ROYAL BANK OF SCOTLAND GROUP PLC
Form 6-K
May 28, 2009

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

28 May 2009

The Royal Bank of Scotland Group plc

Gogarburn
PO Box 1000
Edinburgh EH12 1HQ
Scotland
United Kingdom

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F X Form 40-F___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):___

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):___

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No X

If "Yes" is marked, indicate below the file number assigned to
the registrant in connection with Rule 12g3-2(b): 82-___

THE ROYAL BANK OF SCOTLAND plc

CONTENTS Page

THE ROYAL BANK OF SCOTLAND plc

Explanatory note

The Royal Bank of Scotland Group plc is filing this report in order for its wholly-owned subsidiary, The Royal Bank of Scotland plc (hereafter "the Royal Bank", the "Bank" or "Company"), to meet the requirements of item 1115 of Regulation AB issued by the Securities and Exchange Commission. This report contains selected financial data (on pages 4 - 5) and audited financial statements (on pages 56 - 135) as required by Item 3.A. and Item 17 of Form 20-F respectively and other related information.

Presentation of information

For the purpose of this report, the term 'Group' mean the Bank and its subsidiary and associated undertakings and the term 'RBS Group' means The Royal Bank of Scotland Group plc and its subsidiary and associated undertakings. The term 'the holding company' means The Royal Bank of Scotland Group 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' represen millions and thousands of millions of euros, respectively.

The results, assets and liabilities of individual business units are classified as trading or non-trading based on their predominant activity. Although this method may result in some non-trading activity being classified as trading, and vice versa, the Group believes that any resulting misclassification is not material.

International Financial Reporting Standards

As required by the Companies Act 1985 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 International Financial Reporting Interpretations Committee of the IASB (together 'IFRS') as adopted by the European Union. It also complies with IFRS as issued by the IASB. On implementation of IFRS on 1 January 2005, the Group took advantage of the option in IFRS 1 'First-time Adoption of International Financial Reporting Standards' to implement IAS 39 'Financial Instruments: Recognition and Measurement' and IAS 32 'Financial Instruments: Disclosure and Presentation' from 1 January 2005 without restating its 2004 income statement and balance sheet. The date of transition to IFRS for the Group and the date of its opening IFRS balance sheet is 1 January 2004.

The Group is no longer required to include reconciliations of shareholders' equity and net income under IFRS and US GAAP in its filings with the Securities and Exchange Commission in the US.

THE ROYAL BANK OF SCOTLAND plc

Forward-looking statements

Certain sections in this document contain ‘forward-looking statements’ as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘believes’, ‘should’, ‘could’, ‘intend’, ‘plan’, ‘probability’, ‘risk’, ‘Value-at-Risk (“VaR”)’, ‘target’, ‘goal’, ‘objec ‘will’, ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited, to the Group’s potential exposures to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. Such statements are subject to risks and uncertainties. For example, certain of the market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: the extent and nature of future developments in the credit markets, including the sub-prime market, and their impact on the financial industry in general and the Group in particular; general economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G-7 central banks; inflation; deflation; unanticipated fluctuations in interest rates, foreign currency exchange rates, commodity prices and equity prices; changes in UK and foreign laws, regulations and taxes; changes in competition and pricing environments; natural and other disasters; the inability to hedge certain risks economically; the adequacy of loss reserves; acquisitions or restructurings; technological changes; changes in consumer spending and saving habits; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this report speak only as of the date of this report, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

For a further discussion on certain risks faced by the Group, see Risk Factors on page 7.

THE ROYAL BANK OF SCOTLAND plc

SELECTED FINANCIAL DATA

The Group's accounts are prepared in accordance with IFRS as issued by the IASB. Selected data under IFRS for each of the five years ended 31 December 2008 are presented on pages 4 and 5.

The dollar financial information included below has been translated for convenience at the of £1.00 to US$1.4619, the Noon Buying Rate on 31 December 2008.

Amounts in accordance with IFRS

Summary consolidated income statement — IFRS	2008 $m	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Net interest income	19,749	13,509	11,116	10,392	9,711	8,790
Non-interest income	3,432	2,348	11,191	11,176	9,963	8,441
Total income	23,181	15,857	22,307	21,568	19,674	17,231
Operating expenses (1)	29,527	20,198	11,287	11,341	10,672	9,225
(Loss)/profit before impairment	(6,346)	(4,341)	11,020	10,227	9,002	8,006
Impairment	6,880	4,706	1,865	1,873	1,709	1,485
Operating (loss)/profit before tax	(13,226)	(9,047)	9,155	8,354	7,293	6,521
Tax	(738)	(505)	1,903	2,433	2,267	1,751
(Loss)/profit from continuing operations	(12,488)	(8,542)	7,252	5,921	5,026	4,770
Profit from discontinued operations, net of tax	—	—	—	—	—	258
(Loss)/profit for the year	(12,488)	(8,542)	7,252	5,921	5,026	5,028
(Loss)/profit attributable to:						
Minority interests	304	208	53	45	27	53
Other owners	933	638	331	252	154	315
Ordinary shareholders	(13,725)	(9,388)	6,868	5,624	4,845	4,660

Note:
(1) Includes integration and restructuring expenditure of £647 million (2007 - £92 million, 2006 - £120 million, 2005 - £349 million, 2004 - £499 million).

Summary consolidated balance sheet — IFRS	2008 $m	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Loans and advances	1,021,707	698,890	647,795	547,042	485,488	405,512
Debt securities and equity shares	263,810	180,457	169,941	126,621	120,351	91,356
Derivatives and settlement balances (1)	1,386,361	948,328	211,301	109,548	89,479	15,297
Other assets	73,468	50,255	42,701	50,416	49,806	50,436
Total assets	2,745,346	1,877,930	1,071,738	833,627	745,124	562,601
Shareholders' equity	67,186	45,958	47,683	37,936	34,510	34,320
Minority interests	1,889	1,292	152	396	104	679
Subordinated liabilities	58,404	39,951	27,796	27,786	28,422	21,262
Deposits	928,469	635,111	594,490	516,462	452,729	383,669
Derivatives, settlement balances and short positions(1)	1,396,205	955,062	256,921	152,989	128,295	43,812
Other liabilities	293,193	200,556	144,696	98,058	101,064	78,859
Total liabilities and equity	2,745,346	1,877,930	1,071,738	833,627	745,124	562,601

Note:
(1) Derivative balances in 2007 to 2004 have been restated for the netting of certain balances with the London Clearing House.

THE ROYAL BANK OF SCOTLAND plc

SELECTED FINANCIAL DATA (continued)

Other financial data

Based upon IFRS	2008	2007	2006	2005	2004
Return on average total assets(1)	(0.64%)	0.72%	0.71%	0.74%	0.93%
Return on average ordinary shareholders' equity(2)	(22.7%)	19.9%	18.4%	16.9%	17.6%
Average shareholders' equity as a percentage of total assets	3.4%	4.2%	4.4%	4.4%	6.2%
Risk asset ratio					
- Tier 1	8.5%	7.9%	6.7%	6.8%	N/A(4)
- Total	14.2%	12.8%	12.1%	12.3%	N/A(4)
Ratio of earnings to fixed charges and preference dividends(3)					
- including interest on deposits	0.48	1.50	1.57	1.62	1.83
- excluding interest on deposits	(2.94)	5.68	6.30	6.77	6.79
Ratio of earnings to fixed charges only(3)					
- including interest on deposits	0.50	1.53	1.59	1.64	1.91
- excluding interest on deposits	(3.97)	6.89	7.54	7.73	9.37

Notes:

(1) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.

(2) Return on average ordinary shareholders' equity represents profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.

(3) For this purpose, earnings consist of income before taxes and minority interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).

(4) Upon adoption of IFRS by listed banks in the UK on 1 January 2005, the Financial Services Authority ("FSA") changed its regulatory requirements such that the measurement of capital adequacy was based on IFRS subject to a number of prudential filers. The Risk Asset Ratios as at 31 December 2008, 2007, 2006 and 2005 have been presented in compliance with these revised FSA requirements.

Description of business

Introduction

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

Following a placing and open offer in December 2008, Her Majesty's Treasury in the United Kingdom (HM Treasury) owned approximately 58% of the enlarged ordinary share capital of the holding company and £5 billion of non-cumulative sterling preference shares. In April 2009, the holding company issued new ordinary shares by way of a second placing and open offer, the proceeds from which were used in full to fund the redemption of the preference shares held by HM Treasury at 101% of their issue price together with the accrued dividend and the commissions payable to HM Treasury under the second placing and open offer agreement. The second placing and open offer was underwritten by HM Treasury and as a result, HM Treasury currently owns approximately 70% of the enlarged ordinary share capital of the holding company.

Organisational structure and business overview

The Group’s activities are organised in the following business divisions: Global Markets (comprising Global Banking & Markets and Global Transaction Services), Regional Markets (comprising UK Retail & Commercial Banking, US Retail & Commercial Banking, Europe & Middle East Retail & Commercial Banking and Asia Retail & Commercial Banking), Group Manufacturing and the Centre. A description of each of the divisions is given below.

The RBS Group has undertaken a strategic review to re-focus the RBS Group on those businesses with clear competitive advantages and attractive marketing positions, primarily in stable, low-to-medium risk sectors.

Global Banking & Markets is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. In 2008 the division was organised along four principal business lines: rates, currencies, and commodities, including RBS Sempra Commodities LLP (the commodities-marketing joint venture between RBS and Sempra Energy which was formed on 1 April 2008); equities; credit markets; and asset and portfolio management.

Following the RBS Group’s strategic review, GBM is planning to re-focus its business around its core corporate and institutional clients, concentrating its activities in major financial centres and scaling back its presence elsewhere. It will exit illiquid proprietary trading and balance sheet-heavy niche products segments.

Globally, the intention is for GBM to move increasingly towards a “hub-and- spoke” model. Risk will be managed from regional hubs. It is intended that distribution and coverage will be delivered from a mix of hub countries and a scaled-back presence in some local offices. The aim, over time, will be to reduce much of the on-shore trading activity outside the key financial centres.

Assets, products and geographies that fit GBM’s new client-focused proposition will be defined as “core” and will remain within the division. Assets, business lines and some geographies that are non-core will be transferred to the new Non-Core Bank. These non-core activities accounted for approximately £205 billion of third party assets at end 2008.

Global Transaction Services ranks among the top five global transaction services providers, offering global payments, cash and liquidity management, as well as trade finance, United Kingdom and international merchant acquiring and commercial card products and services. It includes the Group's corporate money transmission activities in the United Kingdom and the United States.

Following the RBS Group's strategic review, Global Transaction Services intends to reduce its international network while retaining the capability to serve multinational clients globally.

The business also plans to increase efficiency through development of a lower cost front and back-office operating model and explore joint ventures for growth and selective disposals.

UK Retail & Commercial Banking (RBS UK) comprises retail, corporate and commercial banking and wealth management services. It operates through a range of channels including on-line and fixed and mobile telephony, and through two of the largest networks of branches and ATMs in the UK.

UK Retail Banking offers a full range of banking products and related financial services to the personal market. It serves customers through two of the largest networks of branches and ATMs in the United Kingdom, and also through telephone and internet channels and, according to Gfk NOP, is the second largest provider of personal current accounts. The division also issues credit and charge cards, including through other brands such as MINT.

UK Business & Commercial Banking is the largest provider of banking, finance, and risk management services to the 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, in which, according to the Finance Lease Association, it has a strong market presence through the Lombard brand.

According to Ph. Group, UK Corporate Banking holds the largest market share in the United Kingdom of relationships with larger companies, offering a full range of banking, finance, and risk management services.

US Retail & Commercial Banking provides financial services primarily through the Citizens and Charter One brands. Citizens 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.

Following the RBS Group's strategic review, Citizens intends to invest in its core business through increased marketing activity and targeted technology investments while reducing activity in its out-of-footprint national businesses in consumer and commercial finance.

This strategy will allow Citizens to become fully funded from its own customer deposits over time, and will support a low risk profile.

Europe & Middle East Retail & Commercial Banking comprises Ulster Bank and the Group's combined retail and commercial businesses in Europe and the Middle East.

Ulster Bank, including First Active, provides a comprehensive range of financial services across the island of Ireland. Its retail banking arm has a network of branches and operates in the personal, commercial and wealth management sectors, while its corporate markets operations provide services in the corporate and institutional markets.

The retail and commercial businesses in Europe and the Middle East have smaller activities in Romania, Kazakhstan and the United Arab Emirates. Following the Group's strategic review, the Group has decided to exit sub-scale retail and commercial activities outside its core markets in the United Kingdom, Europe and the United States.

Asia Retail & Commercial Banking is present in markets including India, Pakistan, China, Taiwan, Hong Kong, Indonesia, Malaysia and Singapore. It provides financial services across four segments: affluent banking, cards and consumer finance, business banking and international wealth management, which offers private banking and investment services to clients in selected markets through the RBS Coutts brand.

Following the RBS Group's strategic review, the Group has decided to exit sub-scale retail and commercial activities outside its core markets in the United Kingdom, Europe and the United States.

Group Manufacturing comprises the Group's worldwide manufacturing operations. It 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. Manufacturing 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 has become the centre of excellence for managing large-scale and complex change.

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

Non-core division

The Group intends to create during the second quarter of 2009 a non-core division to manage separately approximately £240 billion of third party assets, £145 billion of derivative balances and £155 billion of risk weighted assets that it intends to run off or dispose of over the next three to five years. The division will contain primarily assets from the GBM division linked to proprietary trading portfolios, excess risk concentrations and other illiquid portfolios. It will also include excess risk concentrations from other divisions as well as a number of small Regional Markets businesses that the Group has concluded are no longer strategic.

Recent developments

Asset Protection Scheme

On 26 February 2009, the RBS Group confirmed its intended participation in HM Treasury's Asset Protection Scheme (APS). The arrangements between the RBS Group and HM Treasury will, if completed, allow the RBS Group to secure asset protection in respect of some of its riskiest assets that enhances its financial strength and provides improved stability for customers and depositors, and also enhances the RBS Group's ability to lend into the UK market.

The proposed entry by the RBS Group into the APS is subject to the approval of independent shareholders of the RBS Group.

Litigation Update

Note 29 of the Notes on the Accounts provides disclosure regarding, among other things, litigation claims in the United Kingdom. With respect to the claims regarding unarranged overdraft charges, the House of Lords has granted the RBS Group and other banks leave to appeal the Court of Appeal's decision. That further appeal is scheduled to take place on 23 June 2009.

Debt Tender and Exchange Offer

On 26 March 2009, RBS Financing Limited ("RBSF"), a subsidiary of the RBS Group, launched a cash tender offer in the United States (the "RBSF US Tender Offer") for any and all of the outstanding securities of ten different series previously issued by the Group and certain of its affiliates. Concurrently therewith, RBSF also launched a cash tender offer outside of the United States (the “RBSF Non-US Tender Offer”) for five different series of securities previously issued by The Royal Bank and certain of its affiliates and an offer outside of the United States to exchange (the “RBSF Exchange Offer”) any or all of the outstanding securities of fourteen different series previously issued by The Royal Bank and certain of its affiliates for new senior unsecured notes of The Royal Bank.

The RBSF Tender Offers and the RBSF Exchange Offer expired on 22 April 2009. In the RBSF US Tender Offer, an aggregate of approximately US $4.1 billion principal amount of securities were validly tendered, resulting in an aggregate purchase consideration paid for the tendered securities of approximately US $1.7 billion.

In the RBSF Non-US Tender Offer, an aggregate of approximately €2.3 billion principal amount of Euro-denominated securities and approximately US $264 million principal amount of Dollar-denominated securities were validly tendered, resulting in aggregate purchase consideration paid for the tendered securities of approximately €1.1 billion and US $100 million, respectively.

In the RBSF Exchange Offer, an aggregate of approximately £3.5 billion principal amount of securities were validly offered for exchange and exchanged for new senior unsecured notes of The Royal Bank in an aggregate principal amount of approximately £1.8 billion.

Competition

The Group faces strong competition in all the markets it serves. However, the global banking crisis has reduced the capacity of many institutions to lend and has resulted in the withdrawal or disappearance of a number of market participants and significant consolidation of competitors, particularly in the US and UK. Competition for retail deposits has intensified significantly reflecting the difficulties in the wholesale money markets.

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 specialised 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 banks, building societies and major retailers. In the mortgage market, the Group competes with UK banks and building societies. A number of competitors have either left or scaled back their lending in the mortgage and unsecured markets.

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

In Europe, Asia and the Middle East, the Group competes in retail banking with local and international banks. In a number of these markets there are regulatory barriers to entry or expansion, and the state ownership of banks. Competition is generally intensifying as more players enter markets that are perceived to be de-regulating and offer significant growth potential.

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 and First Active compete 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.

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

Risk factors

The Royal Bank of Scotland plc is a principal subsidiary of The Royal Bank of Scotland Group plc. Consequently, the risk factors facing RBS Group also apply to the Royal Bank and are therefore discussed in this section. References in this section to ‘RBS’ refer to The Royal Bank of Scotland Group plc.

Set out below are certain risk factors which could affect the RBS Group's future results and cause them to be materially different from expected results. The RBS Group's results are also affected by competition and other factors. The factors discussed in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

RBS may face the risk of full nationalisation and under such circumstances shareholders may lose the full value of their shares.

Under the provisions of the Banking Act, substantial powers have been granted to HM Treasury, the Bank of England and the Financial Services Authority (FSA) as part of the Special Resolution Regime to stabilise banks that are in financial difficulties. The Special Resolution Regime gives the authorities three stabilisation options: private sector transfer, of all or part of the business of a UK-incorporated institution with permission to accept deposits (a "relevant entity"); transfer of all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England; and temporary public ownership (nationalisation) of the relevant entity or its UK-incorporated holding company.

The purpose of the stabilising options is to address the situation where all or part of the business of the relevant entity has encountered, or is likely to encounter, financial difficulties. Accordingly, the stabilisation options may only be exercised if the FSA is satisfied that a relevant entity such as the RBS Group's banking subsidiaries, including the Royal Bank, (i) is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the Financial Services and Markets Act 2000 (the "FSMA") and (ii) having regard to timing and other relevant circumstances it is not reasonably likely that action will be taken that will enable the relevant entity to satisfy those threshold conditions. The threshold conditions are conditions which an FSA-authorised institution must satisfy in order to retain its FSA authorisation. They are relatively wide-ranging and deal with most aspects of a relevant entity's business, including, but not limited to, minimum capital resource requirements. It is therefore possible that the FSA may exercise one of the stabilisation options before a relevant entity is in severe difficulties and before an application for insolvency or an administration order could be made.

The stabilisation options may be exercised by means of powers to transfer property, rights or liabilities of a relevant entity and shares and other securities issued by a relevant entity. HM Treasury may also take the parent company of a relevant entity (such as RBS) into temporary public ownership provided that certain conditions set out in Section 82 of the Banking Act are met. Temporary public ownership is effected by way of a share transfer order.

If HM Treasury makes the decision to take the holding company of a relevant entity into temporary public ownership, it may take various actions in relation to securities issued by the holding company, including:

- to transfer securities free from any contractual or legislative restrictions on transfer;
- to transfer securities free from any trust, liability, or encumbrance;
- to extinguish rights to acquire securities;
- to delist securities; or
- to convert securities into another form or class.

Where HM Treasury has made a share transfer order in respect of securities issued by the holding company of a relevant entity, HM Treasury may make an order providing for the property, rights or liabilities of the holding company or of any relevant entity in the holding company group to be transferred.

Shareholders may have a claim for compensation under one of the compensation schemes provided for in the Banking Act. For the purposes of determining an amount of compensation, an independent valuer must disregard actual or potential financial assistance provided by the Bank of England or HM Treasury.

There can be no assurance that Shareholders would thereby recover compensation promptly and/or equal to any loss actually incurred.

If the RBS Group were made subject to the Special Resolution Regime and a partial transfer of the RBS Group's business was effected, the nature and mix of the assets and liabilities not transferred may adversely affect its financial condition and increase the risk that the RBS Group may eventually become subject to administration or insolvency proceedings.

Over the last six months, the UK Government has taken action under the Banking (Special Provisions) Act 2008 in respect of a number of UK financial institutions including, in extreme circumstances, full and part nationalisation. There have been concerns in the market in recent months regarding the risks of such nationalisation in relation to RBS and other UK banks. If economic conditions in the UK or globally continue to deteriorate, or the events described in the following risk factors occur to such an extent that they have a materially adverse impact on the financial condition, perceived or actual credit quality, results of operations or business of any of the relevant entities in the RBS Group, the UK Government may decide to take similar action in relation to RBS. Given the extent of HM Treasury's and the Bank of England's powers under the Banking Act, it is difficult to predict what effect such actions might have on RBS and any securities issued by it. However, potential impacts may include full nationalisation of RBS and the total loss of value in RBS shares.

If RBS is unable to participate in the APS, or the operation of the APS fails to have the desired effect on RBS's financial and capital position, RBS may face the increased risk of full nationalisation. If the costs of participation outweigh the benefits, this could have a negative impact on RBS's business, earnings and financial prospects and its Share price may suffer.

On 26 February 2009, RBS announced its intention to participate in the APS. However, its ability to participate in the APS is subject to the satisfaction of a number of conditions which may not be satisfied, including, among others, the completion of due diligence by (and to the satisfaction of) HM Treasury, the receipt of certain regulatory approvals (including European Commission State Aid clearance), the approval of a majority of RBS's Independent Shareholders, finalisation of the terms of the APS and RBS's participation therein and the satisfaction by RBS of certain specified application criteria. The failure to satisfy these conditions could result in RBS being unable to participate in the APS and therefore failing to obtain protection against stressed losses through the economic cycle as well as failing to improve its capital ratios at the RBS consolidated Group level. The result of this may mean intervention by the UK Government, which could include full nationalisation, under which circumstances any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may lose the full value of their Shares.

Furthermore, even if RBS is able to participate in the APS, there can be no assurance that such participation will enable RBS to achieve all of the stated goals of the APS. While the APS is expected to limit losses associated with assets to be covered by the APS, RBS would remain fully exposed in respect of a specified "first loss" amount and exposed to 10 per cent. of losses exceeding that "first loss" amount. In addition, RBS would continue to be exposed to the risk of losses, impairments and write-downs with respect to assets not covered by the APS. Although RBS would have the option to obtain an additional £6 billion in capital from HM Treasury (in the form of a subscription for further B Shares) there can be no assurance that such additional capital, together with RBS's strengthened capital position as a result of the Placing and Open Offer, and the capital resulting from the proposed issue of the £6.5 billion and £13 billion of B Shares, will be sufficient to maintain the RBS Group's capital ratios in the event of further losses, which could cause RBS's business, results of operation and financial condition to suffer, its credit rating to drop, its ability to lend and access funding to be further limited, its cost of funding to increase and its Share price to decline, any of which would increase the risk of the full nationalisation of RBS.

In addition, there can be no assurance that the costs to RBS of its participation in the APS will not outweigh any benefits received. For example, RBS has agreed in principle that if it accedes to the APS, it will give up the right to certain tax losses and allowances which may affect the after-tax returns of the RBS Group in future years. As a result of RBS's agreement to give up such UK tax losses and allowances it is likely that RBS will pay UK corporation tax in earlier accounting periods than it would otherwise have done.

The RBS Group's businesses, earnings and financial condition have been and will continue to be affected by the continued deterioration in the global economy, as well as ongoing instability in the global financial markets.

The performance of the RBS Group has been and will continue to be influenced by the economic conditions of the countries in which it operates, particularly the United Kingdom, the United States and other countries throughout Europe and Asia. Recessionary conditions are present in many of these countries, including the United Kingdom and the United States, and such conditions are expected to continue or worsen over the near to medium term. In addition, the global financial system is continuing to experience the difficulties which first manifested themselves in August 2007, and the financial markets have deteriorated significantly since the bankruptcy filing by Lehman Brothers in September 2008. These conditions have led to severe and continuing dislocation of financial markets around the world and unprecedented levels of illiquidity, resulting in the development of significant problems at a number of the world's largest corporate institutions operating across a wide range of industry sectors, many of whom are the RBS Group's customers and counterparties in the ordinary course of its business. In response to this economic instability and illiquidity in the market, a number of governments, including the UK Government, the governments of the other EU member states and the US Government, have intervened in order to inject liquidity and capital into the financial system, and, in some cases, to prevent the failure of these institutions.

Despite such measures, the volatility and disruption of the capital and credit markets have continued at unprecedented levels, and global recessionary conditions are expected to continue. These conditions have produced and will continue to produce downward pressure on stock prices and on availability and cost of credit for financial institutions, including the RBS Group, and will continue to impact on the credit quality of the RBS Group's customers and counterparties. Such conditions, alone or in combination with regulatory changes or actions of other market participants, may cause the RBS Group to experience further reductions in business activity, increased funding costs and funding pressures, lower share prices, decreased asset values, additional write downs and impairment charges and lower profitability or to incur losses.

In addition, the RBS Group will continue to be exposed to the risk of loss if major corporate borrowers or counterparty financial institutions fail or are otherwise unable to meet their obligations. The RBS Group's performance may also be affected by future recovery rates on assets and the historical assumptions underlying asset recovery rates, which may no longer be accurate given the unprecedented market disruption and general economic instability. The precise nature of all the risks and uncertainties the RBS Group faces as a result of current economic conditions cannot be predicted and many of these risks are outside the RBS Group's control.

Any conversion of the B Shares would significantly increase HM Treasury's ownership interest in RBS, have a corresponding dilutive effect on other RBS Shareholders and could result in the delisting of RBS's securities.

At the same time as RBS announced its proposed participation in the APS, RBS announced that, if it participated in the APS, it would issue £6.5 billion of B Shares to HM Treasury. RBS also announced that it would issue a further £13 billion of B Shares to HM Treasury on or after implementation of the APS, and HM Treasury would grant RBS the option to require HM Treasury to purchase a further £6 billion of B Shares from it. The B Shares, if issued, will rank pari passu with the Ordinary Shares on a winding-up. The B Shares would be convertible, at the option of the holder at any time, into Ordinary Shares at an initial conversion price of £0.50 per Ordinary Share. HM Treasury would agree not to convert any B Shares it holds if, as a result of such conversion, it would hold 75 per cent. or more of the Ordinary Shares, unless the price of the Ordinary Shares is equal to or exceeds £0.65 for a specified period in which case conversion is mandatory in any event. In addition, HM Treasury will not be entitled to vote in respect of Ordinary Shares acquired by it as a result of the conversion of B Shares into Ordinary Shares to the extent, but only to the extent, that votes cast on such Ordinary Shares, together with any other votes which HM Treasury is entitled to cast in respect of any other Ordinary Shares held by or on behalf of HM Treasury would exceed 75 per cent. of the total votes eligible to be cast on a resolution presented at a general meeting of RBS. If all £25.5 billion of B Shares are issued, such conversion of the B Shares would significantly increase HM Treasury's ownership interest in RBS up to approximately 84.4 per cent. of the RBS's issued share capital, and have a corresponding dilutive effect on other RBS Shareholders (as would the issue of the B Shares themselves in the event of a winding-up) although any such conversion would have no impact on the RBS Group's Tier 1 capital position. Furthermore, a mandatory conversion of the B Shares by HM Treasury would put RBS in breach of the Listing Rules requirement that 25 per cent. of its issued share capital must be in public hands. Although RBS may apply to the UKLA for a waiver in such circumstances, there is no guarantee that such a waiver would be granted, the result of which could be the delisting of RBS from the Official List and potentially other exchanges where its securities are currently listed and traded.

Lack of liquidity is a risk to the RBS Group's business and its ability to access sources of liquidity has been, and will continue to be, constrained.

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 enterprise specific factors, including an over-reliance on a particular source of funding (including, for example, short term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide have experienced and continue to experience a severe reduction in liquidity and term-funding in the aftermath of events in the US sub-prime residential mortgage market and the current severe market dislocation. Perception of counterparty risk between banks has also increased significantly following the bankruptcy filing by Lehman Brothers. This increase in perceived counterparty risk has led to further reductions in inter-bank lending, and hence, in common with many other banks, the RBS Group's access to traditional sources of liquidity has been, and may continue to be, restricted.

The RBS Group's liquidity management focuses on maintaining a diverse and appropriate funding strategy for its operations, controlling the mismatch of maturities and carefully monitoring its undrawn commitments and contingent liabilities. However, the RBS Group's ability to access sources of liquidity (for example, through the issue or sale of financial and other instruments or through the use of term loans) during the recent period of liquidity stress has been constrained to the point where it, like other banks, has had 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.

In addition, there is also a risk that corporate and institutional counterparties with credit exposures may look to reduce all credit exposures to banks, given current risk aversion trends. It is possible that credit market dislocation becomes so severe that overnight funding from non-government sources ceases to be available.

Furthermore, like many banks, the RBS Group relies on customer deposits to meet a considerable portion of its funding requirements and such deposits are subject to fluctuation due to certain factors outside the RBS Group's control, such as a loss of confidence, competitive pressures 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. Any material decrease in the RBS Group's deposits could, particularly if accompanied by one of the other factors described above, have a negative impact on the RBS Group's liquidity unless corresponding actions were taken to improve the liquidity profile of other deposits or to reduce assets.

The governments of some of the countries in which the RBS Group operates have taken steps to guarantee the liabilities of the banks and branches operating in their respective jurisdiction. Whilst in some instances the operations of the RBS Group are covered by government guarantees alongside other local banks, in other countries this may not necessarily always be the case. This may place subsidiaries operating in those countries, such as Ulster Bank Ireland Ltd, which did not participate in such government guarantee schemes, at a competitive disadvantage to the other local banks and therefore may require the RBS Group to provide additional funding and liquidity support to these operations.

There can be no assurance that these measures, alongside other available measures, will succeed in improving the funding and liquidity in the markets in which the RBS Group operates, or that these measures, combined with any increased cost of any funding currently available in the market, will not lead to a further increase in the RBS Group's overall cost of funding, which could have an adverse impact on the RBS Group's financial condition and results of operations or result in a loss of value in RBS shares.

Governmental support schemes are subject to cancellation, change or withdrawal (on a general or individual basis), which may have a negative impact on the availability of funding in the markets in which the RBS Group operates.

Governmental support schemes are subject to cancellation, change or withdrawal (on a general or individual basis) subject to contract, based on changing economic and political conditions in the jurisdiction of the relevant scheme. Furthermore, certain schemes which have been recently announced have in fact not been fully implemented, or their terms have not yet been finalised. To the extent government support schemes are cancelled, changed or withdrawn in a manner which diminishes their effectiveness, or to the extent such schemes fail to generate additional liquidity or other support in the relevant markets in which such schemes operate, the RBS Group, in common with other banks, may continue to face limited access to, have insufficient access to, or incur higher costs associated with, funding alternatives, which could have a material adverse impact on the RBS Group's business, financial condition, results of operations and prospects and result in a loss of value in RBS shares.

The financial performance of the RBS Group has been and will be affected by borrower credit quality.

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of the RBS Group's businesses. The outlook for the global economy over the near to medium term has continued to deteriorate, particularly in the UK, the United States and other European economies. For example, there is an expectation of further reductions in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers. As a result, the RBS Group has seen and expects to continue to see adverse changes in the credit quality of its borrowers and counterparties, with increasing delinquencies, defaults and insolvencies across a range of sectors. This trend has led and may lead to further impairment charges, higher costs, additional write downs and losses for the RBS Group or result in a loss of value in RBS shares.

The actual or perceived failure or worsening credit of the RBS Group's counterparties has adversely affected and could continue to adversely affect the RBS Group.

The RBS Group's ability to engage in routine funding transactions has been and will continue to be adversely affected by the actual or perceived failure or worsening credit of its counterparties, including other financial institutions and corporate borrowers. The RBS Group has exposure to many different industries and counterparties and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients. As a result, defaults by, or even the perceived creditworthiness of or concerns about, one or more corporate borrowers, financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the RBS Group or by other institutions. Many of these transactions expose the RBS Group to credit risk in the event of default of the RBS Group's counterparty or client. 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 currently experienced. Any such losses could have a material adverse effect on the RBS Group's results of operations and financial condition or result in a loss of value in RBS shares.

The RBS Group's earnings and financial condition have been, and its future earnings and financial condition are likely to continue to be, affected by depressed asset valuations resulting from poor market conditions.

Financial markets are currently subject to significant stress conditions, where steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by recent events affecting asset backed collateralised debt obligations (CDOs), the US subprime residential mortgage market and the leveraged loan market. In dislocated markets, hedging and other risk management strategies have proven not to be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties, including monoline and other insurance companies and credit derivative product companies. Severe market events have resulted in the RBS Group recording large write-downs on its credit market exposures in 2007 and 2008. The RBS Group expects that the deterioration in economic and financial market conditions will lead to further impairment charges and write-downs during the current financial year. Moreover, recent market volatility and illiquidity has made it difficult to value certain of the RBS Group's exposures. Valuations in future periods, reflecting, among other things, then-prevailing market conditions and changes in the credit ratings of certain of the RBS Group's assets, may result in significant changes in the fair values of the RBS Group's exposures, even in respect of exposures, such as credit market exposures, for which the RBS Group has previously recorded write-downs. In addition, the value ultimately realised by the RBS Group may be materially different from the current or estimated fair value. Any of these factors could require the Group to recognise further significant write-downs or realise increased impairment charges, any of which may adversely affect its capital position, its financial condition and its results of operations or result in a loss of value in RBS shares.

The value or effectiveness of any credit protection that the RBS Group has purchased from monoline and other insurers and other market counterparties (including credit derivative product companies) depends on the value of the underlying assets and the financial condition of the insurers and such counterparties.

The RBS Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), 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. Since 2007, monoline and other insurers and other market counterparties (including credit derivative product companies) have been adversely affected by their exposure to residential mortgage linked and corporate credit products. As a result, their actual and perceived credit worthiness deteriorated significantly in 2008 and may continue to be so impacted in 2009. If the financial condition of these counterparties or their actual and perceived credit worthiness deteriorates further, the RBS Group may record further credit valuation adjustments on the CDSs bought from these counterparties in addition to those already recorded.

Changes in interest rates, foreign exchange rates, bond, equity and commodity prices, and other market factors have significantly affected and will continue to affect the RBS Group's business.

Some of the most significant market risks the RBS Group faces are interest rate, foreign exchange, bond, equity and commodity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress, such as those experienced in recent months. 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 (principally ABN AMRO, Citizens and RBS Greenwich Capital) and may affect income from foreign exchange dealing. The performance of financial markets may affect bond, equity and commodity prices and, therefore, cause changes in the value of the RBS Group's investment and trading portfolios. This has been the case during the period since August 2007, with market disruptions and volatility resulting in significant reductions in the value of such portfolios. While the RBS 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 RBS Group's financial performance and business operations or result in a loss of value in RBS shares.

The RBS Group's borrowing costs and its access to the debt capital markets depend significantly on its credit ratings.

On 19 January 2009, S&P affirmed the long-term and short-term counterparty credit ratings for the Royal Bank at A+ and A-1 respectively. The outlook for all entities of the RBS Group was confirmed as stable, reflecting S&P's view that the RBS Group is of systemic importance to the UK banking system and that S&P now explicitly factor four notches of uplift into their long-term counterparty credit rating on the RBS Group. At the same time S&P lowered its ratings on the RBS Group's hybrid capital issues to BB from BBB, additionally the BB rating was placed under CreditWatch with negative implications. On the same date, Fitch affirmed the RBS Group and the Royal Bank's Long-term and Short-term Issuer Default Ratings at AA- and F1+ respectively and downgraded the RBS Group and the Royal Bank's individual ratings to E from B/C. The outlook for the Issuer Default Ratings remains stable reflecting Fitch's expectation of continued strong government support for the RBS Group. The RBS Group's support rating was upgraded from 1 to 5 and its support floor revised to AA- from No Floor. Fitch also downgraded the RBS Group and the Royal Bank's Tier 1 preference shares to BB- from A+, and upper tier 2 hybrid capital instruments issued by RBS Group companies to BB from A+ and placed all of these securities on Rating Watch Negative. Moody's on 20 January 2009 downgraded the senior unsecured rating of the Royal Bank to Aa3 from Aa1 with a negative outlook. The RBS Group's senior debt rating was downgraded to A1 from Aa2 again with a negative outlook. The Bank Financial Strength Rating was lowered to C- from B and remains under review for further possible downgrade. The short term P-1 ratings of both the RBS Group and the Royal Bank were affirmed. The outlook for all RBS Group entities incorporates Moody's view on the long-term credit profile of the RBS Group beyond the current government support phase as well as their view of the very high probability of on-going support from the Aaa-rated UK Government. Any future reductions in the long-term credit ratings of the RBS Group or one of its principal subsidiaries (particularly the Royal Bank) could further increase its borrowing costs. Any further reductions may also limit the RBS Group's access to the capital markets and trigger additional collateral requirements in derivative contracts and other secured funding arrangements. Credit ratings of the RBS Group and the Royal Bank 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 RBS Group's or the Royal Bank's credit ratings could adversely affect its access to liquidity and competitive position, increase its funding costs and have a negative impact on the RBS Group's earnings and financial condition or result in a loss of value in RBS shares.

The RBS Group's business performance could be adversely affected if its capital is not managed effectively.

Effective management of the RBS Group's capital is critical to its ability to operate its businesses, to grow organically and to pursue its strategy. The RBS Group is required by regulators in the United Kingdom, the United States, the Netherlands and in other jurisdictions in which it undertakes regulated activities, to maintain adequate capital. The maintenance of adequate capital is also necessary to enhance the RBS Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy. Accordingly, the purpose of the First Placing and Open Offer and the issue of the Preference Shares was to allow RBS to strengthen its capital position. As at 31 December 2008 the RBS Group's Tier 1 and Core Tier 1 capital ratios were 10.0 per cent. and 6.8 per cent. respectively, using the Basel II methodology. Although the net proceeds of the First Placing and Open Offer and the Preference Share Issue strengthened the RBS Group's capital base significantly, and the net proceeds of the Second Placing and Open Offer were used to redeem the existing £5 billion of Preference Shares and which thereby improved the quality of the RBS Group's capital by increasing the RBS Group's Core Tier 1 capital ratio, any change that limits the RBS Group's ability effectively to manage its balance sheet and capital resources going forward (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, delays in the disposal of certain assets or the inability to syndicate loans as a result of market conditions or otherwise) or to access funding sources, could have a material adverse impact on its financial condition and regulatory capital position or result in a loss of value in RBS shares.

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 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, each as further described in 'Accounting Policies' on page 64 of the financial statements. 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 changes in market conditions, as has been the case during the current financial crisis. In such circumstances, the RBS Group's internal valuation models require the RBS Group to make assumptions, judgements and estimates to establish fair value. In common with other financial institutions, these internal valuation models are complex, and the assumptions, judgements and estimates the RBS Group is required to make often relate to matters that are inherently uncertain, such as expected cash flows, the ability of borrowers to service debt, residential and commercial property price appreciation and depreciation, and relative levels of defaults and deficiencies. Such assumptions, judgements and estimates may 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 RBS Group's earnings and financial condition. Also, recent market volatility and illiquidity has challenged the factual bases of certain underlying assumptions and has made it difficult to value certain of the RBS Group's financial instruments. Valuations in future periods, reflecting prevailing market conditions, may result in further significant changes in the fair values of these instruments, which could have a negative effect on the RBS Group's results of operations and financial condition or result in a loss of value in RBS shares.

The RBS Group's future earnings and financial condition in part depend on the success of the RBS Group's strategic refocus on core strengths and its disposal programme.

In light of the recently changed global economic outlook, the RBS Group has embarked on a restructuring which focused on achieving appropriate risk adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital intensive businesses. The RBS Group will also continue with its disposal programme and continue to review its portfolio to identify further disposals of certain non-core assets. Although the proceeds of the Second Placing and Open Offer improved the quality of the RBS Group's capital by replacing the existing £5 billion of Preference Shares with £5 billion of Core Tier 1 capital, the global credit markets remain challenging and the RBS Group's execution of its current and future strategic plans may not be successful. In connection with the implementation of these plans, the RBS Group may incur restructuring charges, which may be material. Furthermore, if the RBS Group's plans, including any planned disposals, are not successful or fail to achieve the results expected, the RBS Group's business, capital position financial condition, results of operations and future prospects may be negatively impacted or this could result in a loss of value in RBS shares.

The RBS Group operates in markets that are highly competitive and consolidating. If the RBS Group is unable to perform effectively, its business and results of operations will be adversely affected.

Recent consolidation among banking institutions in the United Kingdom, the United States and throughout Europe is changing the competitive landscape for banks and other financial institutions. This consolidation, in combination with the introduction of new entrants into the US and UK markets from other European and Asian countries, could increase competitive pressures on the RBS Group. Moreover, if financial markets continue to be volatile, more banks may be forced to consolidate.

In addition to the effects of consolidation, increased government ownership of, and involvement in, banks generally may have an impact on the competitive landscape in the major markets in which the RBS Group operates. Although, at present, it is difficult to predict what the effects of this increased government ownership and involvement will be or how it will differ from jurisdiction to jurisdiction, such involvement may cause the RBS Group to experience stronger competition for corporate, institutional and retail clients and greater pressure on profit margins. Since the markets in which the RBS Group operates are expected to remain highly competitive in all areas, these and other changes to the competitive landscape could adversely affect the RBS Group's business, margins, profitability and financial condition or result in a loss of value in RBS shares.

The RBS Group has agreed to certain undertakings in relation to the operation of its business in the First Placing and Open Offer Agreement, the Second Placing and Open Offer Agreement and in connection with the proposed APS, which may serve to limit the RBS Group's operations.

Under the terms of the First Placing and Open Offer Agreement, the RBS Group provided certain undertakings aimed at ensuring that the subscription by HM Treasury for the relevant Ordinary Shares and the Preference Shares and the RBS Group's potential participation in the guarantee scheme promoted by HM Treasury as part of its support for the UK banking industry are compatible with the common market under EU law. These undertakings include (i) supporting certain initiatives in relation to mortgage lending and lending to SMEs until 2011, (ii) regulating management remuneration and (iii) regulating the rate of growth of the RBS Group's balance sheet. Under the terms of the Second Placing and Open Offer Agreement, the RBS Group's undertakings in relation to mortgage lending and lending to SMEs were extended to larger commercial and industrial companies in the United Kingdom. These undertakings may serve to limit the RBS Group's operations. In addition, pursuant to the Lending Commitments Letter, the RBS Group is subject to further undertakings, which supersede the lending commitments made to HM Treasury in October 2008 and January 2009 by agreeing to lend £16 billion above the amount the RBS Group had budgeted to lend to UK businesses and £9 billion above the amount the RBS Group had budgeted to lend to UK homeowners in the year commencing 1 March 2009, with a commitment to lend at similar levels in the year commencing 1 March 2010.

The RBS Group could fail to attract or retain senior management or other key employees.

The RBS Group's ability to implement its strategy depends on the ability and experience of its senior management and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a negative impact on the RBS Group's business. The RBS Group's future success will also depend on its ability to attract, retain and remunerate highly skilled and qualified personnel 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 compensation arrangements, in particular those in receipt of Government funding (such as the RBS Group). The RBS Group recently announced changes to its compensation structure which included significant reductions in bonuses to be paid in respect of 2008, and limitations on pay rises in 2009. In addition to the effects of such measures on the RBS Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is becoming more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of appropriately skilled personnel could prevent the RBS Group from successfully implementing its strategy, which could have a material adverse effect on the RBS Group's financial condition and results of, operations or result in a loss of value in RBS shares.

Each of the RBS Group's businesses is subject to substantial regulation and oversight. Any significant regulatory developments could have an effect on how the RBS Group conducts its business and on its results of operations and financial condition.

The RBS Group is subject to financial services laws, regulations, administrative actions and policies in each location in which it operates. All of these are subject to change, particularly in the current market environment, where there have been unprecedented levels of government intervention and changes to the regulations governing financial institutions, including recent nationalisations in the United Kingdom, the United States and other European countries. As a result of these and other ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the RBS Group's participation in any government or regulator-led initiatives), the RBS Group expects to face greater regulation in the United Kingdom, the United States, the Netherlands and other countries in which it operates, including throughout the rest of Europe.

Compliance with such regulations may increase the RBS Group's capital requirements and costs and have an adverse impact on its business, the products and services it offers and the value of its assets or result in a loss of value in RBS shares. Other areas where governmental policies and regulatory changes could have an adverse impact include, but are not limited to:

- the monetary, interest rate, capital adequacy and other policies of central banks and regulatory authorities;
- general changes in government or regulatory policy or changes in regulatory regimes that may significantly influence investor decisions in particular markets in which the RBS Group operates or may increase the costs of doing business in those markets;
- changes to financial reporting standards;
- other general changes in the regulatory requirements, such as prudential rules relating to the capital adequacy framework and the imposition of onerous compliance obligations, restrictions on business growth or pricing and requirements to operate in a way that prioritises objectives other than shareholder value creation;
- changes in competition and pricing environments;
- further developments in the financial reporting environment;
- differentiation amongst financial institutions by governments with respect to the extension of guarantees to bank customer deposits and the terms attaching to such guarantees, including requirements for the entire RBS Group to accept exposure to the risk of any individual member of the RBS Group, or even third party participants in guarantee schemes, failing;
- implementation of, or costs related to, local customer or depositor compensation or reimbursement schemes;
- transferability and convertibility of currency risk;
- expropriation, nationalisation and confiscation of assets;
- changes in legislation relating to foreign ownership; and
- other unfavourable political, military or diplomatic developments producing social instability or legal uncertainty which, in turn, may affect demand for the RBS Group's products and services.

The RBS Group's results have been and could be further 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, at external reporting dates, when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. The value in use and fair value of the RBS 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. For the year ended 31 December 2008, the Group recorded a £8.1 billion accounting write-down of goodwill and other intangibles relating to prior year acquisitions.

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 current employees. Pensions risk is the risk that the liabilities of the RBS Group's various defined benefit pension schemes which are long term in nature will exceed the schemes' assets, as a result of which the RBS Group is required or chooses to make additional contributions to the schemes. 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 and returns from them 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. Given the current economic and financial market difficulties and the prospects for them to continue over the near and medium term, the RBS Group may be required or elect to make further contributions to the pension schemes and such contributions could be significant and have a negative impact on the RBS Group's capital position results of operations or financial condition or result in a loss of value in RBS shares.

The RBS Group is and may be subject to litigation and regulatory investigations that may impact its business.

The 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 Group is, and may in the future be, involved in various disputes, legal proceedings and regulatory investigations in the United Kingdom, the United States and other jurisdictions, including class-action litigation. Furthermore, the RBS Group, like many other financial institutions, has come under greater regulatory scrutiny over the last year and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with new and existing corporate governance, employee compensation, conduct of business, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Disputes, legal proceedings and regulatory investigations are subject to many uncertainties, and their outcomes are often difficult to predict, particularly in the earlier stages of a case or investigation. Adverse regulatory action or adverse judgements in litigation could result in restrictions or limitations on the Group's operations or result in a material adverse effect on the RBS Group's reputation or results of operations or result in a loss of value in RBS shares. For details about certain litigation and regulatory investigations in which the Group is involved, see Note 29 on the financial statements.

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

The RBS Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The RBS Group has complex and geographically diverse operations and operational risk and losses can result from internal or 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-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment 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 identifying and rectifying weaknesses in existing procedures and to training staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the RBS Group. Any weakness in these systems or controls, or any breaches or alleged breaches of applicable laws or regulations could have a materially negative impact on the RBS Group's business, reputation, results of operations and share price. Notwithstanding anything contained in this risk factor, it should not be taken as implying that either RBS or the RBS Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA.

The RBS Group is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes in the jurisdictions in which it operates.

The RBS Group's activities are subject to tax at various rates around the world computed in accordance with local legislation and practice. Action by governments to increase tax rates or to impose additional taxes would reduce RBS's profitability. Revisions to tax legislation or to its interpretation might also affect the RBS Group's results in the future.

The acquisition of a majority shareholding in the RBS Group by HM Treasury in December 2008 could lead to certain adverse tax consequences for the RBS Group.

The acquisition by HM Treasury of a majority shareholding in the RBS Group in consequence of the First Placing and Open Offer could, in certain circumstances, have adverse tax consequences which could affect the post-tax profitability of the RBS Group. However, if the RBS Group enters into the APS it has agreed, in principle, to give up the right to certain UK tax losses and allowances and this may limit the adverse tax consequences of the acquisition by HM Treasury of a majority shareholding in the RBS Group.

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 or from actual or perceived practices in the banking and financial industry. Negative public opinion may adversely affect the RBS Group’s ability to keep and attract customers and, in particular, corporate and retail depositors. The RBS Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In the United Kingdom 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 United Kingdom, the Financial Services Compensation Scheme (the “Scheme”) was established under the FSMA and is the UK’s statutory fund of last resort for customers of authorised financial services firms. The Scheme can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it and, if the Banking Bill is enacted in its current form, 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 that Bill. The Scheme is funded by levies on firms authorised by the FSA, including the RBS Group. In the event that the Scheme 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 RBS Group may have a material impact on its results of operations and financial condition. During the financial year ended 31 December 2008, the RBS Group made a provision of £150 million related to a levy by the Scheme.

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 United States with the Federal Deposit Insurance Corporation), the RBS Group may make further provisions and may incur additional costs and liabilities, which may negatively impact its financial condition and results of operations or result in a loss of value in RBS shares.

The RBS Group’s business and earnings may be affected by geopolitical conditions.

The performance of the RBS Group is significantly influenced by the geopolitical and economic conditions prevailing at any given time in the countries in which it operates, particularly the United Kingdom, the United States and other countries in Europe and Asia. For example, the RBS Group has a presence in countries where businesses could be exposed to the risk of business interruption and economic slowdown following the outbreak of a pandemic, or the risk of sovereign default following the assumption by governments of the obligations of private sector institutions. Similarly the RBS Group faces the heightened risk of trade barriers, exchange controls and other measures taken by sovereign governments which may impact a borrower’s ability to repay. Terrorist acts and threats and the response to them of governments in any of these countries could also adversely affect levels of economic activity and have an adverse effect upon the RBS Group's business.

The restructuring proposals for ABN AMRO are complex and may not realise the anticipated benefits for the RBS Group.

The restructuring plan in place for the integration and separation of ABN AMRO into and among the businesses and operations of the consortium members is complex, involving substantial reorganisation of ABN AMRO’s operations and legal structure. In addition, the plan contemplates activities taking place simultaneously in a number of businesses and jurisdictions. Although integration efforts are well underway and are being advanced on a number of fronts, the implementation of the reorganisation and the realisation of the forecast benefits within the planned timescales, particularly given current market and economic conditions, remains challenging, although the RBS Group remains confident that such goals will be achieved. Execution of the restructuring requires management resources previously devoted to the RBS Group businesses and the retention of appropriately skilled ABN AMRO staff. The RBS Group may not realise the benefits of the acquisition or the restructuring when expected or to the extent projected. The occurrence of any of these events, including as a result of staff losses or performance issues, may have a negative impact on the RBS Group's financial condition and results of operations. It is not expected that the Dutch State's acquisition of Fortis Bank Nederland's shares in RFS Holdings, which was effected in December 2008, will materially affect the integration benefits envisaged by the RBS Group.

The recoverability of certain deferred tax assets recognised by the RBS Group depend on the RBS Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation.

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 losses are quantified on the basis of current tax legislation and are subject to change in respect of the rate of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation may reduce the recoverable amount of the recognised deferred tax assets.

RBS's ability to pay dividends on or make other distributions in respect of the Ordinary Shares will depend on the availability of distributable reserves and may be limited by the terms of the B Shares.

RBS's ability to pay dividends is limited under UK company law, which limits a company to only paying cash dividends to the extent that it has distributable reserves and cash available for this purpose. As a holding company, RBS's ability to pay dividends in the future is affected by a number of factors, principally its ability to receive sufficient dividends from subsidiaries. The payment of dividends to RBS by its subsidiaries is, in turn, subject to restrictions, including certain regulatory requirements and the existence of sufficient distributable reserves and cash in RBS's subsidiaries. The ability of these subsidiaries to pay dividends and RBS's ability to receive distributions from its investments in other entities are subject to applicable local laws and regulatory requirements and other restrictions, including, but not limited to, applicable tax laws and covenants in some of RBS's debt facilities. These laws and restrictions could limit the payment of future dividends and distributions to RBS by its subsidiaries, which could restrict RBS's ability to fund other operations or to pay, in due course, a dividend to holders of the Existing Shares or the New Shares.

In addition, if the B Shares are issued, no cash dividend may be paid on the Ordinary Shares unless the cash dividend payable in respect of the same period on the B Shares is paid in full, and no scrip dividend may be paid on the Ordinary Shares unless the cash or scrip dividend payable in respect of the same period on the B Shares is paid in full.

Risk, capital and liquidity management

Risk, capital and liquidity management is conducted on an overall basis within the RBS Group. Therefore the discussion on risk, capital and liquidity management (pages 15 to 55) refers principally to policies and procedures in the RBS Group. Data is also provided for the Bank and its subsidiaries ('the Group') and the Bank.

On pages 15 to 55 certain information has been audited and is labelled as such.

Risk governance (unaudited)

Risk and capital management strategy is owned and set by the RBS Group's Board of Directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy.

The role and remit of these committees is as follows:

- Group Audit Committee (GAC): Financial reporting and the application of accounting policies as part of the internal control and risk assessment process. GAC monitors the identification, evaluation and management of all significant risks throughout the RBS Group.

- Advances Committee (AC): Deals with transactions that exceed the Group Credit Committee's delegated authority and large exposures.

- Group Executive Management Committee (GEMC): Ensures implementation of strategy consistent with risk appetite.

- Executive Risk Forum (ERF): Acts on all strategic risk and control matters across the RBS Group including, but not limited to, credit risk, market risk, operational risk, compliance and regulatory risk, enterprise risk, treasury and liquidity risk, reputational risk, insurance risk and country risk.

- Group Risk Committee (GRC): Recommends limits and approves processes and policies to ensure the effective management of all material risks across the RBS Group.

    - Group Credit Committee (GCC): Approves credit proposals under the authority delegated to the committee by the Board and/or the Advances Committee.

- Group Asset and Liability Management Committee (GALCO): Identifies, manages and controls the RBS Group balance sheet risks.

- Group Chief Executive's Advisory Group (GCEAG): Acts as a forum for the provision of information and advice to the Group Chief Executive. Forms part of the control process of the RBS Group.

Risk and capital (unaudited)

It is the RBS Group's policy to optimise return to shareholders while maintaining a strong capital base and credit rating to support business growth and meet regulatory capital requirements at all times.

Risk appetite is measured as the maximum level of retained risk the RBS Group will accept to deliver its business objectives. Risk appetite is generally defined through both quantitative and qualitative techniques including stress testing, risk concentration, value-at-risk and risk underwriting criteria, ensuring that appropriate principles, policies and procedures are in place and applied.

15

Risk appetite (unaudited)

Risk and capital management across the RBS Group is based on the risk appetite set by the Board, which is established through setting strategic direction, contributing to, and ultimately approving annual plans for each division and regularly reviewing and monitoring the RBS Group's performance in relation to risk through monthly Board reports.

Risk appetite is defined in both quantitative and qualitative terms as follows:

- Quantitative: encompassing stress testing, risk concentration, value- at-risk, liquidity and credit related metrics.

- Qualitative: focusing on ensuring that the RBS Group applies the correct principles, policies and procedures.

Different techniques are used to ensure that the RBS Group's risk appetite is achieved.

The GEMC is responsible for ensuring that the implementation of strategy and operations are in line with the risk appetite determined by the Board. This is reinforced through a policy framework ensuring that all staff within the RBS Group make appropriate risk and reward trade- offs within pre-agreed boundaries.

The main risks facing the RBS Group are as follows:

- Credit risk: the risk arising from the possibility that the RBS Group will incur losses from the failure of customers to meet financial obligations to the RBS Group.

- Funding and liquidity risk: the risk that the RBS Group is unable to meet obligations as they fall due.

- Market risk: the risk that the value of an asset or liability may change as a result of a change in market rates.

- Operational risk: the risk of financial loss or reputational impact resulting from fraud; human error; ineffective or inadequately designed processes or systems; improper behaviour; legal events; or from external events.

- Regulatory risk: the risks arising from regulatory changes/enforcement.

- Other risk: the risks arising from reputation and pension fund risk.

Credit risk

Principles for credit risk management (audited)

The key principles for credit risk management in the RBS Group are as follows:

- A credit risk assessment of the customer and credit facilities is undertaken prior to approval of credit exposure. Typically, this includes both quantitative and qualitative elements including, the purpose of the credit and sources of repayment; compliance with affordability tests; repayment history; ability to repay; sensitivity to economic and market developments; and risk-adjusted return based on credit risk measures appropriate to the customer and facility type.

- Credit risk authority is specifically granted in writing to individuals involved in the granting of credit approval, whether this is individually or collectively as part of a credit committee. In exercising credit authority, individuals are required to act independently of business considerations and must declare any conflicts of interest.

- Credit exposures, once approved, are monitored, managed and reviewed periodically against approved limits. Lower quality exposures are subject to more frequent analysis and assessment.

- Credit risk management works with business functions on the ongoing management of the credit portfolio, including decisions on mitigating actions taken against individual exposures or broader portfolios.

- Customers with emerging credit problems are identified early and classified accordingly. Remedial actions are implemented promptly and are intended to restore the customer to a satisfactory status and minimise any potential loss to the RBS Group.

- Stress testing of portfolios is undertaken to assess the potential credit impact of non-systemic scenarios and wider macroeconomic events on the RBS Group's income and capital.

Specialist credit risk teams oversee the credit process independently, making credit decisions within their discretion, or recommending decisions to the appropriate credit committee. Assessments of corporate borrower and transaction risk are undertaken using fundamental credit analysis and the application of general corporate and certain specialist counterparty credit risk models.

Financial markets counterparties are approved by a dedicated credit function which specialises in traded market product risk. Specialist credit grading models exist for certain bank and non-bank financial institutions.

Different approaches are used for the management of wholesale and retail businesses:

- Wholesale businesses: exposures are aggregated to determine the appropriate level of credit approval required and to facilitate consolidated credit risk management. Credit applications for corporate customers are prepared by relationship managers (RMs) in the units originating the credit exposures, or by the RM team with lead responsibility for a counterparty where a customer has relationships with different divisions and business units across the RBS Group. This includes the assignment of counterparty credit grades and LGD estimates using approved models, which are also independently checked by the credit team.

- Retail businesses: the retail business makes a large volume of small value credit decisions. Credit decisions will typically involve an application for a new or additional product or a change in facilities on an existing product. The majority of these decisions are based upon automated strategies utilising industry standard credit and behaviour scoring techniques.

16

Credit risk models (audited)
Credit risk models are used throughout the RBS Group to support the analytical elements of the credit risk management framework, in particular the risk assessment part of the credit approval process, ongoing monitoring as well as portfolio analysis and reporting. Credit risk models used by the RBS Group can be broadly grouped into three categories.

- Probability of default (PD): models estimate the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. Customers are assigned an internal credit grade which corresponds to probability of default. Every customer credit grade across all grading scales in the RBS Group can be mapped to a RBS Group level credit grade.

- Exposure at default (EAD): models estimate the expected level of utilisation of a credit facility at the time of a borrower’s default. The EAD may be assumed to be higher than the current utilisation (e.g. in the case where further drawings are made on a revolving credit facility prior to default) but will not typically exceed the total facility limit.

- Loss given default (LGD): models estimate the economic loss that may occur in the event of default and represents, the debt that cannot be recovered. The RBS Group’s LGD models take into account the type of borrower, facility and any risk mitigation such as security or collateral held.

Model validation (audited)
The performance and accuracy of credit models is critical, both in terms of effective risk management and also the calculation of risk parameters (PD, LGD and EAD) used by the RBS Group to calculate RWAs. The models are subject to frequent validation internally and, if used as part of the AIRB Basel II framework, have been reviewed and approved for use by the FSA.

Independent model validation is performed by the RBS Group. This includes an evaluation of the model development and validation for the data set used, logic and assumptions, and performance of the model analysis. Where required, the RBS Group has engaged external risk management consultants to undertake independent reviews and report their findings to the Wholesale or Retail Credit Model Committee. This provides a benchmark against industry practices.

The validation results are a key factor in deciding whether a model is recommended for ongoing use.

The frequency, depth and extent of the validation are consistent with the materiality and complexity of the risk being managed. The RBS Group’s validation processes include:

- Developmental evidence: to ensure that the credit risk model adequately discriminates between different levels of risk and delivers accurate risk estimates.

- Process verification: whether the methods used in the credit risk models are being used, monitored and updated in the way intended in the design of the model. Initial testing and validation is performed when the model is developed with the performance of models being assessed on an ongoing basis.

Credit risk mitigation (audited)
The RBS Group takes a number of steps to mitigate credit risk. The key risk mitigants are as follows:

- Real estate: the most common form of security held is real estate within the consumer and wholesale businesses.

- Financial collateral: is taken to support credit exposures in the non- trading book. Financial collateral is also taken in Global Markets and Regional Markets to support trading book exposures and is incorporated in E* (adjustment to the exposure value) calculations.

- Other physical collateral: the RBS Group takes a wide range of other physical collateral including business assets (stock and inventory, plant and machinery, equipment), project assets, intangible assets which provide a future cashflow and real value, commodities, vehicles, rail stock, aircraft, ships and receivables (not purchased).

- Guarantees: third party guarantees are taken from banks, government entities, export credit agencies, and corporate entities. The RBS Group's recovery value estimation methodology is sensitive to the variations in the credit quality of guarantors. Standby letters of credit are also given value in LGD models. Conditional guarantees are accepted, in accordance with internal requirements, and are included as appropriate in PD and LGD estimates (e.g. small firms loan guarantee schemes, completion guarantees). Personal guarantees are considered in the normal credit process where there is a charge over specific assets. While personal guarantees may be called for and are always accepted, no value is given to unsupported personal guarantees in any credit models.

- Credit derivatives: credit derivative activity is conducted through designated units within GBM to ensure consistency and appropriate control. RBS Group policies are designed to ensure that the credit protection is appropriate to support offset for an underlying trading book asset or improvement to the LGD of a banking book asset. Within the banking book, credit derivatives are used as risk and capital management tools. The principal counterparties are banks, investment firms and other market participants, with the majority subject to collateralisation under a credit support annex. In accordance with internal policy, stress testing is conducted on the counterparty credit risk created by the purchase of credit protection.

- Minimum standards (for example loan to value, legal certainty) are ensured through the policy framework.

Credit risk assets (audited)
Credit risk assets consist of loans and advances (including overdraft facilities), instalment credit, finance lease receivables and other traded instruments across all customer types. The RBS Group uses a series of models to measure the size of its exposure to credit risk and to calculate expected EAD in both its trading and banking books. In so doing, the RBS Group recognises the effects of credit risk mitigation that reduces potential loss.

Credit concentration risk (including country risk) (audited)
The RBS Group defines three key areas of concentration in credit risk that are monitored, reported and managed at RBS Group and divisional levels. These are single name concentration, industry/sector and country risk. The RBS Group has a series of quantitative and qualitative controls in place to limit the amount of concentration risk in credit portfolios. A threshold is set on the aggregate LGD to a single customer group above which approval is required from the RBS Group's most senior credit committee, the Advances Committee.

During the year work progressed on an enhancement of the frameworks for managing single name and sector concentrations. These enhancements are planned to be fully implemented in 2009 to improve the identification and management of concentrations in the portfolio through the introduction of additional parameters and increased scrutiny of concentration limit excesses.

A stress testing framework, Correlated Exposure Loss Testing, assesses the impact on the RBS Group's impairment charge of non-systemic events that affect groups of inter-related sectors in order to limit the impact of these scenarios to within defined tolerances.

Country risk arises from sovereign events (e.g. default or restructuring); economic events (e.g. contagion of sovereign default to other parts of the economy, cyclical economic shock); political events (e.g. convertibility restrictions and expropriation or nationalisation) and natural disaster or conflict. Losses are broadly defined and include credit, market, liquidity, operational and franchise risk related losses. It is the RBS Group's policy to monitor and control country risk exposures and to avoid excessive concentrations.

The RBS Group's appetite is expressed by a matrix of limits by country risk grade and is approved by GEMC. The RBS Group's exposure is managed and measured within this appetite by the Group Country Risk Management Committee (GCRMC), that has delegated authority from the GRC to manage country risk and agree related policy. Membership of GCRMC comprises the Group Chief Credit Officer, Heads of Credit and business representatives from those divisions with material country risk exposures. GCRMC sets limits for each country based on a risk assessment taking into account the RBS Group's franchise and business mix in that country. Additional limitations – on product types with higher loss potential and longer tenor transactions, for example – may be established depending on the country outlook and business strategy. A country watch list framework is in place to proactively monitor emerging issues and facilitates the development of mitigation strategies.

Global Restructuring Group (GRG) (audited)

GRG was formed in 2008, tasked with managing the RBS Group's problem and potential problem exposures to help rejuvenate and restore customers to profitable business. This may include assisting with the restructuring of their businesses and/or renegotiation.

GRG brings together previously disparate functions across the RBS Group. Its primary function is to work closely with the RBS Group's customer facing businesses to support the proactive management of any problem lending. This is based on a clear process (watch listing) which requires the transfer of problem credits to GRG. GRG reports to the Group Chief Risk Officer.

Given the current economic outlook, it is particularly important that potential problems are identified early and referred to GRG as the RBS Group's past experience has shown that the sooner specialists in restructuring are engaged, the greater the likelihood of a successful outcome. Early identification of potential problems therefore has a benefit to the borrower as well as to the RBS Group.

GRG is structured with specialist teams focused on: large corporate cases (higher value, multiple lenders); small/mid size business cases (lower value, bilateral relationships); and recovery/litigations. Given the negative trends in the portfolio in 2008, the size of GRG has grown substantially and further investment in staffing is expected in 2009.

Originating business units liaise with GRG upon the emergence of a potentially negative event or trend that may impact a borrowers' ability to service its debt. This may be a significant deterioration in some aspect of the borrowers' activity, such as trading, where a breach of covenant is likely or where a borrower has missed or is expected to miss a material contractual payment to the RBS Group or another creditor.

On transfer of a relationship to GRG a strategy is devised to:

- Work with the borrower to facilitate changes that will maximise the potential for turnaround of their situation and return them to profitability.

- Define the RBS Group's role in the turnaround situation and assess the risk/return dimension of the RBS Group's participation.

- Return customers to the originating business unit in a sound and stable condition or, if such recovery can not be achieved, avoid additional losses and maximise recoveries.

- Ensure key lessons learned are fed back into origination policies and procedures.

Retail collections and recoveries (audited)
There are collections and recoveries functions in each of the four regional markets. Their role is to provide support and assistance to customers who are currently experiencing difficulties meeting their financial obligations.

Where possible, the aim of collections and recoveries teams is to return the customer to a satisfactory position, by working with them to restructure their finances and/or business. If this is not possible, the team has the objective of reducing the loss to the RBS Group.

There have been material increases in staffing levels in all collections functions to manage the increase in the number of customers in financial difficulty. In the UK and Ireland, there is a common collection and recovery operational model managed by Group Manufacturing. During 2008, there was significant investment in systems development and staff training to make collections activity more efficient and effective.

In the UK there have been several initiatives to ensure fair and appropriate treatment of customers experiencing difficulties. For mortgage customers the RBS Group will not initiate repossession proceedings for at least six months after arrears are evident.

Preventative measures have also been a key focus throughout 2008, and as a result, the RBS Group has announced the introduction of over 1,000 dedicated Money Sense advisers in its branch network who will provide free financial counselling to both customers and non-customers. The RBS Group has also implemented a programme to proactively contact customers who exhibit early signs of financial stress but are not yet in Collections to offer them assistance in managing their finances more effectively.

Credit risk asset quality (audited)
Internal reporting and oversight of risk assets is principally differentiated by credit grades. 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 RBS Group map to both a RBS Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across disparate portfolios. Accordingly, measurement of risk is easily aggregated and can be reported at increasing levels of granularity depending on audience and business need.

The RBS Group has adopted, as part of the move to Basel II, a new master grading scale for wholesale exposures which comprises 27 grades. These in turn map to ten asset quality (AQ) bands used for both wholesale and retail exposures. This replaced the less granular AQ1-5 bands used prior to 2008.

The relationship between these measures is shown below (unaudited).

Master grading scale	PD Range Lower	PD Range Upper	New AQ1-10 bands	Old AQ1-5 bands
1	0%	0.006%		
2	0.006%	0.012%		
3	0.012%	0.017%	AQ1	
4	0.017%	0.024%		
5	0.024%	0.034%		AQ1
6	0.034%	0.048%	AQ2	
7	0.048%	0.067%	AQ3	
8	0.067%	0.095%		
9	0.095%	0.135%		
10	0.135%	0.190%		
			AQ4	
11	0.190%	0.269%		
12	0.269%	0.381%		AQ2
13	0.381%	0.538%		
14	0.538%	0.761%	AQ5	
15	0.761%	1.076%		AQ3
16	1.076%	1.522%	AQ6	
17	1.522%	2.153%		
				AQ4
18	2.153%	3.044%		
19	3.044%	4.305%	AQ7	
20	4.305%	6.089%		
21	6.089%	8.611%		
22	8.611%	12.177%	AQ8	
23	12.177%	17.222%		AQ5
24	17.222%	24.355%		
25	24.355%	34.443%	AQ9	
26	34.443%	100%		
27	100%	100%	AQ10	

Asset grades (unaudited)
Expressed as an annual probability of default, the upper and lower boundaries and the midpoint for each of these RBS Group level asset quality grades are as follows:

	Annual probability of default		
	Minimum	Midpoint	Maximum
Asset quality grade	%	%	%
AQ1	0.00	0.10	0.20
AQ2	0.21	0.40	0.60
AQ3	0.61	1.05	1.50
AQ4	1.51	3.25	5.00
AQ5	5.01	52.50	100.00

The following table provides an analysis of the credit quality of financial assets by the RBS Group's internal credit ratings (audited).

2008	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Group Balances with Group companies £m	Accruing past due £m	Non-accrual £m	Impairment provision £m	Total £m
Cash and balances at central banks	6,806	—	—	—	—	—	—	—	—	6,806
Loans and advances to banks (1)	68,885	91	77	28	230	7,297	—	83	(83)	76,608
Loans and advances to customers	231,688	108,005	144,408	74,314	36,736	4,484	12,797	13,643	(6,572)	619,503
Debt securities	171,685	847	263	3,736	1,220	—	—	33	(18)	177,766
Settlement balances	5,651	516	290	129	256	—	4,029	—	—	10,871
Derivatives	812,895	33,632	24,984	4,077	5,434	56,424	11	—	—	937,457
Other financial instruments	32	—	—	—	—	—	—	—	—	32
	1,297,642	143,091	170,022	82,284	43,876	68,205	16,837	13,759	(6,673)	1,829,043
Commitments	173,350	44,710	43,765	20,983	18,278	51	—	—	—	301,137
Contingent liabilities	20,946	5,976	2,989	2,519	487	—	—	—	—	32,917
Total off-balance sheet	194,296	50,686	46,754	23,502	18,765	51	—	—	—	334,054

2007										
Cash and balances at central banks	5,559	—	—	—	—	—	—	—	—	5,559
Loans and advances to banks (1)	89,357	1,772	426	94	2	1,966	—	2	(2)	93,617
Loans and advances to customers	191,451	109,460	163,792	46,293	19,850	9,088	9,083	6,665	(4,233)	551,449
Debt securities	153,391	8,026	1,383	466	1,165	—	—	1	—	164,432
Settlement balances	3,228	98	344	21	68	—	1,567	—	—	5,326
Derivatives	175,770	21,166	4,801	894	394	2,950	—	—	—	205,975
Other financial instruments	19	—	—	—	—	—	—	—	—	19
	618,775	140,522	170,746	47,768	21,479	14,004	10,650	6,668	(4,235)	1,026,377
Commitments	95,664	73,221	60,895	19,797	12,177	—	—	—	—	261,754
Contingent liabilities	7,658	7,915	4,989	1,214	1,100	—	—	—	—	22,876
Total off-balance sheet	103,322	81,136	65,884	21,011	13,277	—	—	—	—	284,630

Note:
(1) Excluding items in the course of collection of £2,779 million (2007 – £2,729 million).

20

2008	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Bank Balances with Group companies £m	Accruing past due £m	Non-accrual £m	Impairment provision £m	Total £m
Cash and balances at central banks	3,714	—	—	—	—	—	—	—	—	3,714
Loans and advances to banks(1)	54,403	66	50	8	225	36,481	—	81	(81)	91,233
Loans and advances to customers	127,883	50,267	60,255	28,830	9,727	44,368	2,482	5,622	(2,394)	327,040
Debt securities	153,490	804	206	3,396	1,079	708	—	17	(2)	159,698
Settlement balances	4,051	120	129	—	25	—	1,010	—	—	5,335
Derivatives	807,283	31,173	23,224	3,367	4,587	68,860	11	—	—	938,505
	1,150,824	82,430	83,864	35,601	15,643	150,417	3,503	5,720	(2,477)	1,525,525
Commitments	131,942	23,847	17,102	6,659	7,511	346	—	—	—	187,407
Contingent liabilities	16,804	3,093	1,155	1,081	182	—	—	—	—	22,315
Total off-balance sheet	148,746	26,940	18,257	7,740	7,693	346	—	—	—	209,722
2007										
Cash and balances at central banks	3,333	—	—	—	—	—	—	—	—	3,333
Loans and advances to banks(1)	66,418	574	275	70	—	24,115	—	—	—	91,452
Loans and advances to customers	97,715	59,825	75,432	12,645	5,874	74,340	2,501	2,088	(1,273)	329,147
Debt securities	98,303	5,699	1,254	338	1,044	612	—	—	—	107,250
Settlement balances	1,273	89	130	—	39	—	515	—	—	2,046
Derivatives	174,288	20,879	4,575	795	367	7,009	—	—	—	207,913
	441,330	87,066	81,666	13,848	7,324	106,076	3,016	2,088	(1,273)	741,141
Commitments	61,866	39,825	31,604	6,478	5,784	258	—	—	—	145,815
Contingent liabilities	5,876	5,187	2,962	278	703	—	—	—	—	15,006
Total off-balance	67,742	45,012	34,566	6,756	6,487	258	—	—	—	160,821

sheet

Note:
(1) Excluding items in the course of collection of £484 million (2007 – £530 million).

Industry risk – geographical analysis (audited)

					Group	
2008	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset(2) £m
UK						
Central and local government	6,033	34,942	3,998	1	44,974	1,636
Manufacturing	23,640	263	5,929	56	29,888	3,812
Construction	13,346	33	744	—	14,123	1,485
Finance	140,951	64,174	494,667	3,454	703,246	426,522
Service industry and business activities	82,006	4,980	13,229	586	100,801	7,710
Agriculture, forestry and fishing	3,118	—	34	1	3,153	87
Property	73,632	1,662	5,073	2	80,369	1,026
Individuals:						
Home mortgages	80,941	—	14	—	80,955	52
Other	26,182	248	36	—	26,466	5
Finance leases and instalment credit	17,363	3	25	—	17,391	—
Interest accruals	2,690	774	—	—	3,464	—
Total UK	469,902	107,079	523,749	4,100	1,104,830	442,335
US						
Central and local government	352	24,784	45	33	25,214	—
Manufacturing	10,569	102	1,809	128	12,608	217
Construction	885	63	122	6	1,076	—
Finance	25,517	36,408	364,544	5,445	431,914	323,910
Service industry and business activities	25,291	1,133	8,535	907	35,866	2,346
Agriculture, forestry and fishing	30	—	3	1	34	—
Property	6,475	7	97	—	6,579	—
Individuals:						
Home mortgages	34,235	—	—	—	34,235	—
Other	14,368	—	—	—	14,368	—
Finance leases and instalment credit	3,066	—	—	—	3,066	—
Interest accruals	488	466	—	—	954	—
Total US	121,276	62,963	375,155	6,520	565,914	326,473
Europe						
Central and local government	742	1,335	8	5	2,090	—
Manufacturing	11,174	1	31	—	11,206	—
Construction	4,380	—	57	—	4,437	—
Finance	6,145	455	212	110	6,922	7
Service industry and business activities	20,116	48	136	1	20,301	—
Agriculture, forestry and fishing	1,095	1	1	—	1,097	—
Property	18,618	1	299	—	18,918	—
Individuals:						

Home mortgages	23,132	—	—	—	23,132	—
Other	3,933	—	19	—	3,952	—
Finance leases and instalment credit	1,793	—	—	—	1,793	—
Interest accruals	337	1	—	—	338	—
Total Europe	91,465	1,842	763	116	94,186	7
Rest of the World						
Central and local government	534	5,164	268	142	6,108	—
Manufacturing	1,032	155	94	—	1,281	—
Construction	421	—	2	—	423	—
Finance	10,928	2,657	37,035	25	50,645	31,262
Service industry and business activities	6,001	337	328	—	6,666	—
Agriculture, forestry and fishing	15	—	10	—	25	—
Property	1,951	402	53	—	2,406	—
Individuals:						
Home mortgages	439	—	—	—	439	—
Other	1,466	—	—	—	1,466	—
Finance leases and instalment credit	24	—	—	—	24	—
Interest accruals	91	—	—	—	91	—
Total Rest of the World	22,902	8,715	37,790	167	69,574	31,262

	Group					
2008	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset (2) £m
Total						
Central and local government	7,661	66,225	4,319	181	78,386	1,636
Manufacturing	46,415	521	7,863	184	54,983	4,029
Construction	19,032	96	925	6	20,059	1,485
Finance	183,541	103,694	896,458	9,034	1,192,727	781,701
Service industry and business activities	133,414	6,498	22,228	1,494	163,634	10,056
Agriculture, forestry and fishing	4,258	1	48	2	4,309	87
Property	100,676	2,072	5,522	2	108,272	1,026
Individuals:						
Home mortgages	138,747	—	14	—	138,761	52
Other	45,949	248	55	—	46,252	5
Finance leases and instalment credit	22,246	3	25	—	22,274	—
Interest accruals	3,606	1,241	—	—	4,847	—
	705,545	180,599	937,457	10,903	1,834,504	800,077

Notes:

(1) Includes settlement balances of £10,871 million.

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

	Group					
2007	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset(2) £m
UK						
Central and local government	4,722	15,280	1,157	—	21,159	1,531
Manufacturing	19,574	211	1,517	—	21,302	4,031
Construction	12,249	3	741	—	12,993	1,684
Finance	173,741	74,137	186,041	1,678	435,597	190,316
Service industry and business activities	69,011	5,125	4,412	—	78,548	6,690
Agriculture, forestry and fishing	2,564	1	58	—	2,623	104
Property	59,821	603	969	7	61,400	2,033
Individuals:						
Home mortgages	72,726	—	5	—	72,731	—
Other	27,408	260	15	—	27,683	7

Finance leases and instalment credit	15,632	131	27	—	15,790	—
Interest accruals	2,202	857	—	—	3,059	—
Total UK	459,650	96,608	194,942	1,685	752,885	206,396
US						
Central and local government	347	22,982	—	212	23,541	—
Manufacturing	5,412	236	—	—	5,648	—
Construction	793	96	—	—	889	—
Finance	26,722	36,843	9,470	2,800	75,835	7,417
Service industry and business activities	14,254	1,388	233	—	15,875	1
Agriculture, forestry and fishing	20	—	—	—	20	—
Property	6,339	—	—	—	6,339	—
Individuals:						
Home mortgages	27,882	—	—	—	27,882	—
Other	10,879	—	—	—	10,879	—
Finance leases and instalment credit	2,228	—	—	—	2,228	—
Interest accruals	619	379	—	—	998	2
Total US	95,495	61,924	9,703	3,012	170,134	7,420

Industry risk – geographical analysis (audited) continued

	Group					
2007	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset(2) £m
Europe						
Central and local government	551	960	10	—	1,521	—
Manufacturing	5,868	—	—	—	5,868	—
Construction	3,519	—	—	—	3,519	—
Finance	10,984	790	1,011	28	12,813	—
Service industry and business activities	13,391	19	7	—	13,417	16
Agriculture, forestry and fishing	588	—	—	—	588	—
Property	12,971	67	—	—	13,038	—
Individuals:						
Home mortgages	16,276	18	—	—	16,294	—
Other	5,111	—	—	—	5,111	—
Finance leases and instalment credit	1,620	—	—	—	1,620	—
Interest accruals	277	1	—	—	278	—
Total Europe	71,156	1,855	1,028	28	74,067	16
Rest of the World						
Central and local government	239	1,054	—	—	1,293	—
Manufacturing	214	—	—	—	214	—
Construction	463	4	—	—	467	1
Finance	18,176	8,477	38	575	27,266	69
Service industry and business activities	3,103	1	9	—	3,113	2
Agriculture, forestry and fishing	11	—	—	—	11	—
Property	1,751	52	1	—	1,804	—
Individuals:						
Home mortgages	477	—	—	—	477	—
Other	1,149	—	—	—	1,149	—
Finance leases and instalment credit	18	—	254	45	317	—
Interest accruals	128	11	—	—	139	—
Total Rest of the World	25,729	9,599	302	620	36,250	72
Total						
Central and local government	5,859	40,276	1,167	212	47,514	1,531
Manufacturing	31,068	447	1,517	—	33,032	4,031
Construction	17,024	103	741	—	17,868	1,685
Finance	229,623	120,247	196,560	5,081	551,511	197,802
Service industry and business activities	99,759	6,533	4,661	—	110,953	6,709
Agriculture, forestry and fishing	3,183	1	58	—	3,242	104
Property	80,882	722	970	7	82,581	2,033
Individuals:						
Home mortgages	117,361	18	5	—	117,384	—
Other	44,547	260	15	—	44,822	7
Finance leases and instalment credit	19,498	131	281	45	19,955	—
Interest accruals	3,226	1,248	—	—	4,474	2
	652,030	169,986	205,975	5,345	1,033,336	213,904

Notes:

(1) Includes settlement balances of £5,326 million.

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

	Bank					
2008	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Settlement balances £m	Total £m	Netting offset(1) £m
UK						
Central and local government	3,559	33,099	4,003	1	40,662	352
Manufacturing	16,047	263	5,516	15	21,841	1,904
Construction	6,614	33	687	—	7,334	405
Finance	167,225	101,653	502,642	3,462	774,982	426,102
Service industry and business activities	57,456	4,787	11,935	478	74,656	2,290
Agriculture, forestry and fishing	836	—	21	1	858	71
Property	44,390	2,296	4,509	2	51,197	433
Individuals:						
Home mortgages	39,409	—	5	—	39,414	52
Other	7,857	—	6	—	7,863	—
Finance leases and instalment credit	652	—	25	—	677	—
Interest accruals	2,453	761	—	—	3,214	—
Total UK	346,498	142,892	529,349	3,959	1,022,698	431,609
US						
Central and local government	75	319	45	3	442	—
Manufacturing	3,769	44	1,308	5	5,126	—
Construction	203	3	123	—	329	—
Finance	7,937	11,611	365,575	1,314	386,437	320,460
Service industry and business activities	12,305	330	3,838	54	16,527	151
Agriculture, forestry and fishing	—	—	2	—	2	—
Property	1,057	—	97	—	1,154	—
Individuals:						
Home mortgages	—	—	—	—	—	—
Other	—	—	—	—	—	—
Finance leases and instalment credit	120	—	—	—	120	—
Interest accruals	74	61	—	—	135	—
Total US	25,540	12,368	370,988	1,376	410,272	320,611
Europe						
Central and local government	598	—	8	—	606	—
Manufacturing	8,862	—	—	—	8,862	—
Construction	1,031	—	—	—	1,031	—
Finance	1,765	59	—	—	1,824	7
	10,986	—	—	—	10,986	—

Service industry and business activities						
Agriculture, forestry and fishing	2	—	—	—	2	—
Property	5,893	—	—	—	5,893	—
Individuals:						
Home mortgages	4	—	—	—	4	—
Other	1	—	—	—	1	—
Finance leases and instalment credit	90	—	—	—	90	—
Interest accruals	149	1	—	—	150	—
Total Europe	29,381	60	8	—	29,449	7
Rest of the World						
Central and local government	534	1,622	268	—	2,424	—
Manufacturing	1,032	155	94	—	1,281	—
Construction	421	—	2	—	423	—
Finance	9,227	2,934	37,405	—	49,566	31,262
Service industry and business activities	5,979	336	328	—	6,643	—
Agriculture, forestry and fishing	15	—	10	—	25	—
Property	1,930	397	53	—	2,380	—
Individuals:						
Home mortgages	439	—	—	—	439	—
Other	3	—	—	—	3	—
Finance leases and instalment credit	147	—	—	—	147	—
Interest accruals	86	—	—	—	86	—
Total Rest of the World	19,813	5,444	38,160	—	63,417	31,262

25

	Bank					
2008	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Settlement balances £m	Total £m	Netting offset(1) £m
Total						
Central and local government	4,766	35,040	4,324	4	44,134	352
Manufacturing	29,710	462	6,918	20	37,110	1,904
Construction	8,269	36	812	—	9,117	405
Finance	186,154	116,257	905,622	4,776	1,212,809	777,831
Service industry and business activities	86,726	5,453	16,101	532	108,812	2,441
Agriculture, forestry and fishing	853	—	33	1	887	71
Property	53,270	2,693	4,659	2	60,624	433
Individuals:						
Home mortgages	39,852	—	5	—	39,857	52
Other	7,861	—	6	—	7,867	—
Finance leases and instalment credit	1,009	—	25	—	1,034	—
Interest accruals	2,762	823	—	—	3,585	—
	421,232	160,764	938,505	5,335	1,525,836	783,489

Note:

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

	Bank					
2007	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m	Settlement balances £m	Total £m	Netting offset(1) £m
UK						
Central and local government	2,396	13,379	1,158	—	16,933	387
Manufacturing	11,470	209	1,416	—	13,095	1,775
Construction	5,834	3	716	—	6,553	768
Finance	178,673	73,290	188,740	1,673	442,376	189,948
Service industry and business activities	42,694	5,710	4,228	—	52,632	2,143
Agriculture, forestry and fishing	800	—	56	—	856	87
Property	33,741	545	866	7	35,159	588
Individuals:						
Home mortgages	35,710	—	1	—	35,711	—
Other	8,213	—	6	—	8,219	—
Finance leases and instalment credit	708	128	27	—	863	—

Interest accruals	1,554	854	—	—	2,408	—
Total UK	321,793	94,118	197,214	1,680	614,805	195,696
US						
Central and local government	73	1,892	—	—	1,965	—
Manufacturing	2,307	124	—	—	2,431	—
Construction	217	48	—	—	265	—
Finance	31,867	10,799	10,400	321	53,387	4,932
Service industry and business activities	6,640	558	—	—	7,198	—
Property	724	—	—	—	724	—
Finance leases and instalment credit	36	—	—	—	36	—
Interest accruals	67	83	—	—	150	—
Total US	41,931	13,504	10,400	321	66,156	4,932

			Bank			
	Loans and advances to banks and customers	Debt securities and equity shares	Derivatives	Settlement balances	Total	Netting offset(1)
2007	£m	£m	£m	£m	£m	£m
Europe						
Central and local government	389	—	10	—	399	—
Manufacturing	3,910	—	—	—	3,910	—
Construction	630	—	—	—	630	—
Finance	18,964	37	—	—	19,001	—
Service industry and business activities	6,897	—	—	—	6,897	—
Property	4,938	—	—	—	4,938	—
Individuals:						
Home mortgages	3	—	—	—	3	—
Other	1	—	—	—	1	—
Finance leases and instalment credit	113	—	—	—	113	—
Interest accruals	100	1	—	—	101	—
Total Europe	35,945	38	10	—	35,993	—
Rest of the World						
Central and local government	239	1,053	—	—	1,292	—
Manufacturing	214	—	—	—	214	—
Construction	443	—	—	—	443	1
Finance	6,211	2,530	24	—	8,765	69
Service industry and business activities	13,497	—	10	—	13,507	2
Agriculture, forestry and fishing	11	—	—	—	11	—
Property	1,751	26	1	—	1,778	—
Individuals:						
Home mortgages	280	—	—	—	280	—
Other	3	—	—	—	3	—
Finance leases and instalment credit	18	—	254	45	317	—
Interest accruals	66	—	—	—	66	—
Total Rest of the World	22,733	3,609	289	45	26,676	72
Total						
Central and local government	3,097	16,324	1,168	—	20,589	387
Manufacturing	17,901	333	1,416	—	19,650	1,775
Construction	7,124	51	716	—	7,891	769
Finance	235,715	86,656	199,164	1,994	523,529	194,949
Service industry and business activities	69,728	6,268	4,238	—	80,234	2,145
Agriculture, forestry and fishing	811	—	56	—	867	87
Property	41,154	571	867	7	42,599	588
Individuals:						
Home mortgages	35,993	—	1	—	35,994	—
Other	8,217	—	6	—	8,223	—
Finance leases and instalment credit	875	128	281	45	1,329	—
Interest accruals	1,787	938	—	—	2,725	—
	422,402	111,269	207,913	2,046	743,630	200,700

Note:
(1)

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

Impairment (audited)
The RBS Group classifies impaired assets as either Risk Elements in Lending (REIL) or Potential Problem Loans (PPL). REIL represents non-accrual loans, loans that are accruing but are past due 90 days and restructured loans. PPL represents impaired assets which are not included in REIL but where information about possible credit problems cause management to have serious doubts about the future ability of the borrower to comply with loan repayment terms.

Both REIL and PPL are reported gross of the value of any security held, which could reduce the eventual loss should it occur, and gross of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against reported impaired balance. The analyses of risk elements and impairment charges as discussed below form a key part of the data provided to senior management on the credit performance of the Group's portfolios.

The table below sets out loans that are classified as REIL and PPL.

	Group	
	2008	2007
	£m	£m
Non-accrual loans (1)	13,726	6,667
Accrual loans past due 90 days (2)	1,669	256
Total REIL	15,395	6,923
PPL (3)	226	64
Total REIL and PPL	15,621	6,987
REIL and PPL as % of customer loans and advances – gross (4)	2.60%	1.47%

The sub-categories of REIL and PPL are calculated as described in notes 1 to 4 below.

Notes:
(1) All loans against which an impairment provision is held are reported in the non-accrual category.
(2) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.
(3) Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for fully collateralised advances and revolving credit facilities where identification as 90 days overdue is not feasible.
(4) Gross of provisions and excluding reverse repurchase agreements.

Impairment loss provision methodology (audited)
Provisions for impairment losses are assessed under three categories:

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

- Collectively assessed provisions: provisions on impaired credits below an agreed threshold which are assessed on a portfolio basis, to reflect the homogeneous nature of the assets, such as credit cards or personal loans. The provision is determined from a quantitative review of the relevant portfolio, taking account of the level of arrears, security and average loss experience over the recovery period.

- Latent loss provisions: provisions held against the estimated impairment in the performing portfolio which have yet to be identified as at the balance sheet date. To assess the latent loss within the portfolios, the RBS 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.

Provision analysis (audited)
The RBS 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 RBS Group operates a clear provisions governance framework which sets thresholds whereby suitable oversight and challenge is undertaken and significant cases will be presented to a committee chaired by the Group Chief Executive or the Group Finance Director.

Impairment charge (audited)
The following table shows total impairment losses charged to the income statement.

		Group
	2008	2007
	£m	£m
New impairment losses	4,917	2,110
less: recoveries of amounts previously written-off	(211)	(245)
Charge to income statement	4,706	1,865
Comprising:		
Loan impairment losses	4,555	1,843
Impairment losses on available-for-sale securities	151	22
Charge to income statement	4,706	1,865

Analysis of loan impairment charge (audited)

		Group
	2008	2007
	£m	£m
Latent loss impairment charge	582	2
Collectively assessed impairment charge	2,183	1,644

Individually assessed impairment charge (1)	1,709	197
Charge to income statement	4,474	1,843
Charge as a % of customer loans and advances – gross (2)	0.75%	0.39%

Notes:

(1) Excludes loan impairment charge against loans and advances to banks of £81 million (2007 – nil).

(2) Gross of provisions and excluding reverse repurchase agreements.

Analysis of loan impairment provisions (audited)

	Group 2008 £m	2007 £m
Latent loss provisions	1,328	600
Collectively assessed provisions	3,380	2,996
Individually assessed provisions	1,864	637
Total provisions (1)	6,572	4,233
Total provision as a % of customer loans and advances – gross (2)	1.10%	0.89%

Notes:
(1) Excludes provisions against loans and advances to banks of £83 million (2007 – £2 million).
(2) Gross of provisions and excluding reverse repurchase agreements.

Provisions coverage (audited)
The provision coverage ratios are shown in the table below.

	Group 2008 £m	2007 £m
Total provision expressed as a:		
% of REIL	43%	61%
% of REIL and PPL	43%	61%

The coverage ratio of closing provisions to REIL and PPL decreased from 61% to 43% during 2008. The lower coverage ratio reflects amounts written- off and the changing mix from unsecured to secured exposures.

Movement in loan impairment provisions (audited)
The following table shows the movement in the provision for impairment losses for loans and advances.

	Group Individually assessed £m	Collectively assessed £m	Latent £m	Total 2008 £m	2007 £m
At 1 January	639	2,996	600	4,235	3,929
Currency translation and other adjustments	164	113	176	453	30
(Disposals)/acquisitions	—	(148)	(30)	(178)	6
Amounts written-off	(636)	(1,811)	—	(2,447)	(1,652)
Recoveries of amounts previously written-off	23	188	—	211	245
Charged to the income statement	1,790	2,183	582	4,555	1,843
Unwind of discount	(33)	(141)	—	(174)	(166)
At 31 December (1)	1,947	3,380	1,328	6,655	4,235

Note:
(1) The provision for impairment losses at 31 December 2008 includes £83 million relating to loans and advances to banks (2007 – £2 million).

Liquidity risk (audited)
The RBS Group's liquidity policy is designed to ensure that it can at all times meet its obligations as they fall due.

Liquidity management within the RBS Group addresses the overall balance sheet structure and the control, within prudent limits, of risk arising from the mismatch of maturities across the balance sheet and from exposure to undrawn commitments and other contingent obligations. The management of liquidity risk within the RBS Group is undertaken within a formal governance structure. The Group Board of Directors oversees the liquidity risk appetite and strategy of the RBS Group; the Group Executive Management Committee reviews the key liquidity metrics and trends in the context of the RBS Group's overall risk profile; the Group Asset and Liability Management Committee (GALCO), chaired by the Group Finance Director and including the chief executives of the business divisions as well as the Group Treasurer, Group Chief Risk Officer and heads of other relevant Group functions, sets explicit metrics across a number of asset and liability targets and these are cascaded to the business and monitored by the Group Treasury and risk functions.

Group Treasury has overall responsibility for the daily monitoring and control of the RBS Group's liquidity and funding positions. The Liquidity Managers' Forum is chaired and directed by the Group Treasurer with membership including the Head of Short Term Markets and Financing, GBM. The forum typically meets weekly with more frequent, ad hoc, meetings as necessary. There are Regional and Country ALCOs that oversee RBS Group policy in our business in Europe, Asia and the Americas. The RBS Group is divided into Liquidity Reporting Units each of which is required to have its own liquidity limits and contingency funding plan. In addition, all subsidiaries and branches outside the UK are required to comply with local regulatory liquidity requirements and are subject to Group Treasury oversight.

Management of term structure
The RBS Group evaluates on a regular basis its structural liquidity risk and applies a variety of balance sheet management and term funding strategies to maintain this risk within its normal policy parameters. The degree of maturity mismatch within the overall long-term structure of the RBS Group's assets and liabilities is managed within internal policy guidelines, aimed at ensuring term asset commitments may be funded on an economic basis over their life. In managing its overall term structure, the RBS Group analyses and takes into account the effect of retail and corporate customer behaviour on actual asset and liability maturities where they differ materially from the underlying contractual maturities.

Daily management
The primary focus of the daily management activity is to ensure access to sufficient liquidity to meet cash flow obligations within key time horizons, in particular out to one month ahead. The short-term maturity structure of the RBS Group's liabilities and assets is managed daily to ensure that all material or potential cash flow obligations, arising from undrawn commitments and other contingent obligations can be met. Potential sources include cash inflows from maturing assets, new borrowings or the sale of various debt securities held (after allowing for appropriate haircuts). Short-term liquidity risk is generally managed on a consolidated basis with liquidity mismatch limits in place for subsidiaries and non-UK branches which have material local treasury activities, thereby assuring that the daily maintenance of the RBS Group's overall liquidity risk position is not compromised. Citizens Financial Group manages liquidity locally, given different regulatory regimes, subject to review by Group Treasury.

Stress testing
The RBS Group performs stress tests to simulate how events may impact its funding and liquidity capabilities. Such tests inform the overall balance sheet structure and help define suitable limits for control of the risk arising from the mismatch of maturities across the balance sheet and from undrawn commitments and other contingent obligations. The form and content of stress tests are updated where required as market conditions evolve.

Contingency planning

Contingency funding plans have been developed to anticipate and respond to approaching or actual material deterioration in market conditions. The RBS Group reviews its contingency plans in the light of evolving market conditions. The contingency funding plan covers: the available sources of contingent funding to supplement cash flow shortages; the lead times to obtain such funding; the roles and responsibilities of those involved in the contingency plans, including the communication lines for escalation of events which give rise to liquidity stress; assumptions, including the expected change impact of market conditions; and the ability and circumstances within which the RBS Group accesses central bank liquidity.

Liquidity management in 2008 (audited)

The amount of unsecured wholesale funding of the Group represented by bank funding and debt securities increased from £206 billion in December 2007 to £298 billion in December 2008. The gap between customer loans and customer deposits increased over this period from £109 billion to £199 billion. The market disruption during 2008 had a marked effect on the Group’s liquidity and funding which was at its most acute in the autumn of 2008 following the collapse of Lehman Brothers. During that period, the Group’s credit ratings were downgraded constraining both access to and tenor of wholesale funding and there was an outflow of customer deposits. The effective closure of the term funding markets and sharp reduction in the quantity and maturity of short term bank funding had profound consequences for the Group.

Whilst the Group’s customer funding sources remain well diversified and its retail franchise proved resilient, the availability of longer term funding diminished. The Group therefore increased its shorter term wholesale funding exposure, increased its access to central bank funding and issued government guaranteed debt to fund the balance sheet. The government schemes have enabled the mitigation of the financial crisis as the Group rebalances its asset and liability structure.

An analysis of the Group's funding is set out below.

	Group			
		2008		2007
Sources of funding	£m	%	£m	%
Customer accounts (excluding repos)				
Repayable on demand	248,978	27	226,451	27
Time deposits	150,056	16	141,502	17
Total customer accounts (excluding repos)	399,034	43	367,953	44
Debt securities in issue over one year remaining maturity	57,447	6	50,580	6
Subordinated liabilities	39,951	4	27,796	3
Owners' equity	45,958	5	47,683	5
Total customer accounts and long term funds	542,390	58	494,012	58
Repo agreements with customers	54,095	6	75,029	9
Repo agreements with banks	66,006	7	75,154	9
Total customer accounts, long term funds and collateralised borrowing	662,491	71	644,195	76
Debt securities in issue up to one year remaining maturity	122,495	13	79,552	9
Deposits by banks (excluding repos)	115,976	12	76,354	9
Short positions	37,172	4	47,058	6
Total	938,134	100	847,159	100

Customer accounts – the principal source of funds for the Group is its core customer deposits gathered by its retail banking, private client, corporate and SME franchises. The underlying strength of the franchise is demonstrated by the performance of the Group in these markets as customer deposits increased from £368 billion in December 2007 to £399 billion at the end of December 2008. There was a fluctuation in balances at the height of the market disruption in October 2008 but this was recovered by the year end. The Group's multi-brand offering and strong client focus is a key part of the funding strategy and continues to benefit the Group's funding position.

Repo agreements are borrowings collateralised by a range of debt securities and other assets undertaken with a range of corporate and institutional customers and banks. These reduced in the course of 2008 as the Group took strategic actions and wholesale markets retrenched.

Short positions in various securities are held primarily by GBM including RBS Greenwich Capital in the US.

Debt securities in issue over one year, subordinated liabilities and equity – during 2008, the debt markets saw reduced activity, in both the term and the securitisation markets; as a result the maturity profile of the Group's wholesale funding has become shorter in duration over the course of the year. This was partly offset by issues of government guaranteed debt in the latter part of 2008. The maturity profile of debt securities is predominantly concentrated under one year and this is a source of refinancing risk in the coming twelve months.

Short term debt and bank deposits – the Group saw considerable pressure and risk aversion in the short term debt and bank deposit markets. In order to relieve funding shortages in the market, central banks across the world allowed banks to pledge assets to access funding. The Group has used central bank schemes to support its funding and pledged assets into several of these schemes in a number of countries in which it operates. The Group has set up a series of initiatives to improve the liquidity value of its assets to assist in relieving funding pressures.

Undrawn commitments – the Group provides undrawn commitments to both its corporate and personal customers in the form of products such as overdrafts and credit card facilities. The commitments portfolio is well diversified in terms of customers, geography and business type. The total amount of the Group’s undrawn commitments at the end of 2008 was £294 billion.

Conduits – the Group’s most significant multi-seller conduits have thus far continued to fund the vast majority of their assets solely through asset backed commercial paper (ABCP) issuance. There were significant disruptions to the liquidity of the financial markets during the year following the bankruptcy filing of Lehman Brothers in September 2008 and this required a small amount of the assets held in certain conduits to be funded by the Group rather than through ABCP issuance. By the end of 2008 there had been an improvement in market conditions, supported by central bank initiatives, which enabled normal ABCP funding to replace this Group funding of the conduits.

The average maturity of ABCP issued by the Group’s conduits as at 31 December 2008 was 72.4 days (2007– 60.4 days).

The total assets held by the Group’s sponsored conduits are £31.5 billion (2007– £10.7 billion). Since these liquidity facilities are sanctioned on the basis of total conduit purchase commitments, the liquidity facility commitments will exceed the level of assets held, with the difference representing undrawn commitments.

The Group values the funding flexibility and liquidity provided by the ABCP market to fund client and Group-originated assets. Whilst there are plans to decrease the multi-seller conduit business in line with the Group’s balance sheet, the Group is reviewing the potential for new own-asset conduit structures to add funding diversity.

Balance sheet (audited)

The following tables show the contractual undiscounted cash flows receivable and payable up to a period of 20 years including future payments of interest.

On balance sheet assets by contractual maturity

	Group					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2008	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	6,804	—	—	—	2	—
Loans and advances to banks	14,356	3,037	650	343	156	1
Loans and advances to customers	112,181	63,785	117,538	106,942	137,546	129,999
Debt securities	21,104	4,785	14,647	7,983	16,509	23,742
Derivatives held for hedging	5	734	1,842	911	876	268
Settlement balances	10,869	—	—	—	2	—
Other financial assets	2	—	—	10	20	—
	165,321	72,341	134,677	116,189	155,111	154,010

On balance sheet liabilities by contractual maturity

	Group					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2008	£m	£m	£m	£m	£m	£m
Deposits by banks	83,879	5,938	3,114	1,758	662	34
Customer accounts	368,115	18,634	2,313	2,811	4,105	2,718
Debt securities in issue	110,728	30,213	22,461	3,581	5,600	4,038
Derivatives held for hedging	67	755	1,926	674	597	317
Subordinated liabilities	972	2,659	5,113	5,583	17,213	13,287
Settlement balances and other liabilities	10,407	5	7	4	7	6
	574,168	58,204	34,934	14,411	28,184	20,400

Other contractual cash obligations
Other contractual obligations are summarised by payment date in the tables below

	Group					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2008	£m	£m	£m	£m	£m	£m
Operating leases	103	304	743	611	1,174	1,836
Contractual obligations to purchase goods or services	176	696	262	22	—	1
	279	1,000	1,005	633	1,174	1,837
2007						
Operating leases	89	261	638	555	1,073	1,937
Contractual obligations to purchase goods or services	371	815	526	194	3	2
	460	1,076	1,164	749	1,076	1,939

						Bank
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2008	£m	£m	£m	£m	£m	£m
Operating leases	41	118	299	287	599	1,209
Contractual obligations to purchase goods or services	65	170	162	22	—	—
	106	288	461	309	599	1,209
2007						
Operating leases	35	106	269	256	582	1,176
Contractual obligations to purchase goods or services	100	249	199	34	2	—
	135	355	468	290	584	1,176

Undrawn formal facilities, credit lines and other commitments to lend were £294,349 million (2007 – £259,263 million) for the Group and £187,041 million (2007 – £144,185 million) for the Bank. While the Bank and its subsidiaries have given commitments to provide these funds, some facilities may be subject to certain conditions being met by the counterparty. Not all facilities are expected to be drawn, and some may lapse before drawdown.

The tables above show the timing of cash inflows and outflows to settle financial assets and liabilities. They have been prepared on the following basis:

Financial assets have been reflected in the time band of the latest date on which they could be repaid unless earlier repayment can be demanded by the reporting entity; financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas 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 is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. The settlement date of debt securities in issue issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

Assets and liabilities with a contractual maturity of greater than 20 years – the principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table as are interest payments after 20 years.

Held-for-trading assets and liabilities – held-for-trading assets and liabilities amounting to £1,148.7 billion (assets) and £1,091.7 billion (liabilities) have been excluded from the table in view of their short term nature.

This contractual analysis highlights the maturity transformation of the balance sheet that is fundamental to the structure of banking. In practice, this is not a reflection of the actual behaviour of assets or liabilities. In particular the customer funding of the balance sheet exhibits much greater stability and maturity than the tables indicate. This is because the funding franchise of the Group is diversified across an extensive retail network.

Regulatory environment (audited)

The RBS Group is subject to the FSA's liquidity regime, whilst overseas subsidiaries and branches are subject to local regimes.

Sterling liquidity
The FSA requires the RBS Group, on a consolidated basis, to maintain daily a minimum ratio of 100% between:

- a stock of qualifying high quality liquid assets (primarily UK and EU government securities, treasury bills and cash held in branches); and

- the sum of: sterling wholesale net outflows contractually due within five working days (offset up to a limit of 50%, by 85% of sterling certificates of deposit held which mature beyond five working days); and 5% of retail deposits with a residual contractual maturity of five working days or less. The FSA also sets an absolute minimum level for the stock of qualifying liquid assets that the RBS Group is required to maintain each day.

Given the developments in 2008 the FSA has published new proposals for liquidity management (CP08/22) to replace the current regulatory framework. The FSA is proposing a major overhaul of liquidity risk regulation that will include:

- Improved systems and controls including governance standards, pricing, intra day systems and collateral management.

- Individual liquid assessments that will include mandatory scenarios and an analysis of principal liquidity exposure factors.

- Reporting standards improved both in scope and frequency by enhanced mismatch reporting.

Market risk (audited)

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities. Market risk is actively managed and aligned with the RBS Group's risk appetite. Market conditions were difficult throughout 2008 with significant volatility and write-downs across markets and portfolios. The RBS Group manages market risk in the trading and non-trading (treasury) portfolios using the market risk management framework. The framework includes value-at-risk (VaR) limits, backtesting, stress testing, scenario analysis, position/sensitivity analysis and model validation. The focus through 2008 has been on overhauling and reviewing the market risk limits for trading book activities, reflecting market performance and events.

Measurement (audited)
A number of techniques are used to calculate the RBS Group's exposure to market risk, including VaR, sensitivity analysis and stress testing. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the RBS Group's VaR assumes a time horizon of one trading day and a confidence level of 95%. The trading book market risk is calculated using VaR at a confidence level of 99% and a time horizon of ten trading days. From 2009, the RBS Group is adopting 99% confidence limits, in line with industry practice.

The RBS Group calculates VaR using historical simulation models but does not make any assumption about the nature or type of underlying loss distribution. The methodology uses the previous 500 trading days of market data and calculates both general market risk (i.e. the risk due to movement in general market benchmarks) and idiosyncratic market risk (i.e. the risk due to movements in the value of securities by reference to specific issuers). All VaR models have limitations, which include:

- Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.

- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.

- VaR using a 95% confidence level does not reflect the extent of potential losses beyond that percentile.

Traded portfolios (audited)
The primary focus of the RBS Group's trading activities is client facilitation. The Group also undertakes:

- Market making – quoting firm bid (buy) and offer (sell) prices with the intention of profiting from the spread between the quotes.

- Arbitrage – entering into offsetting positions in different but closely related markets in order to profit from market imperfections.

- Proprietary activity – taking positions in financial instruments as principal in order to take advantage of anticipated market conditions.

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 (futures, forwards, swaps and options).

The RBS Group participates in exchange traded and over-the-counter (OTC) derivatives markets. The RBS Group buys and sells financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide margin daily with cash or other security at the exchange, to which the holders look for ultimate settlement. The RBS Group also buys and sells financial instruments that are traded OTC, rather than on a recognised exchange. These instruments range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to the requirements of the RBS Group's customers. In many cases, industry standard documentation is used, most commonly in the form of a master agreement, with individual transaction confirmations. The RBS Group calculates the VaR of trading portfolios at the close of business and positions may change substantially during the course of a trading day. Further controls are in place to limit the RBS Group's intra-day exposure, such as the calculation of the VaR for selected portfolios. The RBS Group cannot guarantee that losses will not exceed the VaR amounts indicated due to the limitations and nature of VaR measurements.

Assets and liabilities in the trading book are measured at their fair value. Fair value is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair values are determined following IAS 39 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 are reviewed and approved either by the market risk function in the business or at RBS Group level. Group Risk provides an independent evaluation of the model for transactions deemed by the Model Product Review Committee (MPRC) to be large, complex and/or innovative. Any profits or losses on the revaluation of positions are recognised in the daily profit and loss.

The VaR for the trading portfolios segregated by type of market risk exposure, including idiosyncratic risk, is presented in the table below.

	Group 2008				2007			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	18.9	25.8	38.8	9.2	11.7	9.6	17.6	7.6
Credit spread	35.0	40.4	51.3	19.4	17.7	37.9	44.0	12.6
Currency	3.9	7.0	10.8	2.1	2.6	2.6	6.9	1.1
Equity	3.4	2.4	11.0	1.5	2.4	1.9	6.8	1.4
Commodity	6.3	5.7	17.4	—	0.2	0.1	1.6	—
Diversification		(31.0)				(12.4)		
Total trading VaR	42.3	50.3	63.9	24.8	20.3	39.7	45.5	13.2

The average total VaR utilisation increased in 2008 compared with 2007 as a result of increased market volatility. This increase was offset by a reduction in trading book exposure throughout the period, due to a reduction in the size of the inventory held on the balance sheet as a result of sales, reclassification of assets to the non-trading book and write-downs.

The 2008 data in the table above excludes exposures to super-senior tranches of asset backed CDOs, as VaR no longer produces an appropriate measure of risk for these exposures due to the illiquidity and opaqueness of the pricing of these instruments over an extended period. For these exposures, the maximum potential loss is equal to the aggregate net exposure, which was £734 million as at 31 December 2008. For more information, please refer to the discussion of Credit market and related exposures – Super senior CDOs on page 46 and Financial statements: Note 10, Financial instruments – Valuation – level 3 portfolios – collateralised debt obligations on pages 87 and 88. RBS Sempra Commodities LLP, the commodities-marketing joint venture between RBS and Sempra Energy, was formed on 1 April 2008, and its trading risks were included in the disclosed VaR from that date.

Backtesting, stress testing and sensitivity analysis (audited)

The RBS Group undertakes a programme of daily backtesting, which compares the actual profit or loss realised in trading activity to the VaR estimation. The results of the backtesting process are one of the methods by which the RBS Group monitors the ongoing suitability of its VaR model.

A ‘Risks not in VaR’ framework has been developed to address those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model various non-VaR controls (e.g. position monitoring, sensitivity limits, triggers or stress limits) are in place.

The RBS Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from exceptional but plausible market events. Stress testing measures the impact of abnormal changes in market rates and prices on the fair value of the RBS Group’s trading portfolios. GEMC approves the high-level market stress test limit for the RBS Group. The RBS Group calculates historical stress tests and hypothetical stress tests.

Historical stress tests calculate the loss that would be generated if the market movements that occurred during historical market events were repeated. Hypothetical stress tests calculate the loss that would be generated if a specific set of adverse market movements were to occur.

Stress testing is also undertaken at key trading strategy level, for those strategies where the associated market risks are not adequately captured by VaR. Stress test exposures are discussed with senior management and are reported to GRC, GEMC and the Board. Breaches in the RBS Group's market risk stress testing limits are monitored and reported.

In addition to VaR and stress testing, the RBS Group calculates a wide range of sensitivity and position risk measures, for example interest rate ladders or option revaluation matrices. These measures provide valuable additional controls, often at individual desk or strategy level.

Model validation governance (audited)
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 all subject to independent review and sign-off. Models are assessed by MPRC as having either immaterial or material model risk (valuation uncertainty arising from choice of modelling assumptions), the assessment being made on the basis of expert judgement.

Those models assessed as having material model risk are prioritised for independent quantitative review. Independent quantitative review aims to quantify model risk by comparing model outputs against alternative independently developed models. The results of independent quantitative review are used by Market Risk to inform risk limits and by Finance to inform reserves. Governance over this process is provided by MPRC, a forum which brings together front office quants, market risk, finance and QuaRC (Quantitative Research Centre, Group Risk's independent quantitative model review function). Risk (market risk, incremental default risk, counterparty credit risk) models are developed both within business units and by Group functions. Risk models are also subject to independent review and sign-off. Meetings are held with the FSA every quarter to discuss the traded market risk, including changes in models, management, back testing results, other risks not included in the VaR framework and other model performance statistics.

Risk control (audited)
All divisions that are exposed to market risk in the course of their business are required to comply with the requirements of the RBS Group's Market Risk Policy Standards (MRPS). The main risk management tools are delegated authorities, specifically hard limits and discussion triggers, independent model valuation, a robust and efficient risk system and timely and accurate management information.

Limits form part of the dealing authorities and constitute one of the cornerstones of the market risk management framework. Upon notification of a limit breach, the appropriate body must take one of the following actions:

- Instructions can be given to reduce positions so as to bring the RBS Group within the agreed limits.
- A temporary increase in the limit (for instance, in order to allow orderly unwinding of positions) can be granted.
- A permanent increase in the limit can be granted.

Non-traded portfolios (audited)
Risks in non-traded portfolios mainly arise in retail and commercial banking assets and liabilities and financial investments designated as available-for-sale and held-to-maturity.

Group Treasury is responsible for setting and monitoring the adequacy and effectiveness of management, using a framework that identifies, measures, monitors and controls the underlying risk. GALCO approves the RBS Group's non-traded market risk appetite, expressed as statistical and non-statistical risk limits, which are delegated to the businesses responsible.

Various banking regulators review non-trading market risk as part of their regulatory oversight. As home regulator, the FSA has responsibility for reviewing non-trading market risk at a RBS Group consolidated level.

The RBS Group is exposed to the following non-traded risks:

Interest Rate Risk in the Banking Book (IRRBB) represents exposures to instruments whose values vary with the level or volatility of interest rates. These instruments include, but are not limited to, loans, debt securities, equity shares, deposits, certificates of deposits, and other debt securities issued, loan capital and derivatives. Hedging instruments used to mitigate these risks include related derivatives such as options, futures, forwards and swaps. Interest rate risk arises from the RBS Group's non-trading activities in four principal forms:

- Repricing risk – arises from differences in the repricing terms of the RBS Group's assets and liabilities.
- Optionality – arises where a customer has an option to exit a deal early.
- Basis risk – arises, for example, where one month LIBOR is used to fund base rate assets.
- Yield curve risk – arises as a result of non-parallel changes in the yield curve.

From an economic perspective, it is the RBS Group's policy to minimise the sensitivity to changes in interest rates in its retail and commercial businesses and, where interest rate risk is retained, to ensure that appropriate resources, measures and limits are applied.

Non-trading interest rate risk is calculated in each business on the basis of establishing the repricing behaviour of each asset, liability and off- balance sheet product. For many retail and commercial products, the actual interest rate repricing characteristics differ from the contractual repricing. In most cases, the repricing maturity is determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are approved by Group Treasury and divisional asset and liability committees at least annually. Key conventions are reviewed annually by GALCO.

A static maturity gap report is produced as at the month-end for each business, in each functional currency based on the behavioural repricing for each product. It is RBS Group policy to include in the gap report, non-financial assets and liabilities, mainly property, plant and equipment and the RBS Group's capital and reserves, spread over medium and longer term maturities. The report includes hedge transactions, principally derivatives.

Any residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the individual business balance sheets. Potential exposures to interest rate movements in the medium to long- term are measured and controlled using a version of the same VaR methodology that is used for the RBS Group's trading portfolios. Net accrual income exposures are measured and controlled in terms of sensitivity over time to movements in interest rates.

Risk is managed within VaR limits approved by GALCO, through the execution of cash and derivative instruments. Execution of the hedging is carried out by the relevant division through the RBS Group's treasury functions. The residual risk position is reported to divisional asset and liability committees, GALCO and the Board.

Foreign Exchange Risk in the Banking Book (FXRBB) represents exposures to changes in the values of current holdings and future cashflows denominated in other currencies. Hedging instruments used to mitigate these risks include foreign currency options, currency swaps, futures, forwards and deposits. Foreign exchange risk results from the RBS Group's investments in overseas subsidiaries, associates and branches in three principal forms:

(i) Structural foreign currency exposures that arise from net investment in overseas subsidiaries, associates and branches;

(ii) Transactional/commercial foreign currency exposures that arise from mismatches in the currency balance sheet; and

(iii) Foreign currency profit streams.

Equity Risk in the Banking Book (ERBB) is defined as the potential variation in the RBS Group's non-trading income and reserves arising from changes in equity prices/income. This risk may crystallise during the course of normal business activities or in stressed market conditions.

Equity positions in the RBS Group's banking book are retained to achieve strategic objectives, support venture capital transactions or in respect of restructuring arrangements. From an economic perspective, it is the RBS Group's policy to ensure that equity exposures in the banking book are identified, monitored and controlled, with the aim of maximising their potential strategic or business value.

The types, nature and amounts of exchange-traded exposures, private equity exposures, and other exposures vary significantly. Such exposures may take the form of listed and unlisted equity shares, linked equity fund investments, private equity and venture capital investments, preference shares classified as equity and Federal Home Loan Stock.

The commercial decision to invest in equity holdings is taken by GEMC, GCC or an appropriate sub-committee within delegated authority. Investments of a strategic nature are referred to GEMC for approval; those involving the purchase or sale by the Group or subsidiary companies also require Board approval, after consideration by GEMC.

Treasury (audited)
The RBS Group's treasury activities include its money market business and the management of internal funds flow within the RBS Group's businesses. In addition, this includes GBM trading portfolio assets that have been reclassified to available-for-sale. Money market portfolios include cash instruments (principally debt securities, loans and deposits) and related hedging derivatives.

Non-trading interest rate VaR (audited)
Non-trading interest rate VaR for the Group's treasury and retail and commercial banking activities was £117.8 million at 31 December 2008 (2007 – £65.1 million) with the major exposure being to changes in longer term US dollar interest rates. During 2008, the maximum VaR was £171.7 million (2007 – £71.8 million), the minimum was £75.9 million (2007 – £51.5 million) and the average was £109.6 million (2007 – £62.9 million).

Citizens Financial Group (CFG) was the main contributor to overall non-trading interest rate VaR. CFG manages non-trading interest rate risk with the objective of minimising accrual accounted earnings volatility.

To do so it uses a variety of income simulation and valuation risk measures that more effectively capture the risk to earnings due to mortgage prepayment and competitive deposit pricing behaviour than a VaR based methodology would. This balance sheet management approach is common for US retail banks. Interest rate risk in the banking book is managed by a professional treasury function which optimises the yield, whilst staying within approved limits on interest rate risk, liquidity and capitalisation.

Mortgages, home equity loans and mortgage-backed securities (MBS) comprise a large portion of CFG's assets. In the US, mortgage and home equity customers may prepay loans without penalty. However, under the requirements of FAS 133, the risk that they may do so cannot be hedged in a cost effective manner and must be born by the lender. Prepayment risk is a primary component of interest rate risk in the banking book at CFG.

	2008		2007	
	Principal(1) US$m	Carrying amount US$m	Principal(1) US$m	Carrying amount US$m
Total MBS and mortgages	63,542	63,165	69,948	69,672
MBS – total				
– high grade (AA or AAA rated)	26,268	25,893	26,848	26,572
– rated C to A	602	600	—	—
MBS – commercial				
– high grade (AA or AAA rated)	2,253	2,089	2,205	2,211

MBS – retail				
– high grade (AA or AAA rated)	24,015	23,804	24,643	24,361
– rated C to A	602	600	—	—
Residential mortgage and home equity loans (non-securitised, fixed rate and ARM, prepayable)	36,672	36,672	43,100	43,100

Note:
(1) The principal on MBS is the redemption amount on maturity or, in the case of an amortising instrument, the sum of future redemption amounts through the residual life of the security.

39

In addition to VaR, the following measures are reported to CFG ALCO, Group Treasury, GALCO and the Board:

- The sensitivity of net accrual earnings to a variety of parallel and non-parallel movements in interest rates.

- Economic value of equity (EVE) sensitivity to a series of parallel movements in interest rates. EVE is only used within CFG and to meet the FSA prescribed standard shock test of +/- 200bp parallel shock.

	Percent increase/ decrease in CFG EVE(1)	
(Unaudited)	2% parallel upward movement in US interest rates	2% parallel downward movement in US interest rates (No negative rates allowed)
Period end	(0.7)	(19.0)
Maximum	(18.2)	(20.8)
Minimum	(0.7)	(4.4)
Average	(12.2)	(12.6)

Note:
(1) Economic value of equity is the net present value of assets and liabilities calculated by discounting expected cash flows of each instrument over its expected life. Risk to EVE is quantified by calculating the impact of interest rate changes on the net present value of equity and is expressed as a percentage of CFG regulatory capital.

Currency risk (audited)

The RBS Group does not maintain material non-trading 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 RBS Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the RBS Group's or the subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity together with the effective portion of foreign exchange differences arising on hedging instruments.

Equity classification of foreign currency denominated preference share issuances requires that these shares be held on the balance sheet at historic cost. Consequently, these share issuances have the effect of increasing the RBS Group's structural foreign currency position.

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

	2008			2007		
	Net investments in foreign operations	Net investment hedges	Structural foreign currency exposures	Net investments in foreign operations	Net investment hedges	Structural foreign currency exposures
	£m	£m	£m	£m	£m	£m
US dollar	16,710	(4,302)	12,408	13,919	(2,437)	11,482
Euro	4,571	(617)	3,954	3,483	—	3,483
Swiss franc	912	(912)	—	563	(561)	2
Other non-sterling	877	(844)	33	185	(153)	32
	23,070	(6,675)	16,395	18,150	(3,151)	14,999

Retranslation gains and losses on the Group's net investments in operations together with those on instruments hedging these investments are recognised directly in equity. Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. A five percent strengthening in foreign currencies would result in a gain of £820 million (2007 – £750 million) recognised in equity, while a five per cent weakening in foreign currencies would result in a loss of £780 million (2007 – £715 million) recognised in equity. These movements in equity would offset retranslation effects on the Group's foreign currency denominated risk weighted assets, reducing the sensitivity of the Group's Tier 1 capital ratio to movements in foreign currency exchange rates.

Equity risk (audited)
Equity positions are measured at fair value. Fair value calculations are based on available market prices wherever possible. In the event that market prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The types, nature and amounts of exchange-traded exposures, private equity exposures, and other exposures vary significantly. Such exposures may take the form of listed and unlisted equity shares, linked equity fund investments, private equity and venture capital investments, preference shares classified as equity and Federal Home Loan Stock.

Credit market and related exposures (unaudited)
These disclosures provide information on certain of the Group's business activities affected by the unprecedented market events of 2008, the majority of which arose within Global Banking & Markets ('GBM'), and are focussed around GBM's credit markets activities, including the conduit business, which have been particularly affected by the widespread market disruptions, as well as similar exposures in US Retail & Commercial ('Citizens').

Market background (unaudited)
Overall, 2008 has been characterised by rapid dislocation in financial markets. In many cases, the dramatic liquidity squeeze and rise in funding costs for financial institutions has resulted in reluctance or inability of market participants to transact, and has adversely affected the performance of most financial institutions globally, including the Group. Stock markets have experienced extraordinary falls, and levels of volatility have been at record highs. Commodity prices have reduced sharply in the second half of the year, and credit spreads continued to widen. Market perception of counterparty risk increased and the failure of major credit protection providers caused fair value losses for the Group and other market participants and further increased the costs of mitigating credit exposure. Sustained falls globally in both residential and commercial real estate prices, fund valuations and worsening loan performance combined with a sustained lack of liquidity in the market, resulted in a greater amount of assets being valued at significantly lower prices.

The first quarter of 2008 saw a continuation of credit and liquidity shortages experienced during 2007, culminating in the collapse of Bear Stearns in March. The centre of the credit issues remained the ABS market with worsening US economic data supporting higher levels of default expectation in the property market. However, these default expectations started to go beyond the sub-prime market with Alt A and other non-conforming classes of loans particularly seeing significant price deterioration. In addition, wider economic concerns led to heavy fair value losses in the commercial mortgage backed securities market, in corporate debt and in leveraged loan exposures. Following this tightening of conditions, the Group incurred significant losses in March and the holding company took steps in April to materially strengthen its capital base through a £12 billion rights issue which was completed in June.

During the second quarter ABS prices initially rallied and steadied, however towards the end of the quarter a negative house price trend in the UK became clear, and in the US, market reaction to sub-prime mortgages extended to prime and near prime lending. Corporate credit spreads followed a similar pattern reacting to rising oil prices, inflationary pressures and continuing high LIBOR despite base rate cuts to 5% in April 2008.

Credit spreads continued to widen across the market through the third quarter and liquidity levels reduced further, resulting in pressure on banks and economies worldwide. This culminated in the demise of Lehman Brothers in September and further market consolidation and global state intervention to provide support to the banking sector.

During the fourth quarter there was a continued lack of confidence in the inter-bank market, with demand for stable investments resulting in US treasuries reaching negative spreads. Corporate and ABS prices fell further particularly in the last two months of the year increasing pressure on banks' capital positions. The year concluded with S&P downgrading the credit ratings of eleven global banks, including the Group.

Asset-backed exposures (audited)
Significant risk concentrations
The Group's credit markets activities gives rise to risk concentrations that have been particularly affected by the market turmoil experienced since the second half of 2007. 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.

During 2008, certain assets identified as being high risk were also transferred to a centrally managed asset unit, set up to provide specific management of this portfolio of higher risk assets. Transferred assets are predominantly ABS and associated protection purchased from monoline insurers and other counterparties.

The table below summarises, for the Group, the net exposures and balance sheet carrying values of these securities by measurement classification.

	Held-for-trading		Available-for-sale		Loans and receivables		Designated at fair value		All ABS	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Net exposure	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
RMBS	20,932	30,616	26,039	12,495	2,248	—	1	—	49,220	43,111
CMBS	908	2,870	917	409	1,151	500	—	—	2,976	3,779
CDOs/CLOs	1,790	4,722	2,225	20	1,141	—	—	16	5,156	4,758
Other ABS	195	2,996	3,208	679	3,375	—	—	186	6,778	3,861
Total	23,825	41,204	32,389	13,603	7,915	500	1	202	64,130	55,509
Carrying value										
RMBS	24,304	32,794	26,381	12,501	2,248	—	1	—	52,934	45,295
CMBS	2,431	2,969	938	409	1,151	500	—	—	4,520	3,878
CDOs/CLOs	7,531	9,568	5,525	20	1,141	—	—	17	14,197	9,605
Other ABS	1,505	5,275	3,208	679	3,375	—	—	186	8,088	6,140
Total	35,771	50,606	36,052	13,609	7,915	500	1	203	79,739	64,918

Notes:

(1) Net exposure is carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment. The protection provides credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default by the debt security counterparty. The value of the protection is based on the underlying instrument being protected.

(2) Carrying value is the amount recorded on the balance sheet.

(3) Certain instruments have been reclassified from the held-for-trading category to loans and receivables or available-for-sale categories, as permitted by the amendment to IAS 39 issued in October 2008, therefore affecting comparability by measurement classification.

Asset backed securities are securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages and, in the case of collateralised debt obligations ('CDOs'), the referenced pool may be ABS or other classes of assets. The process by which the risks and rewards of the pool are passed on to investors via the issuance of securities with varying seniority is commonly referred to as securitisation.

During 2008, as the problems in the sub-prime sector spread to other asset classes on a global basis and credit spreads widened due to concerns over creditworthiness of underlying assets, securitisation volumes continued to be thin. Over the preceding years Global Banking & Markets ('GBM') had established itself as an active arranger of third- party securitisations and a secondary dealer in these securities, and GBM had therefore accumulated assets that became difficult to sell given market conditions.

The Group has exposures to ABS which are predominantly debt securities but can be held in derivative form. These positions had been acquired primarily through the Group's activities in the US leveraged finance market which were expanded during 2007. These include residential mortgage backed securities ('RMBS'), commercial mortgage backed securities ('CMBS'), ABS CDOs, collateralised loan obligations ('CLOs') and other ABS. In many cases the risk on these assets is hedged via credit derivative protection purchased over the specific asset or relevant ABS indices. The counterparty to some of these hedge transactions are monoline insurers.

The net exposure of the Group's holdings of ABS increased from £55.5 billion at 31 December 2007 to £64.1 billion by 31 December 2008, where underlying reductions have been more than offset by the effect of exchange rates. The net exposure incorporates hedge protection but excludes counterparty credit valuation adjustments. All hedge protection referred to in the credit market and related exposures section relates to economic hedges that do not qualify for hedge accounting.

Through a sustained de-risking exercise, the Group made reductions to the overall risk through a combination of direct asset sales and switching to lower risk assets through trading activities. As a large proportion of the ABS are denominated in US dollars, these reductions in exposure were partially offset due to the movement in the exchange rate against sterling. The majority of the Group's RMBS portfolio at 31 December 2008, in terms of net exposure, was AAA rated guaranteed or effectively guaranteed securities of £33.5 billion of US agency securities.

The table below analyses, for the Group, carrying values of these debt securities by measurement classification and rating.

	RMBS							
			Prime					
		Non					Other	
	Sub-prime	conforming	Guaranteed	Other	CMBS	CDOs/CLOs	ABS	Total
2008	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading	1,578	352	18,586	3,788	2,431	7,531	1,505	35,771
Available-for-sale	899	2,184	14,898	8,400	938	5,525	3,208	36,052
Loans and receivables	282	1,482	—	484	1,151	1,141	3,375	7,915
Designated at fair value	—	—	—	1	—	—	—	1
Total	2,759	4,018	33,484	12,673	4,520	14,197	8,088	79,739
Of which:								
AAA rated (1)	1,132	3,532	33,475	11,174	2,928	9,192	3,189	64,622
BBB and above rated (1)	878	338	—	1,391	1,552	2,810	3,422	10,391
Non-investment grade (1)	749	146	—	106	39	1,512	241	2,793
Not publicly rated	—	2	9	2	1	683	1,236	1,933
	2,759	4,018	33,484	12,673	4,520	14,197	8,088	79,739
2007								
Held-for-trading	4,246	2,884	15,627	10,037	2,969	9,568	5,275	50,606
Available-for-sale	7	640	10,533	1,321	409	20	679	13,609
Loans and receivables	—	—	—	—	500	—	—	500
Designated at fair value	—	—	—	—	—	17	186	203
Total	4,253	3,524	26,160	11,358	3,878	9,605	6,140	64,918
Of which:								
AAA rated (1)	1,191	2,733	26,034	10,643	2,820	7,186	3,324	53,931
BBB and above rated (1)	2,384	526	—	557	1,010	1,352	1,179	7,008
Non-investment grade (1)	589	146	—	27	35	248	104	1,149
Not publicly rated	89	119	126	131	13	819	1,533	2,830
	4,253	3,524	26,160	11,358	3,878	9,605	6,140	64,918

Note:
(1) Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto S&P scale.

Residential mortgage-backed securities (audited)
Residential mortgage backed securities (RMBS) are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The risk of the RMBS will vary primarily depending on the quality and geographic region of the underlying mortgage assets and the credit enhancement of the securitisation structure.

Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes, including guarantees over the value of the exposures, often provided by monoline insurers.

The main categories of mortgages that serve as collateral to RMBS held by the Group are described below. As can be seen from the tables below, the Group's RMBS portfolio covers a range of geographic locations and there different categories used to classify the exposures depending on the geographical region of the underlying mortgage.

The categories are described below. 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.

Sub-prime mortgages: are loans to sub-prime borrowers typically having weakened credit histories that include payment delinquencies, and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.

Non-conforming mortgages (or ‘Alt-A’ used for US exposures) have a higher credit quality than sub-prime mortgages, but lower than those prime borrowers. Within the US mortgage industry, non-conforming mortgages are those that do not meet the lending criteria for US agency mortgages (described below). For non-US mortgages, judgement is applied in identifying loans with similar characteristics to US nonconforming loans and also include self-certified loans. Alt-A describes a category of mortgages in which lenders consider the risk to be greater than prime mortgages though less than sub-prime. The offered interest rate is usually representative of the associated risk level.

Guaranteed mortgages are mortgages that form part of a mortgaged backed security issuance by a government agency, or in the US, an entity that benefits from a guarantee (direct or indirect) provided by the US government. For US RMBS, this category includes, amongst others, RMBS issued by Freddie Mac, Fannie Mae and Ginnie Mae.

Other prime mortgages are those of a higher credit quality than nonconforming and sub-prime mortgages, and exclude guaranteed mortgages.

The table below shows, for the Group, RMBS net exposures and carrying values by underlying asset type, geographical location of the property that the mortgage is secured against and the year in which the underlying mortgage was originated.

	2008					2007				
			Prime					Prime		
	Sub-prime	Non conforming	Guaranteed(3)	Other	Total	Sub-prime	Non Conforming	Guaranteed(3)	Other	Total
Net exposure (1)	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
United States	358	1,106	33,458	5,548	40,470	2,662	2,800	26,005	2,643	34,110
United Kingdom	390	2,906	26	2,998	6,320	9	724	149	2,185	3,067
European Union	136	—	—	1,784	1,920	—	—	—	5,787	5,787
Rest of the World	300	—	—	210	510	5	—	—	142	147
	1,184	4,012	33,484	10,540	49,220	2,676	3,524	26,154	10,757	43,111
Carrying values (2)										
United States	1,822	1,112	33,458	5,623	42,015	3,986	2,800	26,005	2,643	35,434
United Kingdom	419	2,906	26	4,084	7,435	9	724	155	2,514	3,402
European Union	155	—	—	2,725	2,880	3	—	—	6,059	6,062
Rest of the World	363	—	—	241	604	255	—	—	142	397
	2,759	4,018	33,484	12,673	52,934	4,253	3,524	26,160	11,358	45,295

Of which originated in:

- 2004 and earlier	646	122	5,537	1,647	7,952	922	176	2,548	1,819	5,465
- 2005	348	1,372	6,014	4,306	12,040	1,113	437	3,209	2,185	6,944
- 2006	1,214	872	1,698	4,023	7,807	1,721	1,188	5,570	4,787	13,266
- 2007 and later	551	1,652	20,235	2,697	25,135	497	1,723	14,833	2,567	19,620
	2,759	4,018	33,484	12,673	52,934	4,253	3,524	26,160	11,358	45,295

Notes:

(1) Net exposures reflect the effect of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment.

(2) Carrying values are amounts recorded on the balance sheet.

(3) Prime guaranteed exposures and carrying values include:

(a) £5.7 billion (2007 – £5.0 billion) guaranteed by US government via Ginnie Mae of which £0.5 billion (2007 – £0.3 billion) are held-for-trading.

(b) £27.8 billion (2007 – £21.0 billion) effectively guaranteed by the US government via its support for Freddie Mac and Fannie Mae of which £17.9 billion (2007 – £15.1 billion) are held-for-trading.

The Group's largest concentration of RMBS assets relate to a portfolio of US agency asset backed securities comprising mainly of current year vintage positions of £33.5 billion at 31 December 2008 (2007 – £26.2 billion). Due to the US government backing implicit in these securities, the counterparty credit risk exposure is low. Financial markets and economic conditions have been extremely difficult in the US throughout 2008, particularly in the last quarter. Credit conditions have deteriorated and financial markets have experienced widespread illiquidity and elevated levels of volatility due to forced de-leveraging. Transaction activity in the securities portfolio has been reduced due to general market illiquidity. Residential mortgages have been affected by the stress that consumers experienced from depreciating house prices, rising unemployment and tighter credit conditions, resulting in higher levels of delinquencies and foreclosures. In particular, the deteriorating economy and financial markets have negatively impacted the valuation, liquidity, and credit quality of private-label securities.

Citizens maintains an available-for-sale investment securities portfolio to provide high-quality collateral to provide a liquidity buffer and to enhance earnings. The size of the portfolio has been relatively stable through 2008, but both the absolute and relative size (% of earning assets) declined in 2006-2007. The portfolio comprises high credit quality mortgage-backed securities, to ensure both pledgeability and liquidity. The US Government guarantees on MBS, whether explicit or implicit, put most of the portfolio in a secure credit position. The non- agency MBS holdings derive credit support in two ways. Firstly, there is senior and subordinated structuring, and Citizens hold only the most senior tranches. Secondly, there is high quality supporting loan collateral. The collateral quality is evidenced (a) by the vintages, with 82% issued in 2005 and earlier, (b) by the borrower's weighted loan to value (LTV) ratio of 65%, and (c) by the borrower's weighted-average FICO score of 734.

The Group has other portfolios of RMBS from secondary trading activities, warehoused positions previously acquired with the intention of further securitisation and a portfolio of assets from the unwinding of a securities arbitrage conduit. This conduit was established to benefit from the margin between the assets purchased and the notes issued. The majority of these held–for–trading RMBS have been grouped together for management purposes.

Some of these assets (£6.7 billion) were reclassified from held-for- trading category to the loans and receivables (£1.5 billion) and available-for-sale (£5.2 billion) categories during the year.

Overall, the Group has recognised significant fair value losses on RMBS assets during the year due to reduced market liquidity and deteriorating credit ratings of these assets. The Group has reduced its exposure to RMBS predominantly through fair value hedges and asset sales during the year. These decreases in were partially offset by the weakening of sterling relative to the US dollar and the euro.

Commercial mortgage-backed securities (audited)
Commercial mortgages backed securities ('CMBS') are securities that are secured by mortgage loans on commercial land and buildings. The securities are structured in the same way as an RMBS but typically the underlying assets referenced will be of greater individual value. The performance of the securities are highly dependent upon the sector of commercial property referenced and the geographical region.

The Group accumulated CMBS for the purpose of securitisation and secondary trading. The largest holding of CMBS arose as a result of the Group's purchase of senior tranches in mezzanine and high grade CMBS structures from third parties. These securities are predominantly hedged with monoline insurers. As a result, the Group's risk is limited to the counterparty credit risk exposure to the hedge. The Group also holds CMBS arising from securitisations of European commercial mortgages originated by the Group.

Asset-backed collateralised debt and loan obligations (audited)
Collateralised debt obligations (CDOs) are securities whose performance is dependant on a portfolio of referenced underlying securitised assets. The referenced assets generally consist of ABS, but may also include other classes of assets. Collateralised loan obligations represent securities in special purpose entities, the assets of which are primarily cash flows from underlying leveraged loans.

The Group's ABS CDO and CLO net exposures comprised super senior CDOs and other CDOs and CLOs. The Group's CDO exposures were structured by the Group from 2003 to 2007 that were unable to be sold to third parties due to prevailing illiquid markets as well as exposures purchased from third parties some of which are fully hedged through CDS with other banks or monoline insurers.

Super senior CDOs
Super senior CDOs represent the most senior positions in a CDO, having subordination instruments (usually represented by a combination of equity, mezzanine and senior notes) which absorb losses before the super senior note is affected. Losses will only be suffered by the super senior note holders after a certain threshold of defaults of the underlying reference assets has been reached. The threshold is usually referred to in percentage terms of defaults of the remaining pool, and known as the 'attachment point'. These super senior instruments carry an AAA rating at point of origination or are senior to other AAA rated notes in the same structure. The level of defaults occurring on recent vintage sub-prime mortgages and other asset classes has been higher than originally expected. This has meant that the subordinate positions have diminished significantly in value, credit quality and rating and, as a result, the super senior tranches of the CDOs have a higher probability of suffering losses than at origination. The ratings of the majority of the underlying collateral are now below investment grade.

Depending on the quality of the underlying reference assets at issuance, the super senior tranches will be either classified as high grade or mezzanine. The majority of the Group's total exposure relates to high grade super senior tranches of ABS CDOs. The table below summarises, for the Group, the carrying amounts and net exposures after hedge protection of the super senior CDOs as at 31 December 2008. The collateral rating is determined with reference to S&P ratings where available. Where S&P ratings are not available the lower of Moody's and Fitch ratings have been used.

		2008(1)			2007	
	High grade	Mezzanine	Total	High grade	Mezzanine	Total
	£m	£m	£m	£m	£m	£m
Gross exposure	4,210	3,720	7,930	3,396	3,040	6,436
Hedges and protection	(2,525)	(691)	(3,216)	(2,150)	(1,250)	(3,400)
	1,685	3,029	4,714	1,246	1,790	3,036
Write-downs on net open position	(1,095)	(2,885)	(3,980)	(147)	(537)	(684)
Net exposure after hedges	590	144	734	1,099	1,253	2,352
	%	%	%	%	%	%
Average price	35	6	18	90	70	78
Underlying RMBS sub-prime assets (origination)	58	91	79	58	91	79
Of which originated in:						
2005 and earlier	53	23	34	53	23	34
2006	41	69	59	41	69	59
2007	6	8	7	6	8	7
Collateral by rating at reporting date: (2)						

AAA	19	—	7	36	—	9
BBB- and above	40	5	17	62	31	32
Non-investment grade	41	95	76	2	69	59
Attachment point (3)	29	46	40	30	46	40
Attachment point post write down	75	97	89	40	62	54

Notes

(1) The above table includes data for two trades liquidated in the last quarter of 2008, to provide consistency with comparatives.

(2) Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto S&P scale.

(3) Attachment point is the minimum level of losses in a portfolio which a tranche is exposed to, as a percentage, of the total notional size of the portfolio. For example, a 5 – 10% tranche has an attachment point of 5% and a detachment point of 10%. When the accumulated loss of the reference pool is less than 5% of the total initial notional of the pool, the tranche will not be affected. However, when the loss has exceeded 5%, any further losses will be deducted from the tranche's notional principal until detachment point, 10%, is reached.

The change in net exposure during the year is analysed below.

	High grade £m	Mezzanine £m	Total £m
Net exposure at 1 January 2008	1,099	1,253	2,352
Net income statement	(723)	(1,140)	(1,863)
Foreign exchange and other movements	214	31	245
Net exposure at 31 December 2008	590	144	734

The fair value of these assets has fallen significantly during the period, representing the decline in performance in the underlying reference assets and the lack of an active market for the securities. Some of the Group's holdings have been hedged with monoline counterparties.

The majority of the Group's high grade super senior exposures represent securities retained in CDO structures originated by the Group. At origination, the reference assets of the high grade structures predominantly comprised investment grade tranches of sub-prime residential mortgage securitisations along with other senior tranches of some combination of other ABS assets, including prime and Alt-A RMBS, CMBS, trust preferred ABS, student loan backed ABS and CDO assets. The underlying assets referenced by these super senior securities are primarily more recent vintages (the year the underlying loan was originated), with 6% being 2007. Generally, loans with more recent vintages carry greater discounts, reflecting the market expectation of greater default levels than on earlier loan vintages.

The mezzanine super senior tranches of CDOs have suffered a greater level of price decline than high grade tranches, due to the relative credit quality of the underlying assets. The majority of the Group's mezzanine super senior exposures represent securities retained in CDO structures originated by the Group.

Other CDOs and CLOs

The Group's net exposure to other CDOs and CLOs was £4.4 billion (2007 – £2.4 billion) after hedge protection with bank or monoline counterparties and include transfers from ABN AMRO in 2008. The unhedged exposures comprise CDOs representing positions with various types of underlying collateral, rating and vintage characteristics.

The positions hedged with derivative protection from banks include a number of positions referencing early vintages of RMBS and other ABS assets against which it purchased protection from bank counterparties through CDS. The Group therefore has no net exposure to these certain CDOs before credit valuation adjustment. Due to the early vintage, the assets underlying these structures have not deteriorated to the same degree as the more recently issued securities. The protection purchased is from banks as opposed to monoline insurers and the credit valuation adjustment on banks is less than on monoline insurers.

Additionally, the Group has one exposure that, while not structured as a super senior security, incorporates similar risk characteristics. The exposure results from options sold to a third-party conduit structure on a portfolio of ABS. The Group assumes the risk of these securities only after the first loss protection has been eroded. The Group also has protection purchased against the remainder of this exposure through a CDS purchased from a monoline insurer. The Group holds other subordinated note positions in CDO vehicles which have experienced significant reductions in value since inception. The majority of these positions are junior notes that have been fully written down by the Group with no ongoing exposure remaining at the balance sheet date.

Collateralised loan obligations represent securities in special purpose entities the assets of which are primarily cash flows from underlying leveraged loans. The Group has CLO exposures resulting from a number of trading activities. They consist of exposures retained by the Group and from notes purchased from third-party structures. The Group holds super senior securities in two CLO structures which were originated by the Group in 2005 and 2007. The underlying collateral of these structures predominantly references leveraged loans.

£5.5 billion of these assets were reclassified from the held-for-trading category to the loans and receivables (£0.9 billion) and available-for- sale (£4.6 billion) categories during the year.

Other asset backed securities

Other assets backed securities are securities issued from securitisation vehicles, similar to those in RMBS and CMBS structures, which reference cash flow generating assets other than mortgages. The Group has accumulated these assets from a range of trading and funding activities.

Counterparty valuation adjustments (audited)

Credit valuation adjustments

Credit valuation adjustments (‘CVAs’) 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. During 2008, as credit spreads have widened, there has been a significant increase in the Group’s CVA as set out in the table below.

	2008	2007
	£m	£m
Monoline insurers	3,289	452
CDPCs	746	—
Other counterparties	1,089	128
Total CVA adjustments	5,124	580

The widening of credit spreads of corporate and financial institution counterparties during the year contributed to a significant increase in the level of CVA adjustments recorded across all counterparties, particularly monoline insurers and credit derivative product companies (‘CDPCs’).

The monoline insurer CVA is calculated on a trade-by-trade basis, and is derived using market observable monoline credit spreads. The majority of the monoline CVA is taken against credit derivatives hedging exposures to ABS. The CDPC CVA is calculated using a similar approach. However, in the absence of market observable credit spreads, the cost of hedging the counterparty risk is estimated by analysing the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle.

The CVA for all other counterparties, including in respect of derivatives with banks, is calculated either on a trade-by-trade basis, reflecting the estimated cost of hedging the risk through credit derivatives, or on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the risk.

Monoline insurers

The Group has purchased protection from monoline insurers, mainly against specific ABS, CDOs and CLOs. Monoline insurers are entities which specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps (‘CDS’) referencing the underlying exposures held by the Group.

During the year the market value of securities protected by monoline insurers continued to decline as markets deteriorated. As the fair value of the protected assets declined, the fair value of the CDS protection from monoline insurers increased. As the monoline insurers had concentrated their exposures to credit market risks, their perceived credit quality deteriorated as concerns increased regarding their ability to meet their contractual obligations. This resulted in increased levels of CVA being recorded on the purchased protection.

The change in the Group’s exposure to monoline insurers during the year has been driven by the increased value of purchased derivative protection and the strengthening of the US$ against sterling as significantly all of the exposures are US$ denominated. The combination of greater exposure and widening credit spreads has increased the level of CVA required. Towards the end of the year the Group reached settlement on a group of contracts with one monoline counterparty, thereby reducing the overall exposure.

The tables below analyse, for the Group, holdings of CDS with monoline counterparties.

	2008 £m	2007 £m
Gross exposure to monolines	6,531	2,275
Hedges with bank counterparties	(518)	—
Credit valuation adjustment	(3,289)	(452)
Net exposure to monolines	2,724	1,823

The change in CVA is analysed in the table below:

	£m
At 1 January 2008	452
CVA realised in 2008	(662)
Net benefit on counterparty hedges	189
Foreign currency movements	748
Net benefit on reclassified debt securities	741
Net income statement effect	1,821
At 31 December 2008	3,289

	2008				2007			
	Notional amount protected assets £m	Fair value protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount protected assets £m	Fair value protected assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated								
CDO of RMBS	—	—	—	—	3,475	1,799	1,676	76
RMBS	3	2	1	—	73	73	—	—
CMBS	96	70	26	12	493	475	18	2
CLOs	3,742	2,780	962	435	6,135	5,993	142	13
Other ABS	91	41	50	24	1,105	1,052	53	1
Other	267	167	100	47	295	269	26	—
	4,199	3,060	1,139	518	11,576	9,661	1,915	92
A/BBB rated								
CDO of RMBS	4,250	964	3,286	1,549	—	—	—	—
RMBS	90	63	27	10	—	—	—	—
CMBS	566	251	315	182	—	—	—	—
CLOs	4,000	2,951	1,049	565	—	—	—	—
Other ABS	493	221	272	140	—	—	—	—
	9,399	4,450	4,949	2,446	—	—	—	—
Sub-investment grade								
CDO of RMBS	161	—	161	121	464	167	297	297
CLOs	350	268	82	60	—	—	—	—
Other ABS	1,208	1,037	171	123	—	—	—	—
Other	155	126	29	21	63	—	63	63
	1,874	1,431	443	325	527	167	360	360
Total								
CDO of RMBS	4,411	964	3,447	1,670	3,939	1,966	1,973	373

RMBS	93	65	28	10	73	73	—	—
CMBS	662	321	341	194	493	475	18	2
CLOs	8,092	5,999	2,093	1,060	6,135	5,993	142	13
Other ABS	1,792	1,299	493	287	1,105	1,052	53	1
Other	422	293	129	68	358	269	89	63
	15,472	8,941	6,531	3,289	12,103	9,828	2,275	452

49

The Group also has indirect exposure through wrapped securities and assets which have an intrinsic credit enhancement from a monoline insurer. These securities are traded with the benefit of this credit enhancement and therefore any deterioration in the credit rating of the monoline is reflected in the fair value of these assets.

Credit derivative product companies
A credit derivative product company (CDPC) is a company that sells protection on credit derivatives. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

The Group has £2.6 billion of gross exposures with CDPCs which predominantly relates to tranched credit derivatives. Tranched credit derivatives have exposure to certain default losses that arise in reference portfolio of assets. The Group has bought protection on tranched credit derivatives from CDPCs. The reference portfolios of assets are predominantly investment grade loans and bonds. CDS spreads have widened and credit protection has become more valuable and the gross exposure to CDPC counterparties has increased. At the same time, the credit quality of CDPC counterparties has declined, reflecting the negative impact of their concentrated credit risk in a declining market. As a result CVA adjustments taken against exposures to these counterparties have increased significantly as described above.

The tables below present a comparison of the protected assets and the fair value and CVA of the CDPC protection for the Group.

	2008 £m	2007 £m
Gross exposure to CDPCs	2,638	90
Credit valuation adjustment	(746)	—
Net exposure to CDPCs	1,892	90

	2008				2007			
	Notional amount protected assets £m	Fair value protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount protected assets £m	Fair value protected assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated	12,835	10,435	2,400	663	1,557	1,467	90	—
A/BBB rated	1,707	1,469	238	83	—	—	—	—
	14,542	11,904	2,638	746	1,557	1,467	90	—

The movement in the year in CDPC CVA is analysed below:

	£m
At 1 January 2008	—
Novations from ABN AMRO	621
Net effect of counterparty hedges	(38)
Foreign currency movement	20
Net income statement effect	143

At 31 December 2008	746
50	

Leveraged finance (audited)
Leveraged finance is commonly employed to facilitate corporate finance transactions, such as acquisitions or buy-outs. A bank acting as a lead manager will typically underwrite the loan, alone or with others, and then syndicate the loan to other participants. The Group's syndicated loan book represent amounts retained from underwriting positions where the Group was lead manager or underwriter, in excess of the Group's intended long term participation.

Since the beginning of the credit market dislocation in the second half of 2007, investor appetite for leveraged loans and similar risky assets has fallen dramatically, with secondary prices falling due to selling pressure and margins increasing, thus also affecting the primary market.

There were a small number of deals executed in the first half of 2008 which were much less significant in overall quantum and leverage and which were priced at less than mid-2007 levels. Concerted efforts to sell positions during the first half of 2008 were only partially successful due to the rapid change in market conditions since origination of the loans. Most of the leveraged finance loans were reclassified from the held-for- trading category to loans and receivables category in the second half of 2008.

The table below shows the carrying value of leveraged finance exposures by industry and geography for the Group.

	2008					2007				
	Americas	UK	Europe	ROW	Total	Americas	UK	Europe	ROW	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
TMT	1,472	628	265	3	2,368	6,824	424	138	—	7,386
Retail	166	550	201	10	927	542	1,318	157	38	2,055
Industrial	280	391	164	—	835	225	1,613	231	—	2,069
Other	—	552	15	35	602	16	339	163	13	531
	1,918	2,121	645	48	4,732	7,607	3,694	689	51	12,041
Of which:										
Held-for-trading	31	31	41	—	103	7,607	3,694	689	51	12,041
Loans and receivables	1,887	2,090	604	48	4,629	—	—	—	—	—
	1,918	2,121	645	48	4,732	7,607	3,694	689	51	12,041
Of which:										
Drawn	1,887	2,090	634	48	4,659	2,116	3,662	687	51	6,516
Undrawn	31	31	11	—	73	5,491	32	2	—	5,525
	1,918	2,121	645	48	4,732	7,607	3,694	689	51	12,041

The table below analyses the movement in the amounts reported above.

	Held-for trading	Loans and receivables	Total
	£m	£m	£m
At 1 January 2008	12,041	—	12,041
Reclassifications	(3,602)	3,602	—
Reclassifications – income effect	216	16	232
Additions	1,853	—	1,853
Sales	(5,708)	—	(5,708)
Realised losses on sale	(298)	—	(298)
	(4,153)	—	(4,153)

Lapsed/collapsed deals			
Changes in fair value	(618)	—	(618)
Exchange and other movements	372	1,011	1,383
At 31 December 2008	103	4,629	4,732

In addition to the leveraged finance syndicated portfolio discussed above, the Group has £6.1 billion of portfolio positions, mostly to European companies, that have been classified as loans and receivables since origination.

SPEs and conduits (audited)

SPEs

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. It is primarily the extent of risks and rewards assumed that determines whether these entities are consolidated in the Group's financial statements. The following section aims to address the significant exposures which arise from the Group's activities through specific types of SPEs.

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. In general 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 as a way of diversifying funding sources, managing specific risk concentrations, and achieving capital efficiency. The Group purchases the securities issued in own- asset securitisations set up for funding purposes. During 2008, the Group was able to pledge AAA-rated asset-backed securities as collateral for repurchase agreements with major central banks under schemes such as the Bank of England's Special Liquidity Scheme, launched in April 2008, which allowed banks to temporarily swap high- quality mortgage-backed and other securities for liquid UK Treasury Bills. This practice has contributed to the Group's sources of funding during 2008 in the face of the contraction in the UK market for inter- bank lending and the investor base for securitisations.

Conduits

The Group sponsors and administers a number of 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 either by further commercial paper issuance, repayment of assets or liquidity drawings. Commercial paper is typically short-dated – the length of time from issuance to maturity of the paper is typically up to three months.

The Group's conduits are multi-seller conduits. In line with market practice, the Group consolidates a conduit where it is exposed to the majority of risks and rewards of ownership of these entities. The Group also extends liquidity commitments to multi-seller conduits sponsored by other banks, but typically does not consolidate these entities as it is not exposed to the majority of the risks and rewards.

The multi-seller conduits were established by the Group for the purpose of providing its clients with access to diversified and flexible funding sources. A multi-seller conduit typically purchases or funds assets originated by the banks' clients. The multi-seller conduits form the vast majority of the Group's conduit business. The Group sponsors six multi- seller conduits, four of which were transferred from ABN AMRO in 2008, that finance assets from Europe, North America and Asia-Pacific. The Group's most significant multi-seller conduits have thus far continued to fund the vast majority of their assets solely through ABCP issuance. There were significant disruptions to the liquidity of the financial markets during the year following the bankruptcy filing of Lehman Brothers in September 2008 and this required a small amount of the assets held in certain conduits to be funded by the Group rather than through ABCP issuance. By the end of 2008 there had been an improvement in market conditions, supported by central bank initiatives, which enabled normal ABCP funding to replace this Group funding of the conduits. The average maturity of ABCP issued by the Group's conduits as at 31 December 2008 was 72.4 days (2007 – 60.4 days).

The total assets held by the Group's sponsored conduits are £31.5 billion (2007 – £10.7 billion). Since these liquidity facilities are sanctioned on the basis of total conduit purchase commitments, the liquidity facility commitments will exceed the level of assets held, with the difference representing undrawn commitments. Assets purchased or financed by the multi-seller conduits include auto loans, credit card receivables, residential mortgages, consumer loans and trade receivables. Most of the assets held by the conduits are recorded on the Group's balance sheet as loans and receivables.

The third-party assets financed by the conduits are structured with a significant degree of first-loss credit enhancement provided by the originators of the assets. This credit enhancement, which is specific to each transaction, can take the form of over-collateralisation, excess spread or subordinated loan, and typically ensures the conduit asset has a rating equivalent to at least a single-A credit. In addition and in line with general market practice, the Group provides a small second- loss layer of programme-wide protection to the multi-seller conduits. Given the nature and investment grade equivalent quality of the first loss enhancement provided to the structures, the Group has only a minimal risk of loss on its program wide exposure. The issued ABCP is rated P-1 / A1 by Moody's and Standard & Poor's.

The Group provides liquidity back-up facilities to the conduits it sponsors. These facilities can be drawn upon by the conduits in the event of a disruption in the ABCP market, or when certain trigger events occur such that ABCP cannot be issued. For a very small number of transactions within two of the multi-seller conduits sponsored by the Group these liquidity facilities have been provided by third-party banks. This typically occurs on transactions where the third-party bank does not use, or have, its own conduit vehicles. Conduit commercial paper issuance is managed such that the spread of maturity dates of the issued ABCP mitigates the short-term contingent liquidity risk of providing back-up facilities. Group limits sanctioned for such facilities as at 31 December 2008 totalled approximately £40.9 billion (2007 – £15.8 billion). The Group's maximum exposure to loss on its multi-seller conduits is £38.8 billion (2007 – £15.3 billion), being the total amount of the Group's liquidity commitments plus the extent of programme-wide credit enhancements which relate to conduit assets for whom liquidity facilities were provided by third parties.

Exposure from both its consolidated conduits and its involvement with third-party conduits for the Group are set out below.

	2008			2007		
	Consolidated conduits £m	Third party £m	Total £m	Consolidated conduits £m	Third party £m	Total £m
Total assets held by the conduits	31,473			10,733		
Commercial paper issued	30,833			10,733		
Liquidity and credit enhancements:						
deal specific drawn liquidity						
– drawn	640	3,078	3,718	—	2,280	2,280
– undrawn	38,201	198	38,399	15,272	490	15,762
programme-wide credit enhancements	2,072	—	2,072	552	—	552
	40,913	3,276	44,189	15,824	2,770	18,594
Maximum exposure to loss (1)	38,841	3,276	42,117	15,272	2,770	18,042

Note:

(1) Maximum exposure to loss is determined as the Group's total liquidity commitments to the conduits and additionally programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

Collateral analysis, geographic, profile, credit ratings and weighted average lives of the assets in the assets relating to the consolidated conduits and related undrawn commitments of the Group are set out in the tables below.

	2008						2007					
	Funded assets			Liquidity			Funded assets			Liquidity		
	Loans £m	Securities £m	Total £m	Undrawn £m	from third parties £m	Total exposure £m	Loans £m	Securities £m	Total £m	Undrawn £m	from third parties £m	Total exposure £m
Auto loans	9,670	383	10,053	1,871	—	11,924	3,119	—	3,119	1,281	(102)	4,298
Credit card receivables	5,632	—	5,632	918	—	6,550	2,123	—	2,123	501	—	2,624
	2,706	—	2,706	1,432	(71)	4,067	223	—	223	15	—	238

Trade receivables												
Student loans	2,555	—	2,555	478	(132)	2,901	329	—	329	545	(132)	742
Consumer loans	2,371	—	2,371	409	—	2,780	562	—	562	207	—	769
Corporate loans	430	—	430	31	—	461	—	—	—	—	—	—
Mortgages												
Prime	1,822	—	1,822	456	—	2,278	1,663	—	1,663	153	—	1,816
Non-conforming	2,181	—	2,181	727	—	2,908	1,289	—	1,289	633	—	1,922
Commercial	1,069	507	1,576	61	(23)	1,614	525	503	1,028	65	(23)	1,070
Other	1,664	483	2,147	985	—	3,132	397	—	397	1,138	—	1,535
	30,100	1,373	31,473	7,368	(226)	38,615	10,230	503	10,733	4,538	(257)	15,014

53

	CP funded assets										
	Geographic distribution						Credit ratings (S&P equivalent)				
	UK	Europe	US	ROW	Total	Weighted average life	AAA	AA	A	BBB and below	Total
2008	£m	£m	£m	£m	£m		£m	£m	£m	£m	£m
Auto loans	801	1,706	7,402	144	10,053	1.7	6,075	868	3,110	—	10,053
Credit card receivables	633	—	4,999	—	5,632	0.7	3,465	62	1,959	146	5,632
Trade receivables	68	922	1,371	345	2,706	0.8	120	1,025	1,561	—	2,706
Student loans	144	—	2,411	—	2,555	0.3	2,296	144	115	—	2,555
Consumer loans	708	1,195	468	—	2,371	1.7	387	993	923	68	2,371
Corporate loans	320	110	—	—	430	1.7	—	—	430	—	430
Mortgages											
Prime	—	—	—	1,822	1,822	3.7	17	1,806	—	—	1,823
Non-conforming	960	1,221	—	—	2,181	4.6	351	368	475	987	2,181
Commercial	713	453	74	336	1,576	12.1	274	518	315	469	1,576
Other	166	1,198	684	99	2,147	2.1	3	601	1,309	233	2,146
	4,513	6,805	17,409	2,746	31,473	2.0	12,988	6,385	10,197	1,903	31,473
2007											
Auto loans	2,071	324	724	—	3,119	1.6	30	1,755	1,334	—	3,119
Credit card receivables	629	—	1,494	—	2,123	0.4	443	—	1,680	—	2,123
Trade receivables	175	—	48	—	223	0.8	—	—	223	—	223
Student loans	140	—	189	—	329	2.4	184	140	5	—	329
Consumer loans	528	—	34	—	562	—	—	229	333		562
Mortgages											
Prime	—	—	—	1,663	1,663	4.4	26	1,638	—	—	1,664
Non-conforming	1,133	156	—	—	1,289	5.8	93	610	586	—	1,289
Commercial	729	—	28	271	1,028	16.4	271	507	250	—	1,028
Other	122	179	—	96	397	2.7	96	—	300	—	396
	5,527	659	2,517	2,030	10,733	3.7	1,143	4,879	4,711	—	10,733

Structured investment vehicles (unaudited)

The Group does not sponsor any structured investment vehicles.

Investment funds set up and managed by the Group (unaudited)
The Group's investment funds are managed by RBS Asset Management (RBSAM), which is an integrated asset management business, which manages investments on behalf of third-party institutional and high net worth investors, as well as for the Group. RBSAM is active in most traditional asset classes and employs both fund of funds structures and multi-manager strategies. Its offering includes money market funds, long only funds and alternative investment funds.

Money market funds
The Group has established and manages a number of money market funds for its customers. When a new fund is launched, RBSAM as fund manager typically provides a limited amount of seed capital to the funds. RBSAM does not have investments in these funds greater than £25 million. As RBSAM does not have holdings in these funds of significant size and as the risks and rewards of ownership are not with the Group, these funds are not consolidated by the Group.

The funds have been authorised by the Irish Financial Services Regulatory Authority as UCITS pursuant to the UCITS Regulations (UCITS Regulations refer to the European Communities' Undertakings for Collective Investment in Transferable Securities Regulations) and are therefore restricted in the types of investments and borrowings they can make. The structure of the assets within the funds is designed to meet the liabilities of the funds to their investors who have no recourse other than to the assets of the funds. The risks to the Group as a result are restricted to reputational damage if the funds were unable to meet withdrawals when requested on a timely basis or in full.

Money market funds had total assets of £13.6 billion at 31 December 2008 (2007 – £11.2 billion). The sub categories of money market funds are:

- £8.0 billion (2007 – £5.1 billion) in Money Funds denominated in sterling, US dollars and euro, which invest in short-dated, highly rated money market securities with the objective of providing security, performance and liquidity.

- £4.9 billion (2007 – £5.5 billion) in multi-manager money market funds denominated in sterling, US dollars and euro, which invest in short dated, highly rated securities.

- £0.7 billion (2007 – £0.6 billion) in Money Funds Plus denominated in sterling, US dollars and euro, which invest in longer-dated, highly rated securities with the objective of providing security, enhanced performance and liquidity.

Non-money market funds
RBSAM has also established a number of non-money market funds to enable investors to invest in a range of assets including bonds, equities, hedge funds, private equity and real estate. The Group does not have investments in these funds greater than £200 million. As RBSAM does not have holdings in these funds of significant size and as the risks and rewards of ownership are not with the Group, these funds are not consolidated by the Group.

The non-money market funds had total assets of £18.7 billion at 31 December 2008 (31 December 2007 – £19.4 billion). The sub categories of non-money market funds are:

- £16.0 billion (2007 – £17.0 billion) in multi-manager funds, which offer fund of funds products across bond, equity, hedge fund, private equity and real estate asset classes.

- £1.6 billion (2007 – £1.3 billion) in committed capital to private equity investments, which invests primarily in equity and debt securities of private companies.

    - £1.1 billion (2007 – £1.1 billion) in credit investments, which invests in various financial instruments.

The structure of the assets within the funds is designed to meet the liabilities of the funds to their investors who have no recourse other than to the assets of the funds. The risks to the Group as a result are restricted to reputational damage if the funds were unable to meet withdrawals when requested on a timely basis or in full, and the Group's own investment in the funds.

The Group's maximum exposure to non-money market funds is represented by the investment in the shares of each fund and was £200 million at 31 December 2008 (2007 – £171 million).

Independent auditors' 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 2008 which comprise the accounting policies, the balance sheets as at 31 December 2008 and 2007, the consolidated income statements, the cash flow statements, the statements of recognised income and expense for each of the three years in the period ended 31 December 2008, the related Notes 1 to 40 and the information identified as 'audited' in the Risk, capital and liquidity management section of the Financial review. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and as regards the Group's consolidated financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion, the information given in the directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Bank has not kept proper accounting records, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report and Accounts 2008 as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information outside the Annual Report and Accounts 2008.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and with the standards of the Public Company Accounting Oversight Board (United States). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Bank and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

The Group is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion.

UK opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its loss and cash flows for the year then ended;

- the Bank financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of affairs of the Bank as at 31 December 2008;

- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and

- the information given in the directors' report is consistent with the financial statements.

Separate opinion in relation to IFRS

As explained in the accounting policies, the Group, in addition to complying with its legal obligation to comply with IFRS as adopted by the European Union, has also complied with IFRS as issued by the International Accounting Standards Board (IASB).

In our opinion the financial statements give a true and fair view, in accordance with IFRS, of the state of the Group's affairs as at 31 December 2008 and of its loss and cash flows for the year then ended.

US opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2008 and 2007 and the results of its operations and its cash flows for each of the three years in the period ended 31 December 2008, in accordance with IFRS as adopted for use in the European Union and IFRS as issued by the IASB.

The financial statements for the year ended 31 December 2007 were restated for the matters disclosed in Note 1 of the Accounting policies.

Deloitte LLP
Chartered Accountants and Registered Auditors
Edinburgh, United Kingdom
25 March 2009

Consolidated income statement for the year ended 31 December 2008

	Note	2008 £m	2007 £m	2006 £m
Interest receivable	1	31,413	28,310	24,319
Interest payable	1	(17,904)	(17,194)	(13,927)
Net interest income	1	13,509	11,116	10,392
Fees and commissions receivable	2	7,483	7,519	7,060
Fees and commissions payable	2	(1,733)	(1,496)	(1,426)
(Loss)/income from trading activities	2	(5,583)	1,142	2,543
Other operating income	2	2,181	4,026	2,999
Non-interest income		2,348	11,191	11,176
Total income		15,857	22,307	21,568
Staff costs	3	5,973	6,181	6,280
Premises and equipment	3	1,760	1,521	1,405
Other administrative expenses	3	2,759	2,147	2,241
Depreciation and amortisation	3	1,562	1,438	1,415
Write-down of goodwill and other assets	3	8,144	—	—
Operating expenses	3	20,198	11,287	11,341
(Loss)/profit before impairment		(4,341)	11,020	10,227
Impairment	11	4,706	1,865	1,873
Operating (loss)/profit before tax		(9,047)	9,155	8,354
Tax	6	(505)	1,903	2,433
(Loss)/profit for the year		(8,542)	7,252	5,921
(Loss)/profit attributable to:				
Minority interests		208	53	45
Preference shareholders	7	638	331	252
Ordinary shareholders		(9,388)	6,868	5,624
		(8,542)	7,252	5,921

The accompanying notes on pages 71 to 135, the accounting policies on pages 61 to 70 and the audited sections of the Financial review: Risk, capital and liquidity management on pages 15 to 55 form an integral part of these financial statements.

Balance sheets at 31 December 2008

			Group		Bank
			Restated		Restated
		2008	2007	2008	2007
	Note				