Countrywide Financial Corp. et al. and related cases. On 25 February 2013, the federal district court overseeing the Thornburg Litigation entered a final order approving a settlement of the litigation, involving a US$11.25 million payment by the defendants.

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 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.

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 various federal laws, including the US commodities and antitrust laws, and state statutory and 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. It is possible that further claims may be threatened or brought in the US or elsewhere relating to the setting of interest rates or interest rate-related trading.

Details of LIBOR investigations affecting the RBS Group are set out under 'Investigations and reviews' on page 305.

Unarranged overdraft charges

RBS Citizens Financial Group, Inc (RBS Citizens) and its affiliates were among more than thirty banks named as defendants in US class action lawsuits alleging that the manner in which defendant banks posted transactions to consumer accounts caused customers to incur excessive overdraft fees. The complaints against RBS Citizens, which concern the period between 2002 and 2010 and were consolidated into one case, alleged that this conduct violated its duty of good faith and fair dealing, was unconscionable and constituted an unfair trade practice and a conversion of customers' funds. In April 2012, RBS Citizens agreed to settle this matter for US$137.5 million. The RBS Group has made a one-time payment of the settlement amount into a settlement fund which, upon final approval of the settlement, will be used to make payments to class members. A motion for final approval of the settlement was filed on 10 January 2013, and that motion was granted on 7 March 2013. Consumers who did not opt out of the settlement are deemed to have released any claims related to the allegations in the lawsuits.

Summary of other disputes, legal proceedings and litigation

In addition to the matters described above, members of the RBS Group are engaged in other disputes and 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, does not expect that the outcome of any of these other claims and proceedings will have a material adverse effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

Investigations and reviews

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 governmental and regulatory authorities, 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 governmental and regulatory authorities, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of the RBS Group's business activities or fines. Any of these events or circumstances could have a material adverse effect on the RBS Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

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.

The RBS Group is co-operating fully with the investigations and reviews described below.

LIBOR and other trading rates

On 6 February 2013 the RBS Group announced settlements with the Financial Services Authority in the United Kingdom, the United States Commodity Futures Trading Commission and the United States Department of Justice (DOJ) in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). The RBS Group agreed to pay penalties of £87.5 million, US$325 million and US$150 million to these authorities respectively to resolve the investigations. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. RBS Securities Japan Limited agreed to enter a plea of guilty to one count of wire fraud relating to Yen LIBOR. The RBS Group continues to co-operate with investigations by these and various other governmental and regulatory authorities, including in the US and Asia, into its submissions, communications and procedures relating to the setting of LIBOR and other trading rates. The RBS Group is also under investigation by competition authorities in a number of jurisdictions, including the European Commission and Canadian Competition Bureau, stemming from the actions of certain individuals in the setting of LIBOR and other trading rates, as well as interest rate-related trading. The RBS Group is also co-operating with these investigations.

It is not possible to estimate reliably what effect the outcome of these remaining investigations, any regulatory findings and any related developments may have on the RBS Group, including the timing and amount of further fines, sanctions or settlements, which may be material.

Technology incident

On 19 June 2012 the RBS Group was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The cause of the incident has been investigated by independent external counsel with the assistance of third party advisors. The RBS Group has agreed to reimburse customers for any loss suffered as a result of the incident. The RBS Group provided £175 million in 2012 for this matter. Additional costs may arise once all redress and business disruption items are clear.

The incident, the RBS Group's handling of the incident and the systems and controls surrounding the processes affected, are the subject of regulatory enquiries (both from the UK and Ireland) and the RBS Group could become a party to litigation. In particular, the RBS Group could face legal claims from those whose accounts were affected and could itself have claims against third parties.

Interest rate hedging products

In June 2012, following an industry wide review, the FSA announced that the RBS Group and other UK banks had agreed to a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses who were classified as retail clients under FSA rules. On 31 January 2013, the FSA issued a report outlining the principles to which it wishes the RBS Group and other UK banks to adhere in conducting the review and redress exercise.

The RBS Group will provide fair and reasonable redress to non-sophisticated customers classified as retail clients, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the RBS Group is required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, the RBS Group will propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients who have purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 will be entitled to approach the RBS Group and request a review.

The redress exercise and the past business review is being scrutinised by an independent reviewer, who will review and agree any redress, and will be overseen by the FSA. The RBS Group made a total provision of £700 million in 2012 in respect of this matter, including £125 million for administration expenses. As the actual amount that the RBS Group will be required to pay will depend on the facts and circumstances of each case, there is no certainty as to the eventual costs of redress.

31 Memorandum items continued

Retail banking

Since initiating an inquiry into retail banking in the European Union (EU) in 2005, the European Commission (EC) continues to keep retail banking under review. In late 2010 the EC launched an initiative pressing for greater transparency of bank fees and is currently proposing to legislate for increased harmonisation of terminology across Member States, with proposals expected in the first quarter of 2013. The RBS Group cannot predict the outcome of these actions at this stage.

FSA mystery shopping review

On 13 February 2013 the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved. The action required includes a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers). The RBS Group will be required to appoint an independent third party to either carry out or oversee this work. The scope and terms of the past business review and the appointment of the independent third party have not yet been determined. The RBS Group cannot predict the outcome of this review at this stage.

Multilateral interchange fees

In 2007, the EC issued a decision that, while interchange is not illegal per se, MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA were in breach of competition law. MasterCard was required 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 General Court in March 2008, with the RBS Group intervening in the appeal proceedings. The General Court heard MasterCard's appeal in July 2011 and issued its judgment in May 2012, upholding the EC's original decision. MasterCard has appealed further to the Court of Justice and the RBS Group has intervened in these appeal proceedings.

In March 2008, the EC also opened a formal inquiry into Visa's MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the EEA. In April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. However, in 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. In July 2012 Visa made a request to re-open the settlement in order to modify the fee. The EC rejected the request and in October 2012 Visa filed an appeal to the General Court seeking to have that decision annulled. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions. On 31 July 2012 the EC announced that it had issued Visa with a supplementary Statement of Objections regarding consumer credit cards in the EEA.

In the UK, the Office of Fair Trading (OFT) has carried out investigations into Visa and MasterCard domestic credit card interchange rates. The OFT has not made any finding of an infringement of competition law and has not issued a Statement of Objections to any of the parties under investigation. In February 2013 the OFT confirmed that while reserving its right to do so, it does not currently expect to issue Statements of Objections (if at all) prior to the handing down of the Court of Justice judgment in the matter of MasterCard's appeal against the EC's 2007 infringement decision.

The outcome of these investigations is not known, but they may have a material adverse effect on the consumer credit industry in general and, therefore, on the RBS Group's business in this sector.

Payment Protection Insurance

The FSA conducted a broad industry thematic review of Payment Protection Insurance (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.

The FSA published a final policy statement in August 2010 imposing significant changes with respect to the handling of complaints about the mis-selling of PPI. 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 reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints. Implementation of the agreed processes is currently under way. Following agreement with the FSA in 2011, the RBS Group increased its provision of £215 million at 31 December 2010 by £850 million in respect of PPI. In 2012 a further provision of £1,110 million was recorded. This strengthened the cumulative provision for PPI to £2.2 billion, from which £1.3 billion in redress had been paid by 31 December 2012.

Personal current accounts

In July 2008 the OFT published a market study report into Personal Current Accounts (PCAs) raising concerns as regards the way the market was functioning. In October 2009 the OFT summarised initiatives agreed with industry to address these concerns. In 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 UK, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes were required for the market to work in the best interests of bank customers. In March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives designed to address its concerns, 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 that it would conduct six-monthly reviews and would also review the market again fully in 2012 and undertake a brief analysis on barriers to entry.

The first six-monthly review was completed in September 2010. The OFT noted progress in switching, transparency and unarranged overdrafts for the period March to September 2010 and highlighted further changes it wanted to see in the market. In March 2011, the OFT published the next update report in relation to PCAs. 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).

Additionally, in May 2010, the OFT announced its review of barriers to entry. The review concerned retail banking and banking for small and medium size enterprises (SMEs) (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 UK. 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.

On 13 July 2012, the OFT launched its planned full review of the PCA market. The review was intended to consider whether the initiatives agreed by the OFT with banks to date have been successful and whether the market should be referred to the Competition Commission (CC) for a fuller market investigation.

The OFT's PCA report was published on 25 January 2013. The OFT acknowledged some specific improvements in the market since its last review but concluded that further changes are required to tackle ongoing concerns, including a lack of switching, the ability of consumers to compare products and the complexity of overdraft charges. However, the OFT recognises that a number of major developments are expected over the coming months including divestment of branches and improvements in account switching and assistance to customers to compare products and services. Therefore the OFT has provisionally decided not to refer the market to the CC at this stage but expects to return to the question of a referral to the CC in 2015, or before. The OFT also announced that it will be carrying out behavioural economic research on the way consumers make decisions and engage with retail banking service, and will study the operation of payment systems as well as the SME banking market.

At this stage it is not possible to estimate the effect of these OFT reviews which may be material.

Securitisation and collateralised debt obligation business

In the United States, the RBS Group is involved in 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, RBS 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.

In September and October 2010, the SEC requested voluntary production of information concerning residential mortgage-backed securities (RMBS) 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. The investigation appears to be focused on certain specific RMBS securitisations underwritten in 2007 and is continuing.

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 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.

US mortgages - loan repurchase matters

The RBS Group's Markets & International Banking N.A. or M&IB N.A. business (formerly Global Banking & Markets 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). M&IB 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).

31 Memorandum items continued

In issuing RMBS, M&IB 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, M&IB N.A. made such representations and warranties itself. Where M&IB N.A. has given those or other representations and warranties (whether relating to underlying loans or otherwise), M&IB 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, M&IB N.A. may be able to assert claims against third parties who provided representations or warranties to M&IB N.A. when selling loans to it; although the ability to recover against such parties is uncertain. Between the start of 2009 and the end of December 2012, M&IB N.A. received approximately US$606 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 M&IB N.A.. However, repurchase demands presented to M&IB N.A. are subject to challenge and rebuttal by M&IB N.A..

RBS Citizens has not been an issuer or underwriter of non-agency RMBS. However, RBS 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, RBS 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. Between the start of 2009 and the end of 2012, RBS Citizens received US$141.9 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to RBS Citizens are subject to challenge and rebuttal by RBS Citizens.

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, RBS Citizens has not been materially impacted by such disruptions and the RBS Group has not ceased making foreclosures.

The volume of repurchase demands is increasing and is expected to continue to increase, and the RBS Group cannot currently estimate what the ultimate exposure of M&IB N.A. or RBS Citizens may be. 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 net assets, operating results or cash flows in any particular period.

Other investigations

On 27 July 2011, the RBS Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (the Order) to address deficiencies related to governance, risk management and compliance systems and controls in RBS plc and RBS N.V. branches. In the Order, the RBS Group agreed to create the following written plans or programmes:

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's U.S. operations on an enterprise-wide and business line basis,
- an enterprise-wide risk management programme for the RBS Group's U.S. operations,
- a plan to oversee compliance by the RBS Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,
- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,
- a plan to improve the U.S. Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve,
- a customer due diligence programme designed to reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations, and
- a plan designed to enhance the U.S. Branches' compliance with OFAC requirements.

The Order (which is publicly available) identified specific items to be addressed, considered, and included in each proposed plan or programme. The RBS Group also agreed in the Order to adopt and implement the plans and programmes after approval by the regulators, to fully comply with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Order. The RBS Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the RBS Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the RBS Group's U.S. operations. The RBS Group continues to test the effectiveness of the remediation efforts undertaken by the RBS Group to ensure they are sustainable and meet regulators' expectations. Furthermore, the RBS Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Order, which will remain in effect until terminated by the regulators.

The RBS Group's operations include businesses outside the United States that are responsible for processing US dollar payments. The RBS Group has been conducting a review of its policies, procedures and practices in respect of such payments, has voluntarily made disclosures to US and UK authorities with respect to its historical compliance with US economic sanctions regulations, and is continuing to co-operate with related investigations by government authorities. The RBS Group has also, over time, enhanced its relevant systems and controls. Further, the RBS Group has initiated disciplinary proceedings against a number of its employees as a result of its investigation into employee conduct relating to this matter. Although the RBS Group cannot currently determine the outcome of its discussions with the relevant authorities, the investigation costs, remediation required or liability incurred could have a material adverse effect on the Group's 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. The RBS Group's activities in the United States may be subject to significant limitations and/or conditions.

In 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 September 2012, SEC staff communicated that it had completed this investigation as to RBS and that it did not, as of the date of that communication and based upon the information then in its possession, intend to recommend any enforcement action. 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. In March 2012, the SEC communicated to the RBS Group that it had completed this investigation and that it did not, as of the date of that communication and based upon the information then in its possession, intend to recommend any enforcement action.

32 Net cash (outflow)/inflow from operating activities

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
Operating (loss)/profit before tax	(3,412)	(864)	(171)	(824)	1,867	384
Decrease/(increase) in prepayments and accrued income	296	700	(247)	585	137	(261)
Interest on subordinated liabilities	1,207	1,034	816	1,134	947	647
Decrease in accruals and deferred income	(1,123)	(1,821)	(471)	(658)	(1,318)	(922)
Provisions for impairment losses	5,214	7,176	9,400	1,548	1,533	3,571
Loans and advances written-off net of recoveries	(3,555)	(3,675)	(4,015)	(1,823)	(1,477)	(2,392)
Unwind of discount on impairment losses	(476)	(479)	(444)	(128)	(135)	(113)
(Profit)/loss on sale of property, plant and equipment	(21)	(11)	(50)	—	7	1
(Profit)/loss on sale of subsidiaries and associates	(150)	67	(675)	174	(3)	305
(Profit)/loss on sale of securities	(1,803)	(867)	(253)	(1,671)	(741)	11
Charge for defined benefit pension schemes	400	329	489	3	2	8
Pension scheme curtailment gains	(38)	—	(78)	—	—	—
Cash contribution to defined benefit pension schemes	(888)	(975)	(641)	(26)	(3)	(3)
Other provisions charged net of releases	2,853	963	355	1,590	417	485
Other provisions utilised	(1,496)	(486)	(207)	(665)	(288)	(156)
Depreciation and amortisation	1,614	1,590	1,689	763	613	561
Gain on redemption of own debt	(454)	(255)	(502)	(454)	—	(345)
Write-down of goodwill and other intangible assets	51	80	1	21	—	—
Elimination of foreign exchange differences	6,111	1,743	(3,107)	4,933	2,331	(1,745)
Other non-cash items	1,499	1,932	413	2,116	1,239	(369)
Net cash inflow/(outflow) from trading activities	5,829	6,181	2,302	6,618	5,128	(333)
Decrease/(increase) in loans and advances to banks and customers	15,155	(5)	13,305	87,416	(22,151)	(16,018)
Decrease/(increase) in securities	12,765	(1,779)	13,077	7,341	1,576	14,914
Decrease in other assets	24,859	2,552	1,830	20,570	4,065	10,248
Decrease/(increase) in derivative assets	89,336	(97,225)	16,967	89,089	(97,891)	17,721
Changes in operating assets	142,115	(96,457)	45,179	204,416	(114,401)	26,865
Increase/(decrease) in deposits by banks and customers	19,116	34,932	(11,297)	(84,117)	47,429	15,042
Decrease in debt securities in issue	(64,224)	(42,618)	(9,609)	(49,695)	(32,597)	(3,148)
(Decrease)/increase in other liabilities	(27,075)	2,099	3,560	(23,357)	(363)	(5,316)
(Decrease)/increase in derivative liabilities	(93,033)	99,895	(3,554)	(92,981)	99,351	(5,481)
(Decrease)/increase in settlement balances and short positions	(13,072)	(1,496)	5,640	(10,835)	(2,120)	1,308
Changes in operating liabilities	(178,288)	92,812	(15,260)	(260,983)	111,700	2,405
Total income taxes (paid)/received	(92)	(98)	771	(84)	(343)	507
Net cash (outflow)/inflow from operating activities	(30,436)	2,438	32,992	(50,033)	2,084	29,444

33 Analysis of the net investment in business interests and intangible assets

Acquisitions and disposals	Group 2012 £m	Group 2011 £m	Group 2010 £m	Bank 2012 £m	Bank 2011 £m	Bank 2010 £m
Fair value given for businesses acquired	(60)	(38)	(195)	(11)	(129)	(169)
Value recognised for business transferred from fellow subsidiary	8,227	7,440	—	8,051	7,440	—
Non-cash consideration	706	—	—	706	—	—
Additional and new investments in Group undertakings	—	—	—	(8,287)	(5,297)	(3,015)
Net inflow/(outflow) of cash in respect of purchases	8,873	7,402	(195)	459	2,014	(3,184)
Other assets sold	12	94	2,790	10	—	(3)
Repayment of investments	—	—	—	206	618	5,072
Non-cash consideration	—	—	—	—	—	899
Profit/(loss) on disposal	150	(67)	675	(174)	3	(305)
Net inflow of cash in respect of disposals	162	27	3,465	42	621	5,663
Dividends received from joint ventures	18	5	5	2	2	2
Cash expenditure on intangible assets	(808)	(918)	(668)	(632)	(570)	(441)
Net inflow/(outflow)	8,245	6,516	2,607	(129)	2,067	2,040

34 Interest received and paid

	Group 2012 £m	Group 2011 £m	Group 2010 £m	Bank 2012 £m	Bank 2011 £m	Bank 2010 £m
Interest received	17,740	19,258	19,531	16,242	14,819	14,029
Interest paid	(6,756)	(7,481)	(6,985)	(10,405)	(11,064)	(9,707)
	10,984	11,777	12,546	5,837	3,755	4,322

35 Analysis of changes in financing during the year

Group	Share capital, share premium and merger reserve			Subordinated liabilities		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
At 1 January	42,865	42,865	42,865	32,324	32,023	34,717
Issue of subordinated liabilities	—	—	—	2,968	940	—
Repayment of subordinated liabilities	—	—	—	(264)	(624)	(880)
Net cash inflow/(outflow) from financing	—	—	—	2,704	316	(880)
Ordinary shares issued on cross-border merger	706	—	—	—	—	—
Currency translation and other adjustments	—	—	—	(1,177)	(15)	(1,814)
At 31 December	43,571	42,865	42,865	33,851	32,324	32,023

Bank	Share capital and share premium			Subordinated liabilities		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
At 1 January	31,984	31,984	31,984	30,014	29,299	30,513
Issue of subordinated liabilities	—	—	—	2,754	940	—
Repayment of subordinated liabilities	—	—	—	—	(193)	(8)
Net cash inflow/(outflow) from financing	—	—	—	2,754	747	(8)
Ordinary shares issued on cross-border merger	706	—	—	—	—	—
Currency translation and other adjustments	—	—	—	(1,133)	(32)	(1,206)
At 31 December	32,670	31,984	31,984	31,635	30,014	29,299

36 Analysis of cash and cash equivalents

	Group			Bank		
	2012 £m	2011 £m	2010 £m	2012 £m	2011 £m	2010 £m
At 1 January						
- cash	97,446	88,622	57,954	86,642	79,621	47,039
- cash equivalents	38,390	40,555	34,984	38,690	34,758	31,677
	135,836	129,177	92,938	125,332	114,379	78,716
Net cash (outflow)/inflow	(2,735)	6,659	36,239	911	10,953	35,663
At 31 December	133,101	135,836	129,177	126,243	125,332	114,379
Comprising:						
Cash and balances at central banks	74,524	68,487	49,423	70,374	64,261	44,584
Treasury bills and debt securities	756	1,148	3,937	480	677	3,439
Loans and advances to banks	57,821	66,201	75,817	55,389	60,394	66,356
Cash and cash equivalents	133,101	135,836	129,177	126,243	125,332	114,379

Certain members of the Group are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

	2012	2011	2010
Bank of England	£0.4bn	£0.4bn	£0.4bn
US Federal Reserve	US$1.2bn	US$1.2bn	US$1.0bn
De Nederlandsche Bank	€0.2bn	—	—

37 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).

In January 2012, the RBS Group announced the reorganisation of its wholesale businesses into 'Markets' and 'International Banking'. Divisional results and the number of persons employed in the divisions (Note 3) have been presented based on the new organisational structure. The Group had previously included movements in the fair value of own derivative liabilities within the Markets operating segment. These movements have now been combined with movements in the fair value of own debt in a single measure, ‘own credit adjustments’ and presented as a reconciling item. Comparatives have been restated accordingly.

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.

International Banking serves the world’s largest companies with a leading client proposition focussed on financing, transaction services and risk management. International Banking serves as the delivery channel for Markets products to corporate clients and serves international subsidiaries of both International Banking and clients from UK Corporate, Ulster Bank and US Retail & Commercial through its international network.

Ulster Bank is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

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.

Markets is a leading origination, sales and trading business across debt finance, fixed income, currencies and investor products. The division offers a unified service to the Group’s corporate and institutional clients. The Markets’ sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division’s trading and structuring teams to meet the client’s objectives across financing, risk management, investment, securitisation and liquidity.

Central Functions comprises Group and corporate functions, such as treasury, 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 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 legacy GBM businesses, 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.

2012	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	4,084	904	4,988	(2,353)	—	(529)	2,106
UK Corporate	2,891	1,748	4,639	(1,751)	(173)	(838)	1,877
Wealth	740	448	1,188	(802)	(19)	(46)	321
International Banking	797	920	1,717	(941)	—	(131)	645
Ulster Bank	634	196	830	(474)	—	(1,364)	(1,008)
US Retail & Commercial	1,954	1,143	3,097	(2,043)	(103)	(91)	860
Markets	(273)	4,168	3,895	(2,165)	(229)	4	1,505
Central items	(1,060)	768	(292)	(577)	(659)	(10)	(1,538)
Core	9,767	10,295	20,062	(11,106)	(1,183)	(3,005)	4,768
Non-Core	865	870	1,735	(465)	(248)	(2,209)	(1,187)
Managed basis	10,632	11,165	21,797	(11,571)	(1,431)	(5,214)	3,581
Reconciling items							
Own credit adjustments	—	(3,904)	(3,904)	—	—	—	(3,904)
Asset Protection Scheme	—	(44)	(44)	—	—	—	(44)
Payment Protection Insurance costs	—	—	—	(1,110)	—	—	(1,110)
Interest Rate Hedging Products redress and related costs	—	—	—	(700)	—	—	(700)
Regulatory fines	—	—	—	(381)	—	—	(381)
Amortisation of purchased intangible assets	—	—	—	—	(41)	—	(41)
Integration and restructuring costs	—	—	—	(1,084)	(142)	—	(1,226)
Gain on redemption of own debt	—	454	454	—	—	—	454
Strategic disposals	—	185	185	—	—	—	185
Bank levy	—	—	—	(175)	—	—	(175)
Write-down of goodwill and other intangible assets	—	—	—	(51)	—	—	(51)
Statutory basis	10,632	7,856	18,488	(15,072)	(1,614)	(5,214)	(3,412)
2011							
UK Retail	4,320	1,126	5,446	(2,490)	—	(788)	2,168
UK Corporate	2,983	1,770	4,753	(1,833)	(172)	(792)	1,956
Wealth	645	457	1,102	(767)	(11)	(25)	299
International Banking	861	1,023	1,884	(883)	(7)	16	1,010
Ulster Bank	713	211	924	(503)	(1)	(1,384)	(964)
US Retail & Commercial	1,932	1,137	3,069	(1,972)	(117)	(326)	654
Markets	(192)	3,336	3,144	(2,355)	(181)	(8)	600
Central items	(1,192)	827	(365)	(304)	(670)	—	(1,339)
Core	10,070	9,887	19,957	(11,107)	(1,159)	(3,307)	4,384
Non-Core	1,228	532	1,760	(606)	(353)	(3,869)	(3,068)
Managed basis	11,298	10,419	21,717	(11,713)	(1,512)	(7,176)	1,316
Reconciling items							
Own credit adjustments	—	797	797	—	—	—	797
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)

37 Segmental analysis continued

2010	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	4,082	1,128	5,210	(2,460)	(1)	(1,160)	1,589
UK Corporate	2,828	1,796	4,624	(1,829)	(173)	(767)	1,855
Wealth	554	445	999	(683)	(11)	(18)	287
International Banking	919	1,625	2,544	(1,160)	(5)	(237)	1,142
Ulster Bank	860	214	1,074	(535)	(2)	(1,161)	(624)
US Retail & Commercial	1,953	1,160	3,113	(2,022)	(99)	(519)	473
Markets	154	4,587	4,741	(2,016)	(104)	(58)	2,563
Central items	(850)	383	(467)	(216)	(735)	(4)	(1,422)
Core	10,500	11,338	21,838	(10,921)	(1,130)	(3,924)	5,863
Non-Core	1,611	661	2,272	(1,005)	(480)	(5,476)	(4,689)
Managed basis	12,111	11,999	24,110	(11,926)	(1,610)	(9,400)	1,174
Reconciling items							
Own credit adjustments	—	(3)	(3)	—	—	—	(3)
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)

	2012			2011			2010		
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	6,498	819	7,317	6,756	409	7,165	6,665	358	7,023
UK Corporate	4,934	119	5,053	4,989	115	5,104	4,872	128	5,000
Wealth	1,059	821	1,880	1,026	729	1,755	956	616	1,572
International Banking	1,932	473	2,405	2,085	368	2,453	3,696	362	4,058
Ulster Bank	1,078	99	1,177	1,299	103	1,402	1,386	133	1,519
US Retail & Commercial	3,411	133	3,544	3,478	205	3,683	3,795	291	4,086
Markets	5,012	4,456	9,468	4,528	4,573	9,101	5,771	3,968	9,739
Central items	3,113	13,441	16,554	3,063	13,920	16,983	2,228	12,251	14,479
Core	27,037	20,361	47,398	27,224	20,422	47,646	29,369	18,107	47,476
Non-Core	2,647	611	3,258	3,352	198	3,550	4,107	194	4,301
	29,684	20,972	50,656	30,576	20,620	51,196	33,476	18,301	51,777
Eliminations	—	(20,972)	(20,972)	—	(20,620)	(20,620)	—	(18,301)	(18,301)
Managed basis	29,684	—	29,684	30,576	—	30,576	33,476	—	33,476
Reconciling items									
Own credit adjustments	(3,904)	—	(3,904)	797	—	797	(3)	—	(3)
Asset Protection Scheme	(44)	—	(44)	(906)	—	(906)	(1,550)	—	(1,550)
Gain on redemption of own debt	454	—	454	255	—	255	502	—	502
Strategic disposals	185	—	185	(57)	—	(57)	645	—	645
Statutory basis	26,375	—	26,375	30,665	—	30,665	33,070	—	33,070

Total income	2012 External £m	2012 Inter segment £m	2012 Total £m	2011 External £m	2011 Inter segment £m	2011 Total £m	2010 External £m	2010 Inter segment £m	2010 Total £m
UK Retail	5,118	(130)	4,988	5,484	(38)	5,446	5,254	(44)	5,210
UK Corporate	5,164	(525)	4,639	5,266	(513)	4,753	5,084	(460)	4,624
Wealth	537	651	1,188	495	607	1,102	507	492	999
International Banking	1,858	(141)	1,717	2,023	(139)	1,884	2,740	(196)	2,544
Ulster Bank	774	56	830	962	(38)	924	962	112	1,074
US Retail & Commercial	2,972	125	3,097	2,874	195	3,069	2,834	279	3,113
Markets	3,404	491	3,895	2,733	411	3,144	4,259	482	4,741
Central items	(420)	128	(292)	(930)	565	(365)	(1,063)	596	(467)
Core	19,407	655	20,062	18,907	1,050	19,957	20,577	1,261	21,838
Non-Core	2,390	(655)	1,735	2,810	(1,050)	1,760	3,533	(1,261)	2,272
Managed basis	21,797	—	21,797	21,717	—	21,717	24,110	—	24,110
Reconciling items									
Own credit adjustments	(3,904)	—	(3,904)	797	—	797	(3)	—	(3)
Asset Protection Scheme	(44)	—	(44)	(906)	—	(906)	(1,550)	—	(1,550)
Gain on redemption of own debt	454	—	454	255	—	255	502	—	502
Strategic disposals	185	—	185	(57)	—	(57)	645	—	645
Statutory basis	18,488	—	18,488	21,806	—	21,806	23,704	—	23,704

	2012 Assets £m	2012 Liabilities £m	2012 Cost to acquire fixed assets and intangible assets £m	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
UK Retail	117,334	109,283	—	114,493	104,028	—	111,911	100,341	—
UK Corporate	110,167	129,643	345	114,147	129,258	712	116,405	126,272	381
Wealth	21,482	39,338	51	21,752	39,022	65	21,167	37,071	63
International Banking	49,092	49,178	24	50,880	40,720	18	52,920	32,919	22
Ulster Bank	30,755	28,769	4	34,812	27,792	45	40,067	34,512	101
US Retail & Commercial	72,675	63,096	308	75,840	67,330	271	72,350	68,475	197
Markets	725,682	697,058	320	823,461	823,963	370	684,099	696,849	508
Central items	98,614	101,244	1,063	102,465	125,490	1,902	69,288	126,751	897
Core	1,225,801	1,217,609	2,115	1,337,850	1,357,603	3,383	1,168,207	1,223,190	2,169
Non-Core	58,473	7,240	169	94,931	13,324	955	139,123	26,533	761
	1,284,274	1,224,849	2,284	1,432,781	1,370,927	4,338	1,307,330	1,249,723	2,930

Segmental analysis of assets and liabilities included in disposal groups.

	2012 Assets £m	2012 Liabilities £m	2011 Assets £m	2011 Liabilities £m	2010 Assets £m	2010 Liabilities £m
UK Retail	—	—	7,048	8,808	—	—
UK Corporate	—	—	11,728	12,976	—	—
International Banking	—	—	—	—	251	549
Markets	—	—	431	117	—	—
Centre	—	—	127	—	—	—
Non-Core	304	135	4,754	939	9,291	6,959
	304	135	24,088	22,840	9,542	7,508

37 Segmental analysis continued

Segmental analysis of goodwill is as follows:

	UK Retail £m	UK Corporate £m	Wealth £m	International Banking £m	US Retail & Commercial £m	Markets £m	Central items £m	Non-Core £m	Total £m
At 1 January 2010	2,790	2,963	788	604	3,808	2	24	28	11,007
Currency translation and other adjustments	—	—	25	16	172	—	—	1	214
Disposals	—	(81)	—	(400)	—	—	—	(14)	(495)
Write-down of goodwill	—	—	(1)	—	—	—	—	—	(1)
At 1 January 2011	2,790	2,882	812	220	3,980	2	24	15	10,725
Transfer to disposal groups	—	—	—	—	—	—	—	(15)	(15)
Currency translation and other adjustments	—	—	—	1	12	1	—	—	14
Acquisitions	—	—	—	—	—	18	—	—	18
Write-down of goodwill	(20)	(60)	—	—	—	—	—	—	(80)
At 1 January 2012	2,770	2,822	812	221	3,992	21	24	—	10,662
Currency translation and other adjustments	—	—	(3)	(2)	(169)	(1)	—	—	(175)
Transfer from fellow subsidiaries	—	—	—	5	—	—	—	—	5
Disposals	—	—	(9)	—	—	—	(24)	—	(33)
Write-down of goodwill	—	—	—	(18)	—	(18)	—	—	(36)
At 31 December 2012	2,770	2,822	800	206	3,823	2	—	—	10,423

(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.

2012	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
Total revenue	14,889	6,272	3,095	2,119	26,375
Net interest income	7,757	2,252	631	(8)	10,632
Net fees and commissions	2,788	1,192	470	145	4,595
Income from trading activities	(394)	1,538	151	216	1,511
Other operating income	991	247	499	13	1,750
Total income	11,142	5,229	1,751	366	18,488
Operating (loss)/profit before tax	(3,578)	1,995	(1,540)	(289)	(3,412)
Total assets	867,353	298,593	63,992	54,336	1,284,274
Of which assets held for sale	—	304	—	—	304
Total liabilities	837,135	281,304	52,561	53,849	1,224,849
Of which liabilities held for sale	—	135	—	—	135
Net assets attributable to equity shareholders and non-controlling interests	30,218	17,289	11,431	487	59,425
Contingent liabilities and commitments	108,437	80,553	44,769	5,152	238,911
Cost to acquire property, plant and equipment and intangible assets	1,770	325	161	28	2,284
2011					
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	2,409	499	1,393	37	4,338

2010	UK £m	USA £m	Europe £m	Rest of the World £m	Total £m
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

38 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:

	2012 £000	2011 £000
Short-term benefits	32,512	36,371
Post-employment benefits	699	3,547
Share-based payments	24,533	21,062
	57,744	60,980

39 Transactions with directors and key management

(a) At 31 December 2012, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £36,915 in respect of loans to six 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:

	2012 £000	2011 £000
Loans and advances to customers	11,748	19,366
Customer accounts	36,250	33,149

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.

40 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 2012, 2011 and 2010 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 232) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (page 224) and FSCS levies (page 302)); 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 which, subject to a first loss of £60 billion, covered 90% of losses net of recoveries in 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. On 18 October 2012, the Group exited the APS.

The Group paid APS premiums totalling £2,500 million (2012 - £275 million; 2011 - £125 million; 2010 - £700 million; 2009 - £1,400 million).

The APS contract was accounted for as a derivative financial instrument, recognised at fair value (2011 - liability £231 million; 2010 - asset £550 million) and included within the Derivative liability/asset balance sheet caption. Changes in fair value of £44 million (2011 - £906 million; 2010 - £1,550 million) were recognised in profit or loss within Income from trading activities.

There was no change in the recognition and measurement of the covered assets as a result of the APS.

In connection with its participation in the APS, the Group agreed to a number of behavioural commitments in respect of lending for businesses in the UK and personal current accounts in the UK. These commitments ran for two years and were completed by the end of February 2011.

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 2012, the Group had no amounts outstanding under these facilities (2011 - nil; 2010 - £16.1 billion).

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.11% of their eligible liabilities. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

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 2012, the Group had no debt outstanding guaranteed by the Government (2011 - £21.3 billion; 2010 - £41.5 billion).

National Loan Guarantee Scheme

The Group participated in the National Loan Guarantee Scheme (NLGS), providing loans and facilities to eligible customers at a discount of one percent. It did not issue any guaranteed debt under the scheme and consequently, it was not committed to providing a particular volume of reduced rate facilities. Lending under the scheme, amounting to £898 million at 31 December 2012, is being accounted for in accordance with the Group's accounting policy for loans and receivables. The NLGS was superseded by the Funding for Lending Scheme.

The Funding for Lending Scheme

The Funding for Lending Scheme was launched in July 2012. Under the scheme UK banks and building societies are able to borrow UK treasury bills from the Bank of England in exchange for eligible collateral during the drawdown period (1 August 2012 to 31 January 2014). Borrowing is limited to 5% of the participant's stock of loans to the UK non-financial sector as at 30 June 2012, plus any expansion in lending from that date to the end of 2013. Eligible collateral comprises all collateral eligible for the Bank of England's discount window facility. The term of each transaction is four years from the date of drawdown. The price for borrowing UK treasury bills under the scheme depends on the participant's net lending to the UK non-financial sector between 30 June 2012 and the end of 2013. If lending is maintained or expanded over that period, the fee is 0.25% per year on the amount borrowed. If lending declines, the fee increases by 0.25% for each 1% fall in lending, up to a maximum fee of 1.5%. As at 31 December 2012, the Group had borrowed UK treasury bills with a fair value of £749 million under the scheme.

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.

	2012 £m	2011 £m	2010 £m
Income			
Interest receivable	163	122	89
Interest payable	930	896	907
Fees and commissions receivable	179	109	148
Fees and commissions payable	99	108	484
Expenses			
Premises and equipment	3	7	7

41 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 2012, 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 65.3% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

42 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.

Additional information

Five year summary

Summary consolidated income statement	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Net interest income	10,632	11,298	12,111	11,543	13,509
Non-interest income (1, 2, 3)	7,856	10,508	11,593	13,000	2,348
Total income	18,488	21,806	23,704	24,543	15,857
Operating expenses (4, 5, 6, 7, 8)	(16,686)	(15,494)	(14,475)	(12,372)	(20,367)
Profit/(loss) before impairment losses	1,802	6,312	9,229	12,171	(4,510)
Impairment losses	(5,214)	(7,176)	(9,400)	(12,174)	(4,706)
Operating loss before tax	(3,412)	(864)	(171)	(3)	(9,216)
Tax (charge)/credit	(364)	(731)	(713)	523	505
(Loss)/profit for the year	(3,776)	(1,595)	(884)	520	(8,711)
(Loss)/profit attributable to:					
Non-controlling interests	19	(8)	29	235	208
Preference shareholders	58	58	60	523	638
Ordinary shareholders	(3,853)	(1,645)	(973)	(238)	(9,557)

Notes:
(1) Includes profit on strategic disposals of £185 million (2011 - £57 million loss; 2010 - £645 million profit; 2009 - nil; 2008 - £442 million profit).
(2) Includes gain on redemption of own debt of £454 million (2011 - £255 million; 2010 - £502 million; 2009 - £2,694 million).
(3) Includes own credit adjustments of £3,904 million loss (2011 - £797 million gain; 2010 - £3 million loss; 2009 - £298 million loss; 2008 - £920 million gain).
(4) Includes Payment Protection Insurance costs of £1,110 million (2011 - £850 million), Interest Rate Hedging Products redress and related costs of £700 million and regulatory fines of £381 million.
(5) Includes integration and restructuring costs of £1,226 million (2011 - £893 million; 2010 - £825 million; 2009 - £859 million; 2008 - £647 million).
(6) Includes amortisation of purchased intangibles of £41 million (2011 - £68 million; 2010 - £63 million; 2009 - £81 million; 2008 - £100 million).
(7) Includes write-down of goodwill and other intangible assets of £51 million (2011 - £80 million; 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	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Loans and advances	576,904	586,539	605,826	604,610	698,890
Debt securities and equity shares	150,457	180,903	168,369	187,586	180,457
Derivatives and settlement balances	450,818	539,709	437,753	455,506	948,328
Other assets	106,095	125,630	95,382	85,279	50,255
Total assets	1,284,274	1,432,781	1,307,330	1,332,981	1,877,930
Owners' equity	59,288	61,726	57,010	55,051	45,958
Non-controlling interests	137	128	597	1,146	1,292
Subordinated liabilities	33,851	32,324	32,023	34,717	39,951
Deposits	621,457	581,485	557,545	569,440	635,111
Derivatives, settlement balances and short positions	469,458	575,060	470,600	468,938	955,062
Other liabilities	100,083	182,058	189,555	203,689	200,556
Total liabilities and equity	1,284,274	1,432,781	1,307,330	1,332,981	1,877,930

Other contractual cash obligations

The tables below summarise other contractual cash obligations by payment date.

	Group					
2012	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	207	168	667	546	886	1,375
Contractual obligations to purchase goods or services	110	334	500	15	—	—
	317	502	1,167	561	886	1,375
2011						
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

	Bank					
2012	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	153	8	295	252	540	879
Contractual obligations to purchase goods or services	108	278	494	15	—	—
	261	286	789	267	540	879
2011						
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

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.

2012	Government £m	Banks £m	Other £m	Total £m	Short positions £m	Net of short positions £m
United States	17,411	1,331	30,713	49,455	12,080	37,375
France	6,132	13,029	5,616	24,777	2,156	22,621
Germany	13,198	3,594	6,696	23,488	1,955	21,533
Netherlands	5,350	2,077	10,700	18,127	1,123	17,004
Japan	4,338	6,822	1,409	12,569	2,326	10,243
Spain	857	1,490	4,652	6,999	514	6,485
Republic of Ireland	89	3,384	2,982	6,455	59	6,396
Italy	3,359	247	1,099	4,705	2,301	2,404
2011						
United States	17,933	6,668	30,574	55,175	13,329	41,846
France	10,263	14,276	7,093	31,632	5,904	25,728
Germany	30,766	4,457	9,370	44,593	2,947	41,646
Netherlands	4,466	1,921	9,124	15,511	910	14,601
Japan	8,349	7,423	3,330	19,102	3,141	15,961
Spain	308	1,245	6,153	7,706	973	6,733
Republic of Ireland	26	3,649	2,566	6,241	68	6,173
Italy	4,495	526	1,199	6,220	4,823	1,397
2010						
United States	19,214	12,944	22,730	54,888	14,240	40,648
France	14,903	15,383	3,377	33,663	4,285	29,378
Germany	17,213	4,553	7,699	29,465	4,675	24,790
Netherlands	2,874	1,905	6,664	11,443	951	10,492
Japan	7,585	1,665	668	9,918	3,246	6,672
Spain	1,315	1,753	6,755	9,823	1,381	8,442
Republic of Ireland	102	3,519	1,108	4,729	139	4,590
Italy	5,532	547	922	7,001	3,199	3,802

Risk factors

Set out below are certain risk factors which could adversely affect the Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the Group.

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.

Macro-economic and geopolitical risks

The RBS Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions

The RBS Group's businesses and performance are affected by local and global economic conditions, 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, including, in particular, the UK, Ireland and the US. Stagnant or weak GDP growth is also expected in the European Monetary Union (EMU) where a relatively robust German economy has been offset by austerity measures in many EMU countries, initiated in response to increased sovereign debt risk, which have resulted in weak economic and GDP growth, particularly in Spain, Italy and France.

The RBS Group's businesses and performance are also affected by financial market conditions. Although capital and credit markets around the world were more stable during 2012, they remained volatile and subject to intermittent and prolonged disruptions. In particular, increasingly during the second and third quarters of 2012, continuing risk of sovereign default relating to certain EU member states had a negative impact on capital and credit markets.

These challenging economic and market conditions create a difficult operating environment for the RBS Group's businesses, which is characterised by:

- downward pressure on asset prices and on credit availability and upward pressure on funding costs, and such conditions continue to impact asset recovery rates and the credit quality of the RBS Group's businesses, customers and counterparties, including sovereigns;
- alone or in combination with regulatory changes or actions of market participants, 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; and
- central bank actions to engender economic growth which have resulted in a prolonged period of low interest rates constraining, through margin compression and low returns on assets, the interest income earned on the RBS Group's interest earning assets.

In particular, should the scope and severity of the adverse economic conditions currently experienced by a number of EU member states and elsewhere worsen or economic recovery remain stagnant for an extended period, particularly in the RBS Group's key markets, 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, financial condition, results of operations and prospects.

The RBS Group has significant exposure to the continuing economic crisis in Europe

In Europe, countries such as Ireland, Italy, Greece, Cyprus, Portugal and Spain have been particularly affected by the recent macroeconomic and financial conditions. Although the risk of sovereign default reduced in 2012 due to actions of the European Central Bank (ECB) and the EU, the risk of default remains. This default risk raises concerns, particularly about the contagion effect such a default would have on other EU economies, including the UK economy, as well as the ongoing viability of the euro currency and the EMU. As a result, yields on the sovereign debt of many EU member states have remained volatile. The EU, the ECB, the International Monetary Fund and various national authorities have implemented measures intended to address systemic stresses in the Eurozone. The effectiveness of these actions is not assured and the possibility remains that the contagion effect spreads to the UK, that the euro could be abandoned as a currency by one or more countries that have already adopted its use, or in an extreme scenario, that the 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 UK, 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;
- result in downgrades of credit ratings for European borrowers, giving rise to increases in credit spreads and decreases in security values;
- disrupt and adversely affect the economic activity of the UK and other European markets; and
- adversely affect the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities and the potential for mismatch.

Risk factors continued

The occurrence of any of these events may have a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

In particular, the RBS Group has significant exposure to customers and counterparties in the Eurozone (at 31 December 2012 principally Germany (£48 billion), The Netherlands (£26 billion), Ireland (£40 billion), France (£19 billion) and Spain (£12 billion)) which includes sovereign debt exposures that have been, and may in the future be, affected by restructuring of their terms, principal, interest and maturity. The RBS Group's Eurozone sovereign debt exposures resulted in the RBS Group recognising an impairment loss of £1,099 million in 2011 in respect of its holding of Greek government bonds. Similar write downs may occur in future periods. At 31 December 2012, the RBS Group's Eurozone sovereign debt exposure amounted to £678 million including aggregate exposure of £51 million to Greece, Ireland, Italy, Spain and Portugal.

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 final report of the Independent Commission on Banking (ICB), and the UK Government's implementation of the recommendations. 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.

The RBS Group is subject to political risks

RBSG and the Royal Bank, its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government intends to hold a referendum in 2014 on the issue of Scottish independence from the UK. Although the outcome of such referendum is uncertain, Scottish independence could affect Scotland's status in the EU and significantly impact the fiscal, monetary and regulatory landscape to which the RBS Group is subject. In addition, in January 2013, the UK Government announced the possibility of a referendum on the UK's membership of the EU, which would only take place some time after 2015. Although the effect of either Scottish independence or any referendum on the UK's EU membership, if either were to occur, is not possible to predict fully, it could have a material adverse effect on the RBS Group's business, financial condition, results of operations and prospects.

RBSG and its UK bank subsidiaries may face the risk of full nationalisation

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 certain deposit-taking UK incorporated institutions 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. If HM Treasury decides to take RBS Group into temporary public ownership pursuant to the powers granted under the Banking Act, it may take various actions in relation to any securities without the consent of holders of the securities.

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 65.3% 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 the RBSG from the Official List of the UK Listing Authority 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 securities issued by the RBS Group.

In addition, UKFI manages HM Treasury's shareholder relationship with the RBS Group 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. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder 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 the RBS Group for the benefit of its members as a whole.

The RBS Group is subject to other global risks

By virtue of the RBS Group's global presence, the RBS Group is 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.

Market and credit related risks

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

Severe market events have resulted in the RBS Group, including the Group recording large write-downs on its credit market exposures in recent years; particularly early in the financial crisis (at RBS Group level, £10.1 billion in 2008 and £6.2 billion in 2009). Any deterioration in economic and financial market conditions or continuing weak economic growth 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, including the 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. As part of the RBS Group's strategy it has materially reduced the size of its balance sheet mainly through the sale and run-off of non-core assets. The RBS Group's assets that remain in its Non-Core division may be more difficult to sell and could be subject to further write-downs or, if sold, realised losses. Any of these factors could require the RBS Group and/or the Group to recognise additional significant write-downs or realise increased impairment charges, which may have a material adverse effect on its financial condition, results of operations and capital ratios. In addition, 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.

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 (principally Germany, The Netherlands, Ireland and France) (at 31 December 2012 credit risk assets in the UK were £316 billion, in North America £101 billion and in Western Europe (excluding the UK) £147 billion); and within certain business sectors, namely personal finance, financial institutions and commercial real estate (at 31 December 2012 residential and personal lending amounted to £182 billion, lending to financial institutions was £114 billion and commercial real estate lending was £63 billion). 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.

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 further 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. This has been particularly the case with respect to large parts of the RBS Group's commercial real estate portfolio. Any such losses could have an adverse effect on the RBS Group's results of operations and financial condition.

Risk factors continued

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of 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.

In certain jurisdictions in which the RBS Group does business, particularly Ireland, there has been disruption during recent years 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.

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 and an inability to engage in routine funding transactions.

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 (CDSs), and other credit derivatives, 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. Many 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 recognises any fluctuations in the fair value of other credit derivatives. 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 (which remain depressed) 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 the RBS Group's non-UK subsidiaries and may affect the RBS Group's reported consolidated financial condition or its income from foreign exchange dealing. For accounting purposes, the RBS Group and the Group values some of its 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 the income statement 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.

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 2012, the RBS Group had accrued £119 million for its share of estimated FSCS levies for the 2012/2013 and 2013/2014 FSCS 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.

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. Pension 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. 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. Contributions started at £375 million per annum in 2011, will increase 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 £250 million for future accrual of benefits.

Funding, liquidity and capital related risks

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, including interbank markets, have experienced severe reductions in liquidity and term-funding during prolonged periods in recent years. Although credit markets generally improved during 2012 (in part as a result of measures taken by the ECB), and the RBS Group's overall liquidity position remained strong, certain European banks, in particular from the peripheral countries of Spain, Portugal, Greece, Italy and Ireland, remained reliant on central banks as one of their principal sources of liquidity and central banks increased their support to banks with the ECB providing significant short and long-term liquidity in the last few months of 2011 and in 2012. Although these efforts had a positive impact, global credit markets remain volatile.

The market perception of bank credit risk has changed significantly as a result of the financial crisis and banks that are deemed by the market to be riskier have had to issue debt at a premium. Any uncertainty regarding the perception of credit risk across financial institutions may lead to reductions in levels of interbank lending and associated term maturities and may restrict the RBS Group's access to traditional sources of liquidity or increase the costs of accessing such 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. The RBS Group has, at times, 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 and changes to asset 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. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. Increased competition for funding during 2013 due to the significant levels of refinancing expected to be required by financial institutions, may also reduce the level of funding available from these sources. Under certain 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.

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. The level of wholesale and retail deposits may fluctuate due to certain factors outside the RBS Group's control, such as a loss of confidence (including as a result of political initiatives, including bail-in and/or confiscation and/or taxation of creditors' funds, in connection with the Eurozone crisis, as seen recently in Cyprus), 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 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 Group's financial condition and results of operations.

Risk factors continued

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.

The Basel Committee on Banking Supervision's package of reforms to the regulatory capital framework includes a material increase to the minimum Core Tier 1 (common equity) requirement and the total Tier 1 capital requirement, a capital conservation buffer and a countercyclical buffer. In addition, a leverage ratio is to be introduced, together with a liquidity coverage ratio and a net stable funding ratio. Further measures may include bail-in debt which may impact existing as well as future issues of debt and expose 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.

The Basel Committee has proposed that global systemically important financial institutions (GSIFIs) be subject to an additional common equity Tier 1 capital requirement, depending on a bank's systemic importance. The RBS Group has been identified by the Financial Stability Board as a GSIFI. As a result the RBS Group was required to meet resolution planning requirements by the end of 2012 as well as have additional loss absorption capacity. In addition, GSIFIs will 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.

The Basel III rules are due to be phased in between 1 January 2013 and 2019 but 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 to implement the changes with a new Directive and Regulation (collectively known as CRD IV). The final form of CRD IV is still under negotiation and the start-date for its implementation is still not known with full implementation still planned by 1 January 2019. The current proposals would allow the UK to implement more stringent prudential requirements than envisaged under Basel III.

The ICB recommendations and the UK Government's response supporting such recommendations include 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. The US Federal Reserve has also proposed changes in how it will regulate the US operations of foreign banking operations such as the RBS Group that may affect the capital requirements of the RBS Group's operations in the US. As the implementation of the ICB recommendations are the subject of draft legislation not yet adopted and the Federal Reserve's recent proposals are in a comment period, 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 applicable capital and loss absorbency requirements.

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, the US 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, which could be mandated by the RBS Group's regulators, could have a number of negative consequences for the RBS Group and its shareholders, including impairing the RBS Group's ability to pay dividends on, or make other distributions in respect of, ordinary shares and diluting the ownership of existing shareholders of the RBS Group. If the RBS Group is unable to raise the requisite Tier 1 and Tier 2 capital, it may be required to reduce further 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.

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 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 2012, the RBS Group's Tier 1 and Core Tier 1 capital ratios were 12.4% and 10.3%, 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, regulatory changes, actions by regulators, 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.

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, the Royal Bank and other RBS 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, the Royal Bank and other RBS Group members, were downgraded during the course of 2011 and 2012 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 Royal Bank 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 2012, a simultaneous one notch long-term and associated short-term downgrade in the credit ratings of RBSG and the Royal Bank by the three main ratings agencies would have required the RBS Group to post estimated additional collateral of £9 billion, without taking account of mitigating action by management.

Any downgrade in the UK Government's credit ratings could adversely affect the credit ratings of the Royal Bank and/or Group companies and may have the effects noted above. In December 2012, Standard & Poor's placed the UK's AAA credit rating on credit watch, with negative outlook and, in February 2013, Moody's downgraded the UK's credit rating one notch to Aa1. Credit ratings of RBSG, Royal Bank, RBS N.V., Ulster Bank Limited and RBS Citizens Financial Group, Inc. are also important to the RBS Group when competing in certain markets, such as over-the-counter derivatives. As a result, any further reductions in the Group's long-term or short-term credit ratings or those of its principal subsidiaries, including the Royal Bank, 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.

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 per cent., until December 2014 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 the RBS Group 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 the RBS Group 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 regulatory capital treatment of certain deferred tax assets recognised by the RBS Group depends on there being no adverse changes to regulatory requirements

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.

Risks to implementation of RBS Group strategy

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 2012, this total had reduced to £57.4 billion (31 December 2011 - £93.7 billion), excluding derivatives, as further progress was made in business disposals and portfolio sales during the course of 2012. 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, during 2012 the RBS Group implemented 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).

Risk factors continued

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 or asset portfolios it is seeking to sell either on favourable economic terms to the RBS Group or at all. Material tax or other contingent liabilities could arise on the disposal of assets and 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 or portfolios 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, 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 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.

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan

The RBS Group was required to obtain State Aid approval for the aid given to the RBS Group by HM Treasury as part of the placing and open offer undertaken by the RBS Group in December 2008, the issuance to HM Treasury of £25.5 billion of B shares in the capital of the RBSG which are, subject to certain terms and conditions, convertible into ordinary shares in the share capital of the 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 in addition to the RBS Group's participation in the Asset Protection Scheme (APS) (which has now been terminated). In that context, as part of the terms of the State Aid approval, the RBS Group, together with HM Treasury, agreed the terms of a restructuring plan.

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 a number of businesses now completed (or substantially completed) as well as the disposal of all or a controlling portion of Direct Line Group (DLG, formerly known as RBS Insurance) (with disposal of its entire interest in DLG required by 31 December 2014), and the Royal Bank branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct and other small and medium-size enterprise (SME) customers and certain mid-corporate customers across the UK. While the initial sale of 34.7% of DLG through an IPO was completed in October 2012 and a further sale in March 2013 reduced the RBS Group ownership below the 50% level, in respect of the Royal Bank and NatWest branch-based business, the sale process continues to progress following the withdrawal of its original buyer in October 2012.

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 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.

The disposal of Global Merchant Services and RBS Sempra Commodities reduced the RBS Group's assets by approximately £13.0 billion and £2.4 billion, respectively (based on total assets immediately prior to disposal). The quantum of assets and deposits that would be included in a divestment of the Royal Bank branch-based business in England and Wales and the NatWest branches in Scotland is not certain. However, at 31 December 2012, this business included approximately £18.8 billion of assets, £21.5 billion of deposits and two million customers.

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.

Macro-prudential, regulatory and legal risks

Each of the RBS Group's businesses is subject to substantial regulation and oversight. Significant regulatory developments and changes in the approach of the RBS Group's key regulators could have a material 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, in many other European countries, the US and at the EU level.

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 (including in relation to compliance with anti-bribery, anti-money laundering, anti-terrorism and other similar sanctions regimes).

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 and the EU, the other parts of Europe in which the RBS Group operates and the US (such as the bank levy in the UK, the EU Recovery and Resolution Directive (the "RRD") 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 proceedings. Any of these developments could have an adverse impact on how the RBS 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.

Areas in which, and examples of where, governmental policies, regulatory changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the RBS Group include those set out above as well as the following:

- the transfer in the UK of regulatory and supervisory powers from the FSA to the 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;
- restrictions on proprietary trading and similar activities within a commercial bank and/or a RBS Group which contains a commercial bank;
- restructuring certain of the RBS Group's non-retail banking activities in jurisdictions outside the UK in order to satisfy local capital, liquidity and other prudential requirements;
- the design and potential implementation of government mandated recovery, 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, product offering, capital, liquidity 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).

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations may adversely affect the RBS Group's business, financial condition and results of operations. In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the RBS Group's ability to engage in effective business, capital and risk management planning.

Risk factors continued

The RBS Group is subject to resolution procedures under current and proposed resolution and recovery schemes which may result in various actions being taken in relation to any securities of the RBS Group, including the write off, write-down or conversion of the RBS Group's securities

As a result of its status as a GSIFI and in accordance with current and proposed resolution and recovery schemes, the RBS Group was required to meet certain resolution planning requirements by the end of 2012 and is required to meet others in 2013 contemplating its possible failure. The RBS Group made the required submissions in 2012 to the FSA and its US business will make its required submissions in 2013. Similar to other major financial institutions, both the RBS Group and its key subsidiaries remain engaged in a constructive dialogue on resolution and recovery planning with key national regulators and other authorities.

In addition to the powers provided by the Banking Act 2009, further resolution powers are expected to be provided as part of the RRD and the reforms implementing the recommendations of the ICB. Such resolution powers are expected to include a bail-in mechanism, pursuant to which losses would be imposed on shareholders and, as appropriate, creditors of the RBS Group (through write-down or conversion into equity of liabilities including debt securities) in order to recapitalise and restore the RBS Group to solvency as well as other options, including those as set forth in the Banking Act 2009. The implementation of any resolution and recovery scheme is the subject of significant debate, particularly for GSIFIs with complex cross border activities. Such debate includes whether resolution and recovery powers may be exercised through a single point of entry at the holding company or at various levels of the corporate structure of a GSIFI.

The potential impacts of these resolution and recovery powers may include the total loss of value of securities issued by the RBS Group and, in addition for debt holders, the possible conversion into equity securities, and under certain circumstances the inability of the RBS Group to perform its obligations under its securities.

The RBS Group is subject to a number of regulatory initiatives which may adversely affect its business. The Independent Commission on Banking's final report on competition and possible structural reforms in the UK banking industry has been adopted by the UK Government which intends to implement the recommendations substantially as proposed. In addition other proposals to ring fence certain business activities and the US Federal Reserve's proposal for applying US capital, liquidity and enhanced prudential standards to certain of the RBS Group's US operations together with the UK reforms could require structural changes to the RBS Group's business. Any of these changes could have a material adverse effect on the RBS Group.

The UK Government published a White Paper on Banking Reform in September 2012, outlining proposed structural reforms in the UK banking industry. The measures proposed were drawn in large part from the recommendations of the ICB, which was appointed by the UK Government in June 2010, 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) promotion of competition, (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) the implementation of a ring-fence of retail banking operations.

The measures in relation to the promotion of competition are already largely in train, including the development of an industry mechanism to make it easier for customers to switch their personal current accounts to a different provider, which is due to be completed by September 2013.

Bail-in mechanisms continue to be discussed by the EU and the RBS Group continues to participate in the debate around such mechanisms, which could affect the rights of creditors, including holders of senior and subordinated bonds, and shareholders in the event of the implementation of a resolution scheme or an insolvency and could thereby materially affect the price of such securities.

The UK Government published in October 2012 a draft bill intended to enable the implementation of these reforms. This draft bill is subject to pre-legislative scrutiny by the UK Parliamentary Commission on Standards in Banking (PCBS), which may recommend changes to the bill. The UK Government published its response to the PCBS in February 2013 and agreed to amend the bill to include provisions giving the regulator the power to enforce full separation between retail and wholesale banking in a specified group. The Financial Services (Banking Reform) Bill, which will provide primary enabling legislation, has now received its second reading in the House of Commons and, if passed, is expected to receive Royal Assent early in 2014. This is with a view to completing the overall legislative framework by May 2015, requiring compliance as soon as practicable thereafter and setting a final deadline for full implementation of 2019.

The impact of any final legislation on the RBS Group is impossible to estimate with any precision at this stage. The introduction of bail-in mechanisms may affect the RBS Group's cost of borrowing, its ability to access professional markets' funding and its funding and liquidity metrics. It is also likely that ring-fencing certain of the RBS Group's operations would require significant restructuring with the possible transfer of large numbers of customers between legal entities. It is possible that such ring-fencing, by itself, or taken together with the impact of other proposals contained in this legislation and other EU legislation that will apply to the RBS Group could have a material adverse effect on the RBS Group's structure and on the viability of certain businesses, in addition to the RBS Group's results of operations, financial conditions and prospects.

It is also possible that the UK's implementation of a ring-fence may conflict with any EU legislation to implement the recommendations of the High-level Expert Group on Reforming the Structure of the EU Banking Sector, whose report, published in October 2012, proposed, inter alia, ring-fencing the trading and market-making activities of major European banks. This could affect the RBS Group's position relative to some competitors. However, it is not yet clear whether the EU will implement ring-fencing proposals and whether they will apply to UK banks, in addition to the UK's own ring-fencing measures.

Under the US Federal Reserve's proposal to change how it regulates the US operations of large foreign banking groups, foreign banking organisations with total global consolidated assets of $50 billion or more ("Large FBOs") would have to create a separately capitalised top-tier US intermediate holding company (IHC) that would hold all US bank and non-bank subsidiaries. The IHC would be subject to US capital, liquidity and other enhanced prudential standards on a consolidated basis. Among other things, an IHC would be subject to the same US risk based and leverage capital standards that apply to a US bank holding company. The adoption of such a regime would likely result in the RBS Group being subject to multiple capital regimes where the US has departed from the international Basel Capital Framework as adopted in the UK and Europe. The imposition of US capital, liquidity and other enhanced prudential standards on an IHC of a Large FBO that is subject to home country capital standards on a group-wide consolidated basis would likely give rise to challenging organisational and compliance issues. The foregoing is only one example of issues that the RBS Group might confront if its US operations were to be subject to these proposals. Under the current proposals the RBS Group's US operations would be subject to these heightened requirements.

If any of the proposals described above are adopted, major changes to the RBS Group's corporate structure, its business activities conducted in the UK and the US and potentially other jurisdictions where the RBS Group operates, as well as changes to the RBS Group's business model, might be required. The changes are likely to include ring-fencing certain banking activities in the UK from other activities of the RBS Group as well as restructuring other operations within the RBS Group in order to comply with these proposed new rules and regulations. The proposals, if adopted, are expected to take an extended period of time to put into place, would be costly to implement and may lack harmonisation, all of 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 is subject to a number of legal and regulatory actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the RBS Group's operating results or reputation

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 a number of legal and regulatory proceedings and investigations in the UK, the EU, the US and other jurisdictions.

The RBS Group is involved in ongoing class action litigation, LIBOR related litigation and investigations, securitisation and securities related litigation, and anti-money laundering, sanctions, mis-selling and compliance related investigations, in addition to a number of other matters. In respect of the LIBOR investigations, the RBS Group reached a settlement on 6 February 2013 with the Financial Services Authority, the Commodity Futures Trading Association and the US Department of Justice. In addition to this settlement, the RBS Group continues to cooperate with these and other governmental and regulatory authorities, including in the US and Asia, into its submissions, communications and procedures relating to the setting of LIBOR and other trading rates, and the probable outcome is that it will incur additional financial penalties. For more detail on the RBS Group's ongoing legal and regulatory proceedings. Legal and regulatory proceedings and investigations are subject to many uncertainties, and their outcomes, including the timing and amount of fines or settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. Adverse regulatory proceedings 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.

The RBS Group may be required to increase provisions in relation to ongoing legal proceedings, investigations and regulatory matters. In 2012, provisions were required to cover costs of redress in respect of past sales of interest rate hedging products to the RBS Group's small and medium sized businesses, having regard to the FSA report issued in January 2013 outlining the principles to which it wishes the RBS Group and other UK banks to adhere in conducting the review and redress exercise. Additional provisions were required in 2012 to cover increased costs associated with Payment Protection Insurance sales practices. Provision was also required in respect of the redress paid to customers following the June 2012 technology incident which resulted in delays in the processing of certain customer accounts and payments. Significant increases in provisions may harm the RBS Group's reputation and may have an adverse effect on the RBS Group's financial condition and results of operations.

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.

Financial reporting related risks

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 (IFRS), 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 the RBS Group 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.

Risk factors continued

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 2012, the RBS Group carried goodwill of £11.3 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.

The recoverability of certain deferred tax assets recognised by the RBS Group depends on the RBS Group's ability to generate sufficient future taxable profits

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. Further rate reductions were announced in 2012 which will lead to a corporation tax rate of 21% by April 2014 and the budget in March 2013 announced a further reduction to 20% from April 2015. Such changes in the applicable tax rates will reduce the recoverable amount of the recognised deferred tax assets.

Operational risks

Operational risks are inherent in the RBS Group's businesses

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. 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. Ineffective management of operational risks could have a material adverse effect on the Group's business, financial condition and results of operations.

The RBS Group's operations are highly dependent on its information technology systems

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 proper functioning of the RBS Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between its branches and main data processing centres, are critical to the RBS Group's operations. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the RBS Group's ability to service its clients, could result in significant compensation costs, could breach regulations under which the RBS Group operates and could cause long-term damage to the RBS Group's business and brand.

For example, failure to protect the RBS Group's operations from cyber attacks could result in the loss of customer data or other sensitive information. The threats are increasingly sophisticated and there can be no assurance that the RBS Group will be able to prevent all threats. In addition, in June 2012, a computer system failure prevented customers from accessing accounts in both the UK and Ireland. Ongoing issues relating to the failure continued for several months, requiring the RBS Group to set aside a provision for compensation to customers who suffered losses as a result of the system failure, in addition to other related costs. See page 281.

The RBS Group may suffer losses due to employee misconduct

The RBS Group's businesses are exposed to risk from potential non-compliance with policies, employee misconduct or negligence and fraud, which could result in regulatory sanctions and serious reputational or financial harm to the RBS Group. In recent years, a number of multinational financial institutions have suffered material losses due to the actions of 'rogue traders' or other employees. It is not always possible to deter employee misconduct and the precautions the RBS Group takes to prevent and detect this activity may not always be effective.

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. Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the impact of damaging information and allegations. 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, which may result in a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

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 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.

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.

Glossary of terms

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.

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 quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Assets under management - assets managed by the Group on behalf of clients.

Bank levy - a levy that applies to 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'.

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.

Bear steepener - a steepening of the yield curve caused by long-term rates increasing faster than short term rates.

BIPRU - the prudential sourcebook for banks, building societies and investment firms. The part of the Financial Services Authority's (FSA) Handbook that sets out detailed prudential requirements for the banks that they regulate.

Bull flattener - a flattening of the yield curve in which long term rates are decreasing faster than short term rates.

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 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.

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.

Compression trades - portfolio compression reduces the overall notional size and number of outstanding contracts in credit derivative portfolios without changing the overall risk profiles of these portfolios. This is achieved by terminating existing trades on single name reference entities and on indices and replacing them with a smaller number of new trades with substantially smaller notionals that carry the same risk profile and cash flows as the initial 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.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

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. CRD IV has yet to be enacted into European law and its implementation date remains uncertain.

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 grade - a rating that represents an assessment of the credit worthiness of a customer. It is a point on a scale representing the probability of default of a customer.

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 mitigation - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit risk spread - the yield spread between securities with the same currency and maturity structure but with different associated credit risks, with the yield spread rising as the credit rating worsens. It is the premium over the benchmark or risk-free rate required by the market to take on a lower credit quality.

Credit valuation adjustments (CVA) - the CVA is the difference between the risk- free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its 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 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.

Debit valuation adjustment (DVA) - an adjustment made by an entity to the valuation of OTC derivative liabilities to reflect within fair value the entity's own credit risk.

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.

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.

Economic capital - an internal measure of the capital required by the Group to support the risks to which it is exposed.

Economic profit - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

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.

Expected loss (EL) - expected loss represents the anticipated loss on an exposure over one year. It is determined by multiplying probability of default, loss given default and exposure at default and can be calculated at individual, credit facility, customer or portfolio level.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

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. where further drawings are made under a revolving credit facility before 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 originated 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.

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 - forbearance takes place when changes to the contractual payment terms of a retail loan are agreed in response to the borrower's financial difficulties.

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 originated 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.

Haircut - a downward adjustment to collateral value to reflect its nature, any currency or maturity mismatches between a credit risk mitigant and the underlying exposure to which it is being applied.

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.

Home loan - see Residential mortgage.

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.

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.

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.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk that the value of an asset or liability will change as a result of market factors such as foreign exchange rates, 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 (monolines) - 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.

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.

Non-performing loans - loans classified as Risk elements in lending and Potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

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 - 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.

Payment concession - an agreed temporary reduction in, or elimination of, the periodic (usually monthly) repayment on a loan. At the end of the concessionary period, the principal amount and accrued interest outstanding are scheduled for repayment over an agreed period.

Pillar 1 - the part of Basel II that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk.

Pillar 2 - the part of the Basel II that sets out the process by which a bank should review its overall capital adequacy and the processes under which the supervisors evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments.

Pillar 3 - the part of Basel II that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Position risk requirement - a capital requirement applied to a position treated under BIPRU 7 (Market risk) as part of the calculation of the market risk capital requirement.

Potential problem loans (PPL) - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for 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 loan - a wholesale loan for which changes to its contractual payment terms have been agreed in response to the borrower's financial difficulties.

Repurchase agreement (Repo) - see Sale and repurchase agreements.

Residential mortgage - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

Residential mortgage backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages.

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.

Slotting approach - a method of calculating regulatory capital, specifically for lending exposures in project finance and income producing real estate, where the PD estimates do not meet the minimum IRB standards. Under this approach, the bank classifies exposures from 1 to 5, where 1 is strong and 5 is default. Specific risk-weights are assigned to each classification.

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.

Standardised approach - a method used to calculate credit risk capital requirements under Pillar 1 of Basel II. In this approach the risk weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12 to 18%, depending on the type of underlying business being considered.

Stressed value-at-risk (SVaR) - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory SVaR, a time horizon of ten trading days is assumed at a confidence level of 99%. (Refer to Value-at-risk definition below).

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

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.

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.

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; high loan-to-value ratios; 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.

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.

Unaudited - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

US Federal Agencies - see Federal Agencies.

US Government National Mortgage Association - see Ginnie Mae.

Value-at-risk (VaR) - a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.

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.

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